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Regular Features

Highlights

Russia Bound by Energy Charter Treaty

In a decision that has potentially far-reaching implications for investors in Russia's energy sector, as well as energy investments in other countries that have signed or ratified the Energy Charter Treaty (ECT), on November 30, 2009 an arbitral tribunal at the Permanent Court of Arbitration in The Hague ruled that it had jurisdiction over a claim that Russia violated the ECT. The Tribunal will now hear the merits of the claim, made by former majority shareholders of oil company Yukos, that Russia undertook discriminatory measures against it and expropriated its investment, causing damages of upwards of $100 billion.

Page 2

Russian Competition Law

Russia introduces criminal sanctions for breaches of the Competition Law. While criminal sanctions technically existed under the previous law, they were not enforced in practice due to the interpretation issues which meant enforcement was not possible. The maximum criminal sanction for antitrust violations in Russia is now seven years imprisonment.

Page 3

Russia, Belarus and Kazakhstan Start Work on the Creation of the Customs Union

The presidents of Russia, Belarus and Kazakhstan signed an Agreement on the creation of a single customs territory and the formation of a Customs Union. The formation of the Customs Union involves the creation of a unified customs territory, within which no customs duties or economic restrictions will apply, except for special protective, anti-dumping and compensatory measures.

Page 4

New Russian Tax Law Improves VAT Refund Procedures

Russia has introduced new procedures for VAT refunds, aimed at simplifying the refund procedures and making them more time-efficient.

Page 6

Energy in Russia

Tribunal in $100 Billion Yukos Arbitration Rules Russia Bound by Energy Charter Treaty

By Sanjay Jose Mullick, Ronan J. McHugh and
Irene Dallas
(Pillsbury Winthrop Shaw Pittman LLP)

In a decision that has potentially far-reaching implications for investors in Russia's energy sector, as well as energy investments in other countries that have signed or ratified the Energy Charter Treaty ("ECT"), on November 30, 2009 an arbitral tribunal at the Permanent Court of Arbitration in The Hague ruled that it had jurisdiction over a claim that Russia violated the ECT. The Tribunal will now hear the merits of the claim, made by former majority shareholders of oil company Yukos, that Russia undertook discriminatory measures against it and expropriated its investment, causing damages of upwards of $100 billion.

The Yukos Arbitration

Yukos was once Russia's largest oil company. From 2003 to 2004, Russia accused Yukos and its largest shareholder, Mikhail Khodorkovsky, of tax evasion and ordered them to pay approximately $28 billion in back taxes. In November 2004, Russia ordered the sale of Yukos' main production subsidiary at auction to recover some of that liability, and the subsidiary was sold one month later to an investor group that itself was then purchased by a Russian state-controlled oil company. The former shareholders of Yukos then filed for arbitration against Russia under the ECT, seeking damages.

Rulings in arbitrations of this nature are not binding on other arbitration tribunals, but nonetheless frequently are considered influential.

The Energy Charter Treaty

Signed in December 1994 and entered into force in April 1998, the ECT is an international energy trade and investment agreement designed to provide transparency and uniform rules in order to foster investment in the energy sector. It has approximately 50 signatories, with a significant portion from Europe. (Neither the U.S. nor China is a signatory.) The ECT contains provisions on "promotion, protection and treatment of investments" in the energy sector. These include guarantees of fair and equitable treatment and of constant protection and security, as well as a prohibition against discrimination based on nationality and protection against expropriation.

Similar to investment protection agreements known as bilateral investment treaties or "BITs," the ECT provides for settlement of investment disputes via investor-state arbitration, by which private parties can bring a claim directly against a foreign government for violation of treaty obligations. The Yukos arbitration is being administered under the rules of the United Nations Commission on International Trade Law (UNCITRAL).

The Meaning of Provisional Application

At the heart of the Yukos jurisdictional dispute was the extent to which the ECT applied to Russia. Russia signed the ECT in 1994, but its Parliament (the Duma) never ratified it. Under Article 45 (1) of the ECT, a party that has signed but not yet ratified the ECT is bound to the Treaty provisionally, i.e., "to the extent such provisional application is not inconsistent with its constitution, laws or regulations." Although the Tribunal's decision has not been made public, it is known that the Tribunal ruled that, as a signatory, Russia was bound by the terms of the ECT, including the investor treatment provisions and the investor-state dispute settlement mechanism, notwithstanding that the Duma never ratified the treaty.

The Tribunal's reasoning may have been guided by a 2007 arbitral decision applying the ECT to Georgia (*Kardassopoulos v. Georgia*, ICSID Case No. ARB 05/18). This case held that, unless domestic law expressly provides that provisional application of treaties is inconsistent with domestic law, a signatory was bound to the ECT upon signing it.

Russia formally terminated its provisional application of the ECT effective October 19, 2009. However, under Article 45 (3) of the ECT, for energy investments made prior to that date, Russia remains bound to the Treaty for 20 more years, allowing investors to arbitrate disputes with Russia concerning those investments.

Continued on page 11

Competition Law

Russia Introduces Criminal Sanctions for Breaches of Competition Law

By Kiran Desai and Elena Klonitskaya
(Mayer Brown International LLP)

The Russian legislator amended Article 178 of the Criminal Code of the Russian Federation ("the New Law"). The New Law sets up criminal penalties for violations under Article 11 (cartels) and Article 10 (abuse of dominant position) of Russia's Law "On Protection of Competition" No 135-FZ ("the Law No 135-FZ"). The maximum criminal sanction for antitrust violations in Russia is now seven years imprisonment. While criminal sanctions technically existed under the previous law, they were not enforced in practice due to the interpretation issues which meant enforcement was not possible.

Paragraph 1 of Article 178 provides that criminal sanctions should apply for the following antitrust violations satisfying the following conditions:

Continued on page 11

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Russia, Belarus and Kazakhstan Start Work on Creating the Customs Union

By Mikhail Komarov
(KPMG)

Background

In October 2007, the presidents of Russia, Belarus and Kazakhstan signed an Agreement on the creation of a single customs territory and the formation of a Customs Union.

In accordance with this Agreement, the supreme bodies of the Customs Union are the Intergovernmental Councils of the Eurasian Economic Community (EAEC) at the level of heads of state and heads of government, and the sole standing regulatory body is the Customs Union Commission.

The formation of the Customs Union involves the creation of a unified customs territory, within which no customs duties or economic restrictions will apply, except for special protective, anti-dumping and compensatory measures.

Recent Developments

At the recent 11th session of the Customs Union Commission, and also at the latest meeting of the Intergovernmental Council of the EAEC, the heads of state of the Customs Union members took several decisions,[1] including on the unified customs–tariff regulations of the customs union, on the unified non-tariff regulation of the customs union, and also on tariff regulation of the import of sugar into the Customs Union.

The formation of the Customs Union involves the creation of a unified customs territory, within which no customs duties or economic restrictions will apply, except for special protective, anti-dumping and compensatory measures.

Under the understandings reached, the unified customs tariff and the unified system of non-tariff regulation will enter into force from January 1, 2010. The Customs Union itself, i.e. the unified customs territory of Russia, Belarus and Kazakhstan, will begin to function with the entry into force of the Customs Code of the Customs Union. This will happen on July 1, 2010. On the same day customs checkpoints will be removed from the Russian–Belarusian border, and one year later from the Russian–Kazakhstan border.

The authority to create the Unified Customs Tariff, i.e. the unified Classification of Goods of Foreign-Trade Activity and Rates for Customs Duties, will be transferred to a supranational body – the Customs Union Commission. The basis of the Unified Customs Tariff (92 percent) consists of existing Russian rates for customs duties; however, for several items the customs duties will be lowered by the Russian side and will be raised by other participating countries. A full list of rates for import customs duties of the Unified Customs Tariff are given in Appendix 1 of Decision No. 130 of the Customs Union Commission, available on the Customs Union's official website.[2]

Significantly, the EAEC Intergovernmental Council also approved a list of sensitive goods for import into the countries of the Customs Union. This document is available on the official website of the Customs Union Commission.[3]

There is a provision that the Customs Union Commission will take a decision on a change in import customs duties on these goods through a consensus. The list of sensitive items includes, inter alia, the meat of bovine animals, pork, poultry and poultry by-products, fish, milk and cream, butter, cheeses and curd, sugar, confectionary products, vegetables and other food products.

Moreover, decisions on import duties on oil and oil products, various chemical products, medicines, products of metalworking, machine-building, etc. must be passed by unanimous vote. This list also includes fabrics, clothing and shoes, and a range of household appliances.

On December 2, the President of Russia signed the Federal Law on Ratifying the Protocol on the Conditions and Procedure for Applying Rates of Import Customs Duties that Differ From the Rates of the Unified Customs Tariff in Exceptional Cases.

This law establishes the procedure for the Custom Union Commission to consider whether a member state may apply an import customs duty that is higher or lower than the rate of the Unified Customs Tariff in relation to goods manufactured in third countries and determines the conditions under which such a decision can be adopted.

Point 1 of article 4 of the Protocol stipulates the transfer to the Custom Union Commission of part of the authorities of the Russian Federation to take decisions on applying an import duty that is higher or lower than the rate of the Unified Customs Tariff by one party in relation to goods manufactured in third countries.

The Customs Code of the Customs Union will become effective from July 1, 2010, and will regulate the legal relations that appear from the date of its entry into legal force. This means that customs clearance will be abolished at the internal borders of the member states of the Customs Union. It should be noted, however, that customs control in the Customs Union will be exercised in accordance with its customs legislation, and any issues that are not regulated by this legislation will be governed by the national legislation of the member states of the Customs Union.

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1 http://www.tsouz.ru/KTS/meeting11/Pages/default.aspx. http://www.tsouz.ru/MGS/Pages/mgs091127_gg.aspx
(Decision No. 130 On the Unified Customs–Tariff Regulation of the Customs Union of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation;
Decision No. 131 On the Tariff Regulation of the Import of Sugar into the Customs Union within the Framework of the Eurasian Economic Community;
Decision No. 132 On the Unified Non-Tariff Regulation of the Customs Union of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation;
Decision No. 133 On the Creation of the Expert Group in the Area of "Protection of Intellectual Property Rights on the Customs Territory of the Customs Union";
Decision No. 134 On the Special Working Group of Authorized Representatives of the Parties;
Decision No. 135 On the Conduct of the Regular Meeting of the Customs Union Commission;
Decision No. 14 On the Report on Progress in Implementing the Plan of Actions to Create the Customs Union within the Framework of the Eurasian Economic Community;
Decision No. 15 On Issues in Organizing the Activity of the Customs Union Commission;
Decision No. 16 On the Expert Council within the Customs Union;
Decision No. 17 On the Agreement on the Customs Code of the Customs Union;
Decision No. 18 On the Unified Customs–Tariff Regulation of the Customs Union of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation;
Decision No. 19 On the Unified Non-Tariff Regulation of the Customs Union of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation;
Decision No. 20 On Issues of the Activity of the Secretariat of the Customs Union Commission;
Decision No. 21 On the Budget Schedule of the Customs Union Commission for 2010;
Decision No. 22 On the Integrated Information System of Foreign and Mutual Trade of the Customs Union;
Decision No. 23 On the Formation of the Unified Economic Space of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation»;
Decision No. 24 On the Creation of the Unified Customs Territory of the Customs Union within the Framework of the EAEC)
2 http://www.tsouz.ru/db/ettr/tnved/Pages/default.aspx
3 http://tsouz.ru/db/ettr/Pages/Chuvstvitelny.aspx

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New Russian Tax Law to Improve VAT Refund Procedures Published

By Evgeny V. Smirnov
(Debevoise & Plimpton LLP)

On December 22, 2009, Law No. 318-FZ, dated December 17, 2009, introducing a new improved procedure for VAT refunds ("Law No. 318-FZ") was officially published and came into force.

Generally, a Russian VAT payer is entitled to reduce its VAT liability to the budget (i.e., output VAT) on its taxable proceeds from sales by the amount of Russian VAT it paid to suppliers of work, goods, services and proprietary rights, as well as on the import of goods to Russia (i.e., input VAT).

If in any given tax period (i.e., a quarter) the amount of credited input VAT exceeds the VAT liability to the budget, the excess amount must be reimbursed to the taxpayer. The availability of any excess input VAT always triggers a desk tax audit, which can result in a decision to reimburse or to deny (in full or in part) reimbursement of VAT to the taxpayer.

Law No. 318-FZ should generally be considered as a positive change that should improve the cash flow position of those taxpayers that have decided to apply for a VAT refund available under the new rules.

In the event of a decision in favor of the taxpayer, the VAT amount can be refunded (transferred to its bank account) or, at the taxpayer's discretion (if the taxpayer does not have unsettled federal tax obligations), credited against its liabilities for other federal taxes, fines or late payment interest.

If the taxpayer has tax obligations that are not settled and the decision of the tax authorities allows recovery of VAT, the tax authorities are entitled to set off the amount of VAT due to the taxpayer against its unsettled obligations for other federal taxes.

In practice, VAT recovery is often denied by the tax authorities on formal grounds, such as technical mistakes in VAT invoices or lack of required supporting documents. Tax disputes on VAT recovery are a significant part of all tax-related disputes in Russia.

Amendments introduced by Law No. 318-FZ are aimed at simplification of the foregoing VAT refund procedure, establishing optional refund conditions that are more generous and time-efficient.

These conditions are available to taxpayers: (a) incorporated more than 3 years prior to the day of filing of the VAT return and that had an aggregate amount of VAT, profits tax and mineral extraction tax of at least 10 billion rubles paid over three years prior to the year of filing; or (b) that have presented a guarantee of a qualifying bank (along with the VAT return claiming a refund) providing for the bank's obligation to pay on the demand of the tax authorities any amount of VAT unduly refunded to the taxpayer under the simplified refund procedure as revealed at completion of the tax audit.

The above taxpayers are entitled to claim a VAT refund prior to completion of the desk tax audit by filing a special application along with the respective VAT return. This application envisages the obligation of a taxpayer to return to the budget all unduly refunded VAT and also pay interest based on double the Central Bank of Russia's refinancing rate (presently 8.75%) should the amount of VAT claimed for refund under the simplified procedure be fully or partially denied as a result of the tax audit performed by the tax authorities.

Taxpayers will be entitled to claim VAT refunds under the described simplified procedure starting from VAT returns filed for the first quarter of 2010.

Although it cannot be ruled out that the practical application of these new refund options will create many issues and raise many practical difficulties, Law No. 318-FZ should generally be considered as a positive change that should improve the cash flow position of those taxpayers that have decided to apply for a VAT refund available under the new rules before the end of a desk tax audit that can officially last for 3 months.

Evgeny V. Smirnov (Evsmirno@debevoise.com) is a Senior Tax Associate with Debevoise and Plimpton LLP in Moscow.

New Framework for Offering Russian Securities to Foreign Investors

By Laura M. Brank and Valentin Andrianov
(Dechert LLP)

On June 10, 2009, the Federal Service for the Financial Markets of the Russian Federation ("FSFM") approved new regulations (the "Regulations")[1] requiring specific permission for Russian issuers to place and circulate[2] securities abroad. The Regulations will likely enhance the liquidity of the local Russian securities market, but they will complicate the process of selling Russian securities in international capital markets. The Regulations will become effective on January 1, 2010.

The Regulations reduce the maximum percentage of each class of a Russian issuer's shares that may be placed and/or circulated abroad (including in the form of depositary receipts). This percentage is determined based upon the quotation list on which the shares are listed on the relevant Russian stock exchange. Under the Regulations, as was previously the case, Russian issuers would still need to list their shares on a Russian stock exchange before listing them abroad.

A Note on Quotation Lists

Russian securities can be traded on the two major Russian stock exchanges – the Moscow Interbank Currency Exchange ("MICEX") and the Russian Trading System Stock Exchange ("RTS") – by virtue of being admitted to one of the following quotation lists:

- A (1st Level or 2nd Level);
- B;
- V; or
- I.

Stricter Limits on the Percentage of an Issuer's Shares Offered Outside of Russia

The new limits specified by the Regulations are as follows:[3]

- 25% for shares on Quotation List A (whether 1st or 2nd Level);
- 15% for shares on Quotation List B;
- 5% for shares on Quotation Lists V or I; and
- 5%, if the Russian issuer is a strategic company that is engaged in geological study, exploration or production of natural resources on subsoil plots of federal significance (a "strategic subsoil company", defined in accordance with Federal Law No. 57-FZ "On the Procedure for Foreign Investment in Commercial Organizations of Strategic Importance for the National Security of the Russian Federation", dated April 29, 2008 (the "Strategic Sectors Law"[4]). Such strategic subsoil companies are capped at 5% regardless of the quotation list on which their securities are included.

For shares listed on Quotation Lists B, V, or I, the 5% limit may be increased to 25%, if the issuer of foreign securities representing the Russian shares (i.e., a depositary) is incorporated in a country whose securities regulator has entered into a cooperation agreement with the FSFM. According to the FSFM's official site, such agreements exist between Russia and the following jurisdictions: Belarus, Brazil, China, Cyprus, France, Germany, Kyrgyzstan, India, Oman, Syria, Turkey, Venezuela and UAE. Unfortunately, in practice, such relief will not be immediately available in connection with many issuances because most depositaries servicing the Russian market are not incorporated in those countries.

The Regulations provide potential relief with respect to issuances of shares by Russian strategic subsoil companies. Companies that receive preliminary approval from the Federal Antimonopoly Service of the Russian Federation ("FAS") to place or circulate shares abroad may receive permission from the FSFM to place or circulate abroad a percentage of their shares approved by FAS, up to a maximum of 25% of all issued shares of the same class. However, it appears that further legislative amendments may be required to implement this, because the authority of FAS to approve transactions that involve placement and circulation of shares abroad is not specified in the Strategic Sectors Law. Without such amendments, such relief is likely to be unavailable in practice.

The Regulations have reduced the percentage of shares per issue that may be offered on foreign exchanges – from 70% to 50%.

Stricter Limits on the Percentage of an Issuer's Shares Per Issue Offered Outside of Russia

In addition, the Regulations have reduced the percentage of shares per issue that may be offered on foreign exchanges – from 70% to 50%. The Regulations stipulate that no more than 50% of the shares of a single issue, or no more than 50% of the shares being offered by an existing shareholder, can be placed or offered abroad. This 50% limit will not apply to circulation abroad of Russian shares made in connection with corporate reorganizations of Russian issuers that previously received permission from the FSFM to place their shares abroad.

Continued on page 8

Securities *(from page 7)*

Although the Regulations have not yet entered into force, the FSFM has already prepared draft amendments to the Regulations, which would also become effective on January 1, 2010[5]. According to the draft amendments, if shares are included on Quotation List A (1st Level or 2nd Level) of the stock exchange, then the 50% limit would not apply if:

1. a signed application is made to the FSFM for consent to sponsor the circulation of shares of a Russian issuer outside the Russian Federation by a depositary established in accordance with the laws of the Russian Federation, provided such depository: has performed depositary activities for at least seven years; has capital of at least 150 billion Rubles; has accepted for depositary service at least 150 billion Rubles of securities; and has not entered into any procedure for insolvency (bankruptcy), or had suspensions of its activities or cancellations of its license for depositary activities initiated against it during the last two years;

The Regulations may be intended to strengthen Russian financial markets by forcing investors to purchase shares of Russian companies in Russia.

2. the contract under which circulation of shares of a Russian issuer is carried out outside the Russian Federation obliges the issuer of foreign securities to open a custody account in the depositary that meets the abovementioned requirements, and the Russian issuer's shares are deposited in this custody account; and
3. the contract under which circulation of shares of a Russian issuer is carried out outside the Russian Federation obliges the issuer of foreign securities to submit to the Russian issuer regularly, on at least a quarterly basis, a list of the owners and/or nominal holders of the foreign securities (persons who are not owners, but who hold rights to foreign securities in favor of third parties), indicating the quantity of foreign securities registered in their name.

Other Changes Under the Regulations

Within 30 days of the completion of the share offering, the issuer (and, with respect to any offering of existing shares, the selling shareholder) must submit a report to the FSFM on the results of the offering. The report must include information about the number of shares offered in Russia and abroad, as well as the stock exchange and the broker involved in the offering.

If any modification is made to an existing depositary receipt program, the issuer (or the depositary bank if the issuer is not a party to the deposit agreement) must notify the FSFM of the modification in writing, and attach a certified copy of the amended agreement in Russian.

In contrast to the current regulations, which do not impose a time limit on the validity of a permit or provide grounds for its revocation by the FSFM, the Regulations stipulate that permits issued by the FSFM will expire if:

— within one year of the date of the permit, the shares are not placed or circulated outside Russia (including by way of a depositary receipts program);

— the report on the results of the offering is not submitted to the FSFM within the prescribed 30-day timeframe; or

— the shares to which a permit relates are redeemed (cancelled).

Impact of the Regulations; Unresolved Issues

Despite the pending effectiveness of the Regulations, it would seem that permits issued under the current regulations will continue to be valid (subject to the regime in existence at the time the permit was issued), although this issue is not expressly addressed in the Regulations. Presumably, the limitations provided by the Regulations would not have retroactive effect.

It also seems reasonable to presume that if, upon effectiveness of the Regulations, an issuer is over the percentage limit of shares that may be placed abroad, its securities may not placed abroad until the securities meet the criteria set forth for a higher level (e.g., a movement from Quotation List B to Quotation List A). The Regulations do not address an issue of circulation (i.e., secondary market sales) of shares that are in the limit according to the current regulations (i.e., 30%) but, after January 1, 2010, would be over the limits provided in the Regulations.

Conclusion

The Regulations do not offer any potential benefits to Russian issuers, and limit the size of Russian issuers' depositary receipt programs. The Regulations may be intended to strengthen Russian financial markets by forcing investors to purchase shares of Russian companies in Russia. For Russian issuers contemplating an international offering, one of the main obstacles to raising capital under the Regulations lies in the requirement to obtain an initial listing at the relevant level. Perhaps the Regulations are also intended to ensure that only large companies experienced in placing their shares abroad can do so.

The Regulations may make it more attractive to establish a group holding company as an IPO vehicle in an offshore jurisdiction (e.g., Cyprus, the Netherlands, Luxembourg or Channel Islands with a Cyprus company as an intermediary holding company). In this scenario, the foreign holding company would then issue the securities and offer them on international stock exchanges. However, the FSFM might construe this as evasion of the Regulations, and prohibit such action. In addition, transferring the shares of Russian strategic companies to foreign holding companies would also probably require approval of the Government Commission for Control over Foreign Investment in the Russian Federation, which might likewise construe this as evasion and refuse to approve such a transaction.

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1 "Regulation on the Procedure of Issuance by the Federal Service for the Financial Markets of Approvals for Placement and (or) Organization of Circulation of Securities of Russian Issuers Outside the Russian Federation", approved by the FSFM order dated June 10, 2009 No. 09-21/pz-n and registered in the Ministry of Justice on October 2, 2009.
2 A placement is considered the issuance of securities by an issuer to its initial shareholders (i.e., sales of newly issued securities). A circulation is considered the conclusion of transactions that entail the transfer of title to securities (i.e., secondary market sales).
3 According to the current regulations, the limit is 30%.
4 The Strategic Sectors Law lists 42 sectors that the Russian Government considers to be of strategic importance. Any company engaged in any of the 42 listed activities is deemed to be a strategic company. The Strategic Sectors Law applies to proposed transactions that would result in a foreign investor controlling, directly or indirectly, a strategic company. However, the 5% limit mentioned above applies only to strategic subsoil companies.
5 Apparently, strategic non-subsoil companies, which are subject to a 25% limitation under the current regime, would be subject to the same requirements as Russian issuers that are not strategic companies at all.
6 The draft amendments are available on the FSFM web site at http://www.fcsm.ru/document.asp?ob_no=212785.

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RUSSIA

Update of Russian Legislation

By Eric Michailov
(White & Case LLC)

Stability of the Financial System

On 25 November 2009 the President signed Federal Law No. 279-FZ amending Federal Law No. 173-FZ, dated 13 October 2008.

The amendments extend the term of the Central Bank's authority to enter into agreements with credit organizations for the partial compensation of their losses suffered in the interbank market by one more year – i.e. until 31 December 2010.

The Law entered into force on 27 November 2009.

On 25 November 2009 the President signed Federal Law No. 280-FZ amending Federal Law No. 174-FZ, dated 13 October 2008.

The amendments extend the term of Central Bank's authority to impose a limit (for up to one year) on the amount of interest payable by a bank on individual deposits by one more year – i.e. until 31 December 2010.

The Law entered into force on 27 November 2009.

On 16 November 2009 it was reported that the Central Bank has made conditions for granting unsecured loans to credit organizations tougher to gradually reduce volumes of unsecured lending.

As of 1 February 2010, (i) the credit risk limits will be decreased, and (ii) the minimum required credit rating level assigned by the national rating agencies will be increased. Thus, the rating should be no less than "BB" as per RusRating, or no less than "A" as per Expert RA or the National Rating Agency. The list of required ratings was published in the Central Bank Herald on 18 November 2009.

On 12 November 2009 the Central Bank issued Directive No. 2333-U regarding increasing the banks' capitalization.

The Directive follows Federal Law No. 181-FZ "On the Use of State Securities of the Russian Federation to Increase the Banks' Capitalization," dated 18 July 2009.

The Law, among other things, (i) requires that the charter of a bank be amended to increase its capitalization by way of exchange of the bank's preferred shares for federal loan bonds, and (ii) allows the bank to repurchase such preferred shares from the state subject to Central Bank consent.

Continued on page 10

Update *(from page 9)*

The Directive now sets out the procedures for registration of amendments to the bank's charter and for obtaining the Central Bank's consent.

The Directive entered into force on 16 December 2009.

On 12 November 2009 the Central Bank issued Regulation No. 347-P regarding the increase of banks' capitalization.

The Regulation follows Federal Law No. 181-FZ "On the Use of State Securities of the Russian Federation for Increasing Banks' Capitalization," dated 18 July 2009.

The Law provides for the possibility of increasing banks' capitalization by way of exchange of preferred shares for federal loan bonds. The bank and its shareholders will be able to repurchase such shares from the state. Ten years after the preferred shares are issued their holders will be able to convert such shares into ordinary shares in the bank.

The Regulation now sets out specifics of issuing the preferred shares (which are paid by federal loan bonds) and the ordinary shares for conversion.

The Directive entered into force on 16 December 2009.

On 11 November 2009 the Central Bank issued Directive No. 2329-U amending Central Bank Regulation No. 215-P "On the Method of Calculation of the Net Worth (Capital) of Credit Organizations," dated 10 February 2003.

Under Regulation No. 215-P a credit organization's net worth (capital) consists of the core capital and additional capital (Tier 1 and Tier 2 capital, respectively).

According to the Directive, which follows Federal Law No. 181-FZ (see above), the preferred shares issued under this Law make up part of the bank's core capital.

The Directive entered into force on 16 December 2009.

Banking

On 25 November 2009 the Central Bank issued Directive No. 2342-U amending its Instruction No. 28-I, dated 14 September 2006, on opening bank accounts.

The Directive, in particular, introduces rules on opening more than one bank account on the basis of a single agreement, supplements rules on documents submitted for opening bank accounts and rules on banks using copies of sample signature cards. Banks must amend their banking rules in line with the Directive within three months from the date of its entry into force.

The Directive will enter into force on 3 January 2010.

Monetary Policy

On 11 November 2009 the Central Bank Board of Directors approved "Guidelines for a Unified State Monetary Policy for 2010-2012."

The Guidelines provide an overview of economic development in the Russian Federation in 2009 and plans for economic development in 2010 – 2012. The principal goals are as follows: (i) reduction of inflation rates to 9 – 10% in 2010 and 5 – 7% in 2012, and (ii) maintenance of stability of the financial system.

The Central Bank will continue developing the banking sector and banking supervision. The Central Bank's priority measures, listed in the Guidelines, include:

— expansion of refinancing opportunities for credit organizations;

— closer supervision over credit organizations' credit and liquidity risk management and use of state support funds

— legislation developments regarding (i) capital adequacy rules, as well as sanctions applied to credit organizations, in line with Basel documents; (ii) creation of database of banking employees, who violate banking legislation; (iii) transfer of assets of a bankrupt credit organization to the solvent one; and (iv) combating money-laundering.

The Central Bank's measures aimed at the improvement of financial markets include implementation of action plan for creating an international financial center in Russia, and legislation development regarding liquidation netting, clearing activities and organization of trade in the securities market.

Eric Michailov (emichailov@whitecase.com) is a Partner at White & Case LLC. His broad based Russian and cross-border practice relates primarily to corporate and M&A transactions, with a particular emphasis on the representation of investment funds, and companies involved in the telecommunications and real estate sectors.

Kazakhstan Won't Let Foreigners Take Over Key Banks

Kazakhstan will not allow foreign investors to take over its key banks as a result of the financial crisis, President Nursultan Nazarbayev said. Three Kazakh lenders, BTA, Alliance and Astana Finance, went into default in 2009 and are negotiating debt restructuring deals that typically involve giving creditors shares in exchange for debt write-offs.

Nazarbayev told a televised question and answer session with Kazakh citizens that foreign investors would not be allowed to own systemically important banks. Creditors of BTA, in particular, are seeking to get a controlling stake in the bank after the restructuring, but the bank, currently controlled by the state, has rejected their demands. —*Reuters*

Yukos *(from page 2)*

The Impact on Energy Investments

Rulings in arbitrations of this nature are not binding on other arbitration tribunals, but nonetheless frequently are considered influential. The Yukos ruling will have the following impacts:

- The Tribunal's validation of the application of the ECT to Russia confirms for investors who believe Russia already has violated their rights under the ECT that they have an avenue to seek recourse.
- For energy investments in Russia made prior to October 19, 2009, the ruling may have the effect of providing a check against future discriminatory and other adverse investment measures now that it is known Russia can potentially be made liable for such conduct.
- Investors with energy investments in other ECT signatory countries may now have actionable claims for measures undertaken by host States after they signed the ECT but before they ratified it.

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RUSSIA

Competition Law *(from page 3)*

(i) decisions by independent corporations and concerted practices which have as their object or effect the prevention, restriction or distortion of competition (Article 11 of the Law No 135-FZ); and/or

(ii) "repeated abuse" of a dominant position by a corporation (Article 10 of the Law No 135-FZ) in the form of the imposition of unfair prices, refusal to enter into contractual relationships with other trading parties thereby placing them at a competitive disadvantage or market foreclosure;

if as a result of the antitrust violations in question the accused person or persons (i) caused damages to individuals, organisations or the State exceeding RUR 1 million (€23,218), OR (ii) gained income in excess of RUR 5 million (€116,090).

"Repeated abuse" of a dominant position is deemed established when a person is successfully prosecuted for at least three offences within a consecutive period of three years. A successful prosecution means in each case a decision by the Federal Antimonopoly Service ("FAS") that there has been a violation of the Russian antitrust laws identified above and the accused corporation has exhausted any court challenges to that decision.

Sanctions for violations under paragraph 1 of Article 178 include:

- *fines* up to RUR 500 thousand (€11,609) or up to two-years salary or income of the accused person or persons, or

- *imprisonment* for up to three years with or without prohibition to hold certain positions or have certain activities for a period of up to one year.

Paragraphs 2 and 3 of Article 178 set up tougher penalties for antitrust violations under paragraph 1 of Article 178, namely, *imprisonment* for up to seven years and potentially in addition a fine of up to RUR 1 million (€23,218) or up to five-years salary or income of the guilty person. In addition, the penalty can include the prohibition of holding certain positions or undertaking certain activities for a period of up to three years. These tougher penalties may be imposed if the guilty person committed an abuse of a public office for personal gain, caused or threatened to cause damage to or destruction of property, caused damaged to individuals or organisations of the

While criminal sanctions technically existed under the previous law, they were not enforced in practice due to the interpretation issues which meant enforcement was not possible.

Continued on page 12

Competition Law *(from page 11)*

State exceeding RUR 3 million (€69,654) or if the unlawful action resulted in the guilty person obtaining a benefit as a result of the antitrust violation of at least RUR 25 million (€580,450). Finally, the tougher penalties identified above will also apply for antitrust violations if committed with violence or threat of violence.

Note 3 to Article 178 releases from criminal liability persons who assisted with investigating the crime, compensated damages caused and repaid income derived from the illegal activities into the federal budget.

The FAS cannot initiate criminal antitrust proceedings itself. Criminal proceedings for antitrust violations will be initiated by the respective law enforcement bodies - namely, a department of the Ministry of Internal Affairs that is specialised in antitrust violations. However, the law enforcement bodies will only be able to initiate a criminal case under Article 178 after the FAS has determined the related antitrust violation and adopted a ruling and after the accused person has exhausted challenges to that ruling in court.

The New Law does not have retrospective effect and will apply to antitrust violations committed as of October 30, 2009.

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Ukraine Import-Export Taxes

By Scott Brown
(Frishberg & Partners)

As in other European countries, Ukrainian import-export operations are subject to various taxes, including, but not limited to, customs duties and value added tax. Further, depending on the specific product, excise tax and other official costs associated with obtaining licenses or necessary product labels may be applicable. The Cabinet of Ministers has also implemented a licensing system for the import of certain goods, such as chemical substances, fertilizers, pharmaceuticals, cosmetics and veterinary items, among others.

The various taxes associated with standard import operations are summarized below.

Value-Added Tax

Ever since December 26, 1992, when the Cabinet of Ministers executed its Decree No. 14-92, "On Value Added Tax," the legislation governing value added tax ("VAT") has changed frequently, arousing the ire of many companies, foreign and local, large and small.

Staying true to its reputation for constantly amending key legislation, on April 3, 1997, the Parliament approved a new and improved VAT law, which became effective on October 1, 1997 (as lastly amended on July 24, 2009). Subsequently, the Cabinet of Ministers passed Resolution No. 540, dated June 9, 1997, implementing a new VAT payment procedure.

Generally, the law continues to apply a 20% tax for all businesses and other legal entities (such as funds) providing goods and services on the territory of Ukraine, but the calculation mechanism has been liberalized somewhat. The new law finally closed one of the last loopholes by canceling tax holidays for non-profit "Chernobyl-type" organizations, but kept the exemptions for products used by underprivileged children and the disabled, (e.g., children's food products, magazines and newspapers, etc.). The law also implemented a new mechanism for effectuating the payment of value added tax: the importer simply posted a promissory note instead of effectuating a cash payment.

Ukrainian VAT legislation sets up a two-tier structure, designed to effectively protect domestic market from foreign imports. Below we describe each of the two VAT tiers separately.

Import VAT

The VAT rate under Ukrainian law is 20%, as levied against taxable turnover, which does not include VAT. Taxable turnover for import VAT is calculated as the customs value of the goods, including customs duties and any applicable excise taxes. This import VAT is due and payable at the same time customs duties are being assessed (with a potential thirty-day extension made at the discretion of the customs office).

VAT on Retail Sale in Ukraine

Of course, VAT is levied on all products and services manufactured and sold in Ukraine. Costs associated with obtaining/maintaining equipment that are reflected in the final price of the goods also are subject to VAT.

Even a miniscule degree of non-compliance with Ukrainian import rules may lead to significant delays, increased costs, additional efforts, and even lost profits (especially in case of perishable goods).

Any goods or services sold in Ukraine are subject to a 20% VAT, which is levied against the costs of the materials and is included in the sale/purchase price (i.e., sales turnover). Upon resale, sales VAT is levied on the total difference between customer-paid VAT and the VAT paid by the seller for all component materials.

In the event that an imported product is re-sold in Ukraine, VAT is paid on the difference between the sale price and the customs value (including customs duties and any excise taxes) plus import VAT.

Excise Tax

The Ukrainian government has always levied excise tax on luxury items imported into Ukraine, such as alcoholic beverages and tobacco products, and the letter from the State Tax Inspection "On Excise Tax," No. 16-1221/10-7232, dated September 9, 1997, merely reaffirms this fact. Other legislation governing excise tax includes Decree No. 18-92 of the Cabinet of Ministers "On Excise Tax," dated December 26, 1992 and the Law of Ukraine No. 329/95-VR "On Excise Tax on Alcoholic Beverages and Tobacco Products," dated September 15, 1995.

In the past, there was no clear system of tracking the importation and distribution of cigarettes and liquor products. Naturally, the sale of unchecked contraband products resulted in a gold mine of tax-free opportunities for all types of traders, who supplied Ukraine with well-

Continued on page 14

Import/Export *(from page 13)*

recognized vices with virtually no payment of taxes.

In an attempt to control the illegal importation and distribution of cigarettes and liquor, on July 12, 1995, the President executed Order No. 609/95, "On Excise Stamps on Alcoholic Beverages and Tobacco Products." Unlike the excise tax law, this order provided a new approach for collection of excise tax by requiring importers to purchase special customs stamps and place them on each bottle of alcohol and every individual cigarette pack. Without such stamps, no alcohol or tobacco products could henceforth enter or be sold in Ukraine and, if found in Ukraine, they are subject to confiscation.

As a rule, all imports are subject to payment of customs duty (and, of course, the much-hated value added tax). The only exception applies to foreign investors who contribute qualified foreign investment into a Ukrainian resident company's authorized capital in exchange for the ownership rights in such company.

Entirely too much legislative attention has been devoted to alcohol and tobacco, as evidenced by the Parliament's Resolution, dated September 15, 1995, "On the Procedure for Implementing the Law of Ukraine 'On Excise Tax on Alcohol Drinks and Tobacco Products;'" the Cabinet of Ministers' Resolution No. 1755 "On the Term of Validity of Licenses for Carrying Out Certain Types of Economic Activity and the Procedure for Calculating the Payment Amount for the Issuance Thereof," dated Novemder 29, 2000; Decree No. 666 "On Measures for Implementing Excise Stamps on Domestic Alcohol Drinks," dated June 20, 1996; Decree No. 493 "On the Temporary Procedure for Issuing Licenses for Import, Export and the Wholesale Trade of Ethyl Alcohol, Cognac Alcohol Drinks and Tobacco Products," dated May 13, 1996, among others.

Other luxury items are also subject to the excise tax, and they are identified in the Cabinet of Ministers' Resolution No. 1078, dated September 29, 1997, as caviar, crab, shrimp, chocolate, automobile tires, audio and video cassettes, televisions, among others. Interestingly, the minimum rates for television and video equipment imported by Sony and Panasonic were higher than for Daewoo and LG Electronics, but no official explanation was given.

The excise tax rates and the listed products tend to change constantly, which keeps the importers on their toes. On June 2, 1997, for instance, the Cabinet of Ministers imposed minimum customs values for certain foodstuffs (e.g., coffee, black caviar, frozen chicken and turkey legs, among others.) and clothing (fur coats and leather jackets).

Customs Duties

As a rule, all imports are subject to payment of customs duty (and, of course, the much-hated value added tax). The only exception applies to foreign investors who contribute qualified foreign investment into a Ukrainian resident company's authorized capital in exchange for the ownership rights in such company.

The Foreign Investment Law expressly provides that in-kind investment imported into Ukraine as a foreign partner's contribution to the authorized capital of any Ukrainian company, such as a joint venture or a 100% foreign-owned subsidiary, is exempt from customs duty, but is still subject to value added tax. If, however, the above foreign investor's property is alienated within three years from the date it is credited to the Ukrainian company's balance, the Ukrainian company will need to pay customs duty thereon. Importantly, the registration of foreign investment is mandatory from June 23, 2009 until at least January 1, 2011.

The specific rates for various products may be found in various laws starting with the Customs Code of Ukraine, effective on January 1, 2004, and the Cabinet of Ministers' Decree No. 4-93, "On Unified Customs Tariff," dated January 11, 1993. Other legislation evidencing that import duty rates are subject to constant changes include the Cabinet's Resolution No. 1648 "On Introduction of Amendments to and Recognition of Certain Resolutions of the Cabinet of Ministers of Ukraine Which Were Rendered Ineffective," dated December 13; Law No. 313/96-VR, "On Rates of Excise Tax and Import Duties on Certain Products," dated July 11, 1996, as amended on May 22, 2003; the Law of Ukraine No. 2097-XII "On Uniform Customs Tariff," dated February 5, 1992, among others.

On December 21, 2000, the Parliament adopted amendments to the Law "On the Unified Customs Tariff," according to which the Cabinet of Ministers no longer has the authority to establish rates of customs duties. Reacting swiftly, on January 12, 2001, the Cabinet of Ministers adopted Resolution No. 16 "On Amending the Rates of Import Duties for Certain Types of Products and Certain Resolutions of the Cabinet of Ministers of

Ukraine," which was thereafter rendered ineffective by the Cabinet of Minister's Resolution No. 1648 of December 13, 2001.

Currently, the Law "On the Unified Customs Tariff" bestows upon the Parliament the authority to have the final approval over the Cabinet's proposals regarding the unified customs tariff. Additionally, the Law of Ukraine No. 2371-III "On Customs Tariff" was passed on April 5, 2001, which replaced the old Commodity Nomenclature for Foreign Economic Activity with the Ukrainian Classification of Goods of Foreign Economic Activity.

Miscellaneous Costs: Labels and Certification

Several categories of import products are subject to special licenses or "certifications" such as pharmaceutical, agro-chemical and food products (e.g., the Cabinet of Ministers' Resolution No. 1996 "On the List of Goods, the Importation and Exportation of Which is Subject to Licensing and On Which Quotas are Established").

Naturally, cigarettes and alcohol are subject to a mandatory "certification" process under Orders Nos. 378 and 379 of the State Committee on Standards, Metrology and Certification, entitled "The Rules of Obligatory Certification of Tobacco Products" and "The Rules of Obligatory Certification of Alcohol Products," both dated September 13, 1996.

Food products were the next in line for certification. As of January 1, 1997, all imported food products undergo a "certification" process, during which the required labels containing various information (in the Ukrainian language) must be affixed onto the product. The required information includes the product's name, volume, chemicals and additives, expiration date, and calorie content, among others.

On November 4, 1997, the Cabinet of Ministers' Resolution No. 1211 "On Approval of the Procedure of the Customs Clearance of Imported Goods (Products) Which Are Subject to Mandatory Certification in Ukraine" approved the procedure for the customs clearance of imported products subject to obligatory certification in Ukraine. Four years later, on December 13, 2001, the above procedure was slightly amended by the Cabinet's Resolution No. 1671.

The practical implementation of the otherwise reasonable certification requirements continues to cause great anxiety amongst importers. Many foreign companies complain, and rightfully so, that clear and transparent compliance with this particular piece of legislation is often possible only after rewarding (in cash or in-kind) the state official(s) responsible for granting the necessary permissions. Regrettably, this viewpoint has merit.

While product certification is designed to ensure consumer safety and quality standards, it can also become a good tool to protect domestic producers from importers. A good example of this dichotomy is provided by Procter & Gamble's struggles with the Ukrainian authorities. On March 3, 1998, the State Committee for Standardization,

Several categories of import products are subject to special licenses or "certifications" such as pharmaceutical, agro-chemical and food products.

Certification and Metrology ("DerzhStandart") revoked Proctor & Gamble's laundry detergent certificates, which reportedly cost the company USD 135,000 to acquire. The DerzhStandart asserted that the formula used to produce Procter & Gamble's soap powder was of inferior quality and was aimed at the poor Ukrainian public.

Procter & Gamble disagreed wholeheartedly, and launched a counter-attack on March 20, 1998, by requesting that the Presidential Independent Chamber on Foreign Investments form an expert panel to resolve this conflict, and initiating a criminal investigation to trace its payment of USD135,000 for the certificates. In the meantime, the dispute had a negative side-effect on Procter & Gamble's activities.

Conclusion

As a rule, in any import-export transaction something can always go wrong at any moment. Even a miniscule degree of non-compliance with Ukrainian import rules may lead to significant delays, increased costs, additional efforts, and even lost profits (especially in case of perishable goods). As legislation in this area changes all too frequently, foreign business entities wishing to sell their products in Ukraine must inform themselves about the latest applicable import taxes and duties, certificates and licenses, contract formalities and related matters.

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Amendments to Ukrainian Laws Aimed at Overcoming the Adverse Effects of the Financial Crisis

By Oleg Stepanov and Sergiy Melnyk
(Salans)

On November 24, 2009, the Law of Ukraine No. 1533-VI "On Amending Certain Legislative Acts of Ukraine with a View to Overcoming the Impact of the Financial Crisis" (the "Law") came into force. In particular, the Law introduces the following amendments to the laws of Ukraine:

1. The law of Ukraine "On the Procedure for Settlements in Foreign Currency," stipulating that:

The maximum period for depositing the financial proceeds of exporting goods, works or services in "hard currency" on accounts opened by resident entities has been reduced from 180 to 90 days. Further, the maximum period for the delivery of imported goods, works or services delivered on terms providing for a delay in delivery from the date of payment, or issue of a promissory note, has been reduced from 180 to 90 days.

Taxation of interest received by individuals on bank deposits will start from January 1, 2013 (instead of January 1, 2010).

2. The law of Ukraine "On Banks and Banking Activity":

The amendments stipulate that the minimum amount of a bank's charter capital as of the bank's registration date has been changed from Euro 10 million to UAH 75 million; (Salans Comment: equivalent to about Euro 6.5 million based on exchange rate established by the National Bank of Ukraine as of December 30, 2009.)

Subordinated debt provided to Ukrainian banks in foreign freely convertible currency shall be accounted in UAH based on current exchange rate established by the National Bank of Ukraine as of the reporting date.

3. Foreign investments in Ukraine.

For the period until January 1, 2011: Amendments have been introduced to the law of Ukraine "On the Foreign Investments Regime," stipulating that:

— it is provided that foreign investors may make investments in monetary form only through investment accounts opened with authorized Ukrainian banks;

— foreign investments are subject to compulsory state registration; the rules and procedure for registration of foreign investments in currency valuables shall be adobted by the National Bank of Ukraine;

— foreign investments in monetary form must be made in freely convertible currency converted into the official Ukrainian currency.

4. Debts restructuring under the loans of physical persons.

Until December 31, 2010 banks are empowered to restructure debts under the loans granted to physical persons before January 10, 2008 and amount of which loans do not exceed UAH 1 million or its equivalent (under exchange rate as of January 10, 2008), and, in case of mortgage loans, secured only by residential real property. Under so restructured loans:

— debtors shall be released from payment of any penalties accrued until the restructuring date;

— debtors are entitled to demand annual reducement of the principal amount by 0.25% during 5 coming years provided the debtor has no overdue amounts the restructured loan.

5. For the period until January 1, 2011 the loans in foreign currency to physical persons (who are not registered as private entrepreneurs) can be granted only for the purposes of medical treatment or education abroad.

The loans in foreign currency granted after the Law became effective, and principal amounts and interests thereunder shall be granted (respectively repaid) by wire bank transfer.

6. Credits from non-residents to Ukrainian residents.

For the period until January 1, 2011:

— It is prohibited for residents to make any amendments to loan (facility) agreements with non-resident lenders with respect to early fulfillment of resident borrowers' obligations to non-resident lenders under such agreements;

— The National Bank of Ukraine ("NBU") shall refuse in registration of the above amendments;

— Resident borrowers (including under loan (facility) agreements executed prior to the effective date of the Law) are prohibited from early repayment of facilities in foreign currency obtained by resident borrowers from non-residents.

7. The law of Ukraine "On Value Added Tax":

— A VAT exemption for supplies (sales or transfers of title) by banks and other financial institutions of property pledged and mortgaged by individuals, private entrepreneurs and other individuals who are not VAT payers, if enforcement of a debt has been made against such property.

8. The law of Ukraine "On Corporate Profit Tax":

— NBU has been granted authority to approve a list of tax deductible expenses for banks, related to providing employees with special clothes, footwear for professional activities and special diet products.

— Tax accounting rules (for corporate tax purposes) for financial results concerning sales (transfers) or acquisitions of a right of claim in monetary form for goods delivered or services rendered by a third party, liabilities under financial loans and other civil contracts. In particular, on the first transfer of a right of claim, the primary creditor must treat funds received from such transfer as taxable income and, as a rule, may treat the amount of indebtedness which is being transferred as a tax deductible expense. In other words, on the sale of a right of claim with a discount, the losses of the primary creditor may be treated as tax deductible expenses. However, losses accrued on the next transfer of a right of claim may not be treated as tax deductible expenses by the transferor.

— 80% tax deductibility for insurance reserves held by financial institutions and 100% deductibility for banks until 1 January 2011.

— A creditor will be entitled to reimburse itself for any indebtedness under a promissory note from its insurance reserve, since the debtor in question is considered to be bankrupt.

— A creditor will be entitled to reimburse itself for any indebtedness under debt securities (except for promissory notes) from its insurance reserve, since the issuer in question is considered to be bankrupt.

The maximum period for depositing the financial proceeds of exporting goods, works or services in "hard currency" on accounts opened by resident entities has been reduced from 180 to 90 days.

— The indebtedness of financial institutions under shares and securities, the issuers of which are considered bankrupt and in respect of which registration of share issues has been cancelled, shall be reimbursed from the institutions' insurance reserves after the decision about the cancellation of registration of share issues is made public, provided that an agreement on the acquisition of such securities or charter capital contributions was signed

Continued on page 18

Turkmenistan - U.S. Urges Turkmenistan to Allow Investment in Gas Fields

The United States urged Turkmenistan to allow U.S. companies to invest in onshore Turkmen gas deposits including South Iolotan, a giant field seen as a key future source of Caspian energy.

In the Turkmen capital Ashgabat to attend an annual energy conference, U.S. Deputy Assistant Secretary of State George Krol told Reuters U.S. companies were keen to develop Turkmen gas but were allowed only to invest in riskier offshore projects.

Turkmenistan has so far allowed only China's state-owned major China National Petroleum Corp (CNPC) to invest onshore into a gas project linked to a Turkmenistan-China gas pipeline due to open next month. Western companies have urged Turkmenistan's new leadership to allow them to bid for projects like South Iolotan.

—Reuters

Crisis *(from page 17)*

by the relevant financial institution before notice is given regarding cancellation of registration of share issues. A pledgee will be entitled to reimburse itself for any part of existing indebtedness from its insurance reserve, if such indebtedness has not been settled after an enforcement of the debt is made against the pledged property.

On the first transfer of a right of claim, the primary creditor must treat funds received from such transfer as taxable income and, as a rule, may treat the amount of indebtedness which is being transferred as a tax deductible expense.

— In order to determine taxpayers' taxable income or deductible expenses resulting from the decrease or increase in insurance reserves, starting from the reporting period when the Law comes into force, the amount of insurance reserves formed as of January 1, 2009 is to be calculated. Deductible expenses and income resulting from the formation and use of insurance reserves before January 1, 2009 will not be adjusted.

— From January 1, 2009 until January 1, 2011 inclusive, Ukrainian banks will need to recognize taxable income from credit operations only upon receipt of income from such operations. Income from credit operations of banks accrued from January 1, 2009 till December 31, 2010 inclusive, but not received as of January 1, 2011, must be treated as taxable income of the bank at the date of actual receipt.

9. The law of Ukraine "On Personal Income Tax":

— Individual taxpayers will be entitled to treat as tax credit interest paid under a residential mortgage loan provided either in UAH or in a foreign currency. If such interest is paid in a foreign currency, it must be recalculated in UAH using the official NBU exchange rate effective on the date of payment.

— Taxation of interest received by individuals on bank deposits will start from January 1, 2013 (instead of January 1, 2010).

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Toxic Rains of Ukraine's State Guarantees — Acid-Proof Umbrella is Needed

By Dmytro Sakharuk
(Squire, Sanders & Dempsey L.L.P.)

In 2009, Ukraine's government announced a storm of state guarantees for various projects. In all, the government adopted 19 resolutions (the Investment Resolutions) regarding implementation of investment projects to be financed by non-Ukraine-based lenders with state guarantees.

The largest investment projects include road construction (8 billion UAH); development of EURO 2012 infrastructure (2.4 billion UAH); purchase of medical equipment and transport from companies from Austria (€500 million), the United States (US$1.3 billion) and China (US$500 million); and purchase of agricultural and energy-saving equipment from suppliers from Ukraine (1.3 billion UAH) and other countries (US$1 billion).

Among the financial institutions that Ukraine's government has named as potential lenders are the Export-Import Banks of China, the United States and Korea; Private Export Funding Corporation (USA); UniCredit; Canada-based export agency EDC; the Japan Bank for International Cooperation; and others.

Why the Guarantees May Be Toxic

With the flood of Investment Resolutions, Ukraine's government has announced a willingness to issue state guarantees up to 53.8 billion UAH (approximately US$6.56 billion) (not including the state guarantee of approximately 16.4 billion UAH [approximately US$2 billion] for the debt restructuring of the state oil and gas company Naftogaz).

At the same time, the 2009 State Budget Law limits the government to issuing a maximum of 37 billion UAH (approximately US$4.62 billion) in state guarantees. It is not clear exactly how much the government has guaranteed to date, as the Investment Resolutions speak to a maximum issuance for certain projects and are not guarantees in themselves.

Nevertheless, if state guarantees in excess of the US$4.62 billion are issued in 2009, the next government (if it is formed by a political party adverse to the current prime minister) may refuse to satisfy the claim of a lender based on such state guarantees.

In addition, if there is a change in the next government, a Ukraine court may find reason to refuse enforcement in Ukraine of a guarantee-based arbitration award granted in favor of a lender.

The president may suspend an Investment Resolution (as any other government resolution) if he believes that such resolution is "unconstitutional." Using this right, as of November 2009 the president already has suspended seven Investment Resolutions equal to approximately 17.3 billion UAH (US$2.11 billion); the last two were suspended on 10 November 2009. The suspensions are disputable from a legal point of view, and the ultimate authority for resolving the issue, the Constitutional Court of Ukraine, may disagree with the president's actions and uphold the legality of the Investment Resolutions. Nevertheless, with presidential election campaigns underway, the president has been willing to veto or suspend much legislation proposed by the current prime minister, which means that suspension of other Investment Resolutions is possible. The question of whether such acts by the president are legitimate will not likely be resolved before 2010.

The president may suspend an Investment Resolution (as any other government resolution) if he believes that such resolution is "unconstitutional."

Acid-Proof Umbrella

In such an environment, the main questions for potential lenders and suppliers relying on guarantees are (i) whether they should devote time and money to negotiate investment projects with the government and (ii) if so, how they can protect themselves from the risk that a respective Investment Resolution will be suspended, cancelled or invalidated.

Timing is the key for answering the first question. All Investment Resolutions provide that loan agreements must be signed and state guarantees issued by the end of 2009. This is despite the fact that a majority of the Investment Resolutions were adopted only in the second half of 2009 (four resolutions in July, two in August, two in

Continued on page 20

State Guarantees *(from page 19)*

September and four in October). Therefore, if lenders or suppliers need the state guarantee component for their project to succeed, they should strive to ensure that a loan agreement is signed and a state guarantee is issued by year-end.

Understanding that suspension, cancellation or invalidation of an Investment Resolution may suspend or terminate the whole investment project is the key to answering the second question. To mitigate such risks, they should be shifted to the state.

In the case of traditional project finance schemes, the lender may achieve such protection by including in the loan agreements such events of default as suspension, cancellation and invalidation of a respective Investment Resolution. For the supplier of goods the same events should be included in the supply agreements as the basis for suspension or termination of the supply of goods. In addition, the text of a state guarantee should provide a warranty that such state guarantee will be issued within the limits provided by the 2009 State Budget Law (37 billion UAH).

Because almost all Investment Resolutions provide for prepayments for goods, proper attention also should be paid to how such prepayment should be applied in case of early termination of a supply agreement.

The parties should keep in mind the "180 days rule," which provides that goods must be delivered and imported into Ukraine within 180 days of prepayment. Otherwise, if the prepayment is not returned, a Ukraine-based buyer would be subject to penalties of 0.3 percent of the prepayment amount each day following the 180-day period.

Basics of Ukraine State Guarantees

In pursuing a state guarantee, along with the advice listed above, the lender should keep in mind the following basic rules and principles to ensure protection:

- A state guarantee is a guarantee issued by the government to secure fulfillment of debt obligations of Ukraine-based entities.
- For the purposes of issuance of a state guarantee, the government is represented by the Ministry of Finance.
- A state guarantee may be issued only within the limits set by the State Budget Law for a particular calendar year.
- A state guarantee is not free. A borrower whose obligations are secured by a state guarantee must pay an interest to the state for issuance and maintenance of such guarantee.
- A state guarantee is always a term guarantee. It may not be issued for an indefinite period of time.
- A borrower whose obligations are secured by a state guarantee must provide to the state a counter-guarantee of banks. Such guarantee is irrevocable and unconditional, and an issuing bank must comply with the economic norms established by the National Bank of Ukraine for the period of 2007 to 2009. Alternatively, such borrower may provide some other appropriate security (mortgage, shares pledge, etc.).

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