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Articles

Regular Features

Highlights

What if Putin's Plan for the Russian Economy is Wrong?

Mr. Putin's remarkable concentration of power has been seen as an expedient way of invigorating the Russian economy. The problem is, Mr. Putin's assumptions of the best way forward for the economy may be wrong, as evidenced by increasing state interference, lack of competitiveness and low levels of investment. Page 2

Reducing Red Tape for Oil & Gas Companies in Kazakhstan

Kazakhstani law requires oil and gas companies (and other possessors of mineral rights) to receive permission from the Ministry of Mineral Resources before they can buy or sell subsoil rights. However there may be alternatives, such as the purchase of controlling shares of a company that holds a mineral license. Page 3

Getting U.S. Courts to Take Jurisdiction over Russian Disputes Becoming More Difficult

A recent U.S. Federal Court decision is making it more difficult for plaintiffs to persuade U.S. courts to take jurisdiction over disputes that arose in Russia. Plaintiffs that indicate an inclination toward forum shopping, including concerns over inadequate court awards in Russia, are at a decided disadvantage. Page 8

Giving Disgruntled Shareholders in Russia More Power to Contest Board Decisions

A draft law is making its way through the Duma which would make it easier for shareholders to challenge decisions by the board of directors of joint stock companies. Page 12

Foreign Oil Investors Still Coming to Russia

Despite the uncertainty surrounding Yukos, foreign oil companies are still investing in Russia. Such investments, along with solid tax revenues and proceeds from privatization sales will reduce Russia's financing needs for the next year. Page 14

Considerations when Signing Contracts in Ukraine

Ukraine's legal requirements for a valid contract are formalistic, and will surprise unsavvy investors. Page 18

IN MY VIEW

From Third Way to Wrong Way?

by Roland Nash

On a recent drive from the Ukraine border to Moscow, we covered roughly 500 km and passed through 22 separate police checkpoints. We were stopped and asked for our papers 11 times and were forced to pay four sets of 'fines' totaling about $50. We were successfully charged with speeding twice (in a 25 year-old Citroen 2CV), drunk-driving once (at 11:00 am on a Sunday morning and from which we were allowed to continue our journey) and, in a charge inspired by creative desperation, for only having two digits on the expiry year of my British driving license—it could, apparently, have expired in 1942. We probably would have been fined more regularly, but there seemed to be considerable amusement value in a banker and a blonde driving a red and yellow 2CV through Russia's outback.

With ConocoPhillips about to take a lump of LUKOIL, the RTS again driving higher and the Gazprom ring-fence primed to fall, the economic headlines suggest that momentum continues despite YUKOS and growing authoritarianism. Yet day-to-day economic reality appears to belie the headlines—life in Russia seems to get more difficult and the bureaucracy more petty the more reforms continue and authority is concentrated.

What If Mr. Putin's Economic Policies Are Wrong?

The single major justification for much of the political centralization under President Vladimir Putin is that it is good for the economy. The fundamental assumption underlying the argument for the centralization of power in the Kremlin is that Mr. Putin will implement the 'right' economic policy. The overriding aim of his administration, as publicly repeated on every suitable occasion by Mr. Putin, is to create a strong, secure Russia based on a growing economy. Therefore, the greater the concentration of authority, the more rapidly can the conditions be created for investment and economic growth. To expect delivery of policy without centralized politics, so goes the argument, is a naive misunderstanding of both the magnitude of the task facing Mr. Putin and of Russia's historical legacy.

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The danger to this rationale has always been that Mr. Putin might decide to implement the wrong economic policy. The greater the centralization of power, and the weaker the checks and balances, the easier it would be for Russia to slip towards a set of policies that fail to promote growth. In contrast to the positive surprise of the same period during his first term, Mr. Putin's first six months of term two suggest that focus is moving in that wrong direction.

When Alexander Voloshin and Mikhail Kasyanov were removed as head of the Presidential Administration and Prime Minister, respectively, there was little sense of any prospective shift in policy. Power it seemed, was to be even further concentrated, with loyal Putinites replacing the last bastions of the Yeltsin era. Policy was anyway determined in the Kremlin, and the personnel change would just mean a more effective chain of command.

It would be a mistake to assume that Gazprom ring-fence removal and power politics in the strategic economy signal that it is getting any easier to do business in Russia.

Absence of Reformers

But with retrospect and the hindsight of Yukos, Messrs. Kasyanov and Voloshin appear to have had considerably more influence over the economic agenda and the protection of the business environment (not simply big business) than that with which they were credited. Since their early retirement, the hopeful band of St. Petersburg reformers is notable only by its absence. Andrei Illarionov has become obsessed with Kyoto (on which he appears to be ignored anyway), German Gref rarely lifts his head above the political barricades and Alexei Kudrin seems content to sit in the Ministry of Finance counting all his oil money. Monetary policy is controlled by the loyal, if uninspiring, Sergei Ignatyev, and, in the Duma, the absence of any liberal party severely limits the scrutinizing of economic legislation. Of the lesser lights, Mikhail Dmitriev has retired, Arkady Dvorkovich has

Continued on page 12

OIL & GAS

Transfer of Subsoil-Use Rights under Kazakhstani Law: Is the Prior Consent of State Always Required?

by Alexey Bukhtiyarov

The ability to transfer subsoil-use rights without the state being involved has always been one of the key issues for many entrepreneurs engaged in subsoil use activities in the Kazakhstan. How easily can they acquire subsoil-use rights[1] from another subsoil user without obtaining approved by government agencies? Are there any specific legal mechanisms that would minimize the involvement of government bodies in the process of transfer of subsoil-use rights? The answers to these questions may have a significant impact on the transactional value of subsoil-use rights, as well as the interest of entrepreneurs in acquiring them.

The purpose of this article provides an analysis of the above issues under current Kazakhstani law, as well as describing the existing impediments in the process of subsoil-use rights transfer.

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Direct Transfer of Subsoil Use Rights

The main legal acts regulating subsoil use operations in Kazakhstan are the Edict of the President of Kazakhstan, having force of Law, No. 2828 dated January 27, 1996 "On Subsoil and Subsoil Use" (Subsoil Law) and the Edict of the President of Kazakhstan, having force of Law, No. 2350 dated June 28, 1995 "On Petroleum" (Petroleum Law).

Article 14(1) of the Subsoil Law provides that transfer of subsoil-use rights by one subsoil user to another requires the prior approval of the competent body, which is the Ministry of Energy and Mineral Resources of Kazakhstan (MEMR). Such prior approval is necessary regardless of whether the transfer is for value or free of charge, and regardless of whether the transfer constitutes a contribution to the charter capital of a new legal entity. Moreover, Article 14(9-2) of the Subsoil Law states that the transfer of subsoil-use rights comes into effect at the moment when the respective subsoil-use contract is reissued (amended) in the name of a new subsoil user.

The rules require obtaining the prior approval of MEMR for transfer of subsoil-use rights from one subsoil user to another. Normally, MEMR would approve the transfer

Continued on page 4

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Subsoil-Use Rights *(from page 3)*

transaction only if provided with evidence that a new subsoil user possesses sufficient financial, technical and other resources to conduct subsoil-use operations and comply with the terms.

Article 14(9-1) of the Subsoil Law obliges MEMR to permit the transfer of subsoil-use rights from a parent company to its subsidiary where the parent guarantees compliance by the subsidiary with the subsoil-use contract.

Based on the above, it appears that direct transfer of subsoil-use rights from one subsoil user to another always requires the prior authorization of MEMR, which sometimes constitutes a bureaucratic problem.

Acquiring Controlling Interest in Entity Possessing Subsoil-Use Rights

A company can also acquire subsoil rights by purchasing controlling shares in a company that possesses such subsoil-use rights. By means of such transaction, a new company would obtain, in addition to equity, management control over a particular subsoil user and its subsoil-use operations. At the same time, the subsoil-use rights are not transferred per se and remain with the subsoil user, since the previous shareholder transfers only shares in a subsoil user to the new company.

Is prior approval of MEMR required in such case?

At first glance, neither the Subsoil Law nor the Petroleum Law expressly requires a company to obtain prior approval from MEMR before purchasing a controlling interest in a subsoil user. However, the discussion below identifies some issues related to the Petroleum Law that are relevant to our discussion.

Article 53(1) of the Petroleum Law states that "[a subsoil user] may transfer all or part of its contractual rights and obligations to another legal entity or an individual or an international organization, *including by means of an alienation of controlling set of shares*, only with the written permission of the Licensing and Competent body" (emphasis added). Strictly speaking, the cited rule may be interpreted as requiring a subsoil user to obtain from MEMR prior approval for its shareholders to sell a majority of their shares to another entity willing to acquire control over that subsoil user.

However, in our view, such interpretation lacks legal grounds for two main reasons. First, according to the theory of interpretation of Kazakhstani law, legal norms are interpreted in accordance with the literal meaning of their wording. It appears from the wording of Article 53(1) of the Petroleum Law that it regulates only the issues of "transfer of all or part of contractual rights and obligations to another legal entity" under a subsoil-use contract. In other words, if the transfer takes place, then Article 53(1) will be applied. If there is no transfer of subsoil rights, there is no obligation to obtain the approval of MEMR. Such interpretation fully complies with the purpose of Article 14 of the Subsoil Law.

The sale of shares in an enterprise does not bring about a transfer of rights and obligations by a subsoil user, since that subsoil user remains a party to a subsoil-use contract. Moreover, under Article 33(1) of the Civil Code of Kazakhstan (dated December 27, 1994), a legal entity and its participants have separate legal personalities. In other words, transfer of shares by shareholders and transfer of subsoil-use rights by a subsoil user are distinct. It is our view, therefore, that the wording "by means of an alienation of a controlling set of shares" can be described as poor drafting of the Petroleum Law.

Second, prior to August 11, 1999, the Subsoil Law contained Article 39(2) whereby the consent of the government of Kazakhstan was required for any changes to the composition of participants of a particular subsoil user (for example, a change in the participants of a joint venture that holds the license as a subsoil user) if such composition was a specific condition under the granted subsoil use license. In other words, there did exist a requirement to obtain prior approval for transfer of shares in a company conducting subsoil-use operations. However, on August 11, 1999, this requirement was eliminated by amendments to the Subsoil Law. This elimination may be interpreted as the general intent of the state to grant "freedom" to transfer shares in an entity holding subsoil-use rights, without the involvement of the competent state bodies.

Nonetheless, it should be emphasized that there exists some risk that in practice Kazakhstani authorities may interpret and apply Kazakhstani laws differently. Accordingly, it may be advisable for each subsoil user to at least notify MEMR as to the change of its shareholders and then comply with MEMR's directions, if any. Further, for major transactions, we suggest that the company request from MEMR either approval or an official letter stating that obtaining of such approval is not required under the laws of Kazakhstan. In our view, the decision of whether to apply to MEMR would mainly depend on a desire to minimize possible risks of a transaction to be challenged by MEMR in the future, especially taking into account the value of that transaction and consequences of its nullification.

Antimonopoly Law Issues

Even if the above provides a subsoil user with some basis for avoiding MEMR's prior approval for acquiring a controlling interest in an entity possessing subsoil-use rights, the following analysis shows that the state may still control that transaction though its antimonopoly (antitrust) bodies.

Clause 18(1)(3) of Law No. 144-II (dated January 19, 2001) "On Competition and Limitation of Monopoly Activities" (Antimonopoly Law) states that a purchaser of shares must receive authorization by antimonopoly authorities for acquiring the majority of shares in a particular company. It should be noted that permission of antimonopoly authorities would be required only if the total value of assets of the purchasing and target companies exceeds 100,000

Continued on page 7

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MARKET OPPORTUNITIES

Aeronautics

Hungary

Government may cancel Malev sale. Hungary may cancel the sale of Malev, the unprofitable national airline, after it received only one bid, Hungarian daily newspaper *Magyar Hirlap* reported. The newspaper provided no sources for the story. A company represented by Ferenc Kovacs, former Malev CEO, offered 150 mln forint ($775,000) for the Budapest-based airline, the newspaper said. The company also agreed to invest 10 mln forint into the airline after the purchase and 1.9 bln forint later, according to the report. However, the bid did not include any assumption of Malev's debt, currently amounting to about 36 bln forint. The assumption of debt was a tender condition, the newspaper said. This is Hungary's fourth attempt to sell Malev.

Banking and Finance

Hungary

Lawmakers expected to turn down reintroduction of capital gains tax. The Hungarian Parliament is expected to reject a government proposal to reintroduce a tax on capital gains from trading shares, business daily newspaper *Napi Gazdasag* said, citing opposition politicians, including former Finance Minister Mihaly Varga. Fidesz and the Hungarian Democratic Forum, or MDF, the two opposition parties, as well as the Free Democrats, the smaller member in the two-way government coalition, oppose the tax, the business daily said. The Socialist Party alone does not have a majority in parliament. The capital gains tax rate would be 25 percent, according to the draft law on 2005 taxes as the government needs revenue to help narrow the budget deficit and prepare for euro adoption. The current Socialist-led coalition abolished an earlier 20 percent capital-gains tax when it took office in 2002.

OTP Bank considering regional expansion. Hungary's OTP Bank Rt., the largest lender by market value in the 10 countries that joined the European Union (EU) in May, may bid for Nova Banka (Croatia) and Jubanka a.d. (Serbia) next month, according to information provided by a market source. Budapest-based OTP is examining the books of Nova Banka, based in Zadar on the Adriatic, and has also completed an initial look at Jubanka's finances earlier this month, the source said. Nova Banka is owned by Charlemagne Capital (UK) and a fund controlled by Hungarian-born financier George Soros. It is Croatia's seventh largest bank with assets of 600 mln kuna ($102 mln). Jubanka had total assets of 217 mil euros ($278 mln) at the end of 2003. Societe Generale (France), HVB Group (Germany) and Banca Intesa (Italy) are also interested in Nova Banka, according to several media reports.

Poland

PZU told to prepare an IPO, signaling end to shareholder conflict. Treasury Minister Jacek Socha requested that PZU, Poland's biggest insurer, begin to prepare for an initial public offering (IPO) in 2005, anticipating the end to a conflict with shareholder Eureko (The Netherlands). Poland plans to sell assets worth 5.7 bln zloty ($1.7 bln) next year to reduce the budget deficit and qualify for the euro currency this decade. The sale of Warsaw-based PZU would boost revenue above that target, Socha said. The sale of PZU has been held up by the dispute with Eureko, which bought 30 percent of the insurer in 1999 for $700 mln. Amsterdam-based Eureko filed a complaint with an arbitration panel in Brussels last year, saying Poland failed to sell it an additional 21 percent as agreed when it bought the stake. There will be no IPO of PZU before the conflict ends, Socha said, adding that the conflict at this stage makes it impossible for him to sign off on the PZU prospectus and send the company to the Warsaw Stock Exchange.

Communications

Czech Republic

Decision on Cesky Telecom depresses stock. Shares of Cesky Telecom (CS) fell after the Czech government committee for the sale of the country's largest phone company recommended that the state sell its 51 percent stake in the company through the capital markets. The committee, consisting of various ministry officials, made the decision after considering a recommendation from sale advisers Credit Suisse First Boston (Switzerland) and Czech bank Ceska Sporitelna.

Energy

Lithuania

Ignalina first reactor will close on schedule. Lithuanian President Valdas Adamkus said that Vilnius will keep its pledge to the European Union (EU) and close the Ignalina nuclear plant's first reactor by the end of 2004. Adamkus made the comment in an emailed press statement following a meeting with Prime Minister Algirdas Brazauskas. Brazauskas had said earlier in October that the government would ask the EU to delay the scheduled closure to avoid power shortages in the Baltic region. The EU, which Lithuania joined on May 1, ruled Ignalina unsafe because it uses the same type of reactors as the Ukrainian plant at

Continued on page 19

Draft Amendments to Tax Code of Kazakhstan regarding Individual Income Tax

by Doug Flaherty and Aigul Zhumanbayeva

A series of amendments to the Tax Code of the Republic of Kazakhstan is currently under consideration. The government passed the package of amendments to the Tax Code to the Mazhilis for further consideration on August 27, 2004. If they are adopted, they will enter into force from January 1, 2005.

Income Not Subject to Taxation

The list of income not subject to taxation will be extended. According to article 144, among other types of income, the following types of income will be exempt from taxation:

- dividends on shares of share investment funds and shares of equity investment funds, and also income on the shares of share investment funds when they are repurchased by the managing company of the fund in question;
- pension payments to be made by savings pension funds from pension savings which are inheritable in accordance with the procedure established by legislation;
- sponsorship aid;
- insurance premiums payable by an employer under obligatory and (or) savings insurance agreements for its employees.

Tax Deductions

The list of tax deductions for individual income tax purposes will be extended. In particular, the list, mentioned in article 152, includes interest paid on mortgages obtained by resident individuals of Kazakhstan to housing construction savings banks[1] for the repair, construction or purchase of housing in the territory of Kazakhstan. In addition, the limit currently imposed for insurance premiums paid in favor of an individual by that individual under accumulative insurance agreements for the purpose of calculating individual income tax has been removed.

Furthermore, voluntary professional pension contributions have been excluded from the list of tax deductions, and from January 1, 2005, will be regarded as income not subject to taxation.

Seconded Foreign Specialists

The amendments to be introduced in articles 153-1 and 187-1 propose the following mechanism for individual income tax to be paid for seconded foreign specialists, "If the resident tax agent is an employer of foreign personnel, seconded by a non-resident under a contract to provide foreign personnel, individual income tax from the income of the foreign personnel payable outside the Republic of Kazakhstan . . . shall be calculated and paid by a resident tax agent through the advance payment mechanism, or through the mechanism for withholding at the source of payment. In the event that income is paid to this personnel in the Republic of Kazakhstan, individual income tax from the income of the foreign personnel shall be calculated, withheld and paid by a resident tax agent by withholding it at the source of payment."

We believe that the wording of these articles may lead to additional questions from taxpayers. Bearing in mind that seconded foreign specialists are the employees of a non-resident legal entity seconding foreign specialists, the Kazakhstani company accepting these foreign specialists may not be considered as the employer of these seconded foreign specialists.

Income from One-off Payments

According to the amendments to be introduced, the base for the calculation of individual income tax on income from one-off payments will be changed. In particular, "the amount of individual income tax shall be calculated by means of applying the rates established by point 1 of Article 145 to income from one-off payments, which are subject to tax at the source of payment," without reducing it by obligatory pension contributions to savings pension funds in the amount and in those cases established by legislation of Kazakhstan. (The current wording of article 155 subjects one-off payments to obligatory pension fund contributions for personal income tax calculation purposes.)

However, in connection with the fact that a tax agent may make one-off payments to individuals on the basis of civil and legal agreements, while an employer may do so on the basis of an individual labor agreement, the question arises as to whether income from one-off payments (related to payroll), which is payable by an employer to an employee, will be reduced by the amount of obligatory pension contributions.

Income Not Taxable at Source of Payment

The amendments to be introduced to article 164 propose an additional type of income that is not taxable at the source of payment. Citizens of Kazakhstan receiving income from the provision of services, the execution of work in Kazakhstan for entities that are not tax agents, shall pay individual income tax by means of making advance payments.

The concept of income from property, envisaged in article 166, will be extended. The income from property

Continued on page 7

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Income Tax *(from page 6)*

of a taxpayer will now include capital gains following the realization of mechanical vehicles and trailers that are subject to state registration and that have been owned for less than one year or that have been received on the basis of a power of attorney to drive a vehicle with the right to disposal.

Individual Income Tax Declarations

According to the current version of article 171, taxpayers who have made a large one-off purchase during the tax year of over 2,000 times the monthly calculation index,[2] are obliged to submit an individual income tax declaration. In accordance with the proposed amendments, this requirement will be removed.

Procedure for Individuals to Pay Individual Income in Absence of Tax Agent

The proposed amendments modify the procedure for the payment of individual income tax through the advance payments mechanism in subsequent tax periods. In particular, article 191 proposes: ". . . In subsequent tax periods advance individual income tax payments shall be calculated by a non-resident individual based on the actual tax liability of the non-resident individual as indicated in an individual income tax declaration for the previous tax period, taking into account the estimated amount of individual income tax for the current tax period . . ."

However, we are of the opinion that the proposed wording for the calculation of individual income tax is difficult to implement on practice. The amount of actual tax liabilities for the previous year indicated in the annual personal income tax declaration is rarely known on the 20th of January of the current year (deadline for the submission of a statement of advance payments).

[1]Resolution of the Government of the Republic of Kazakhstan, No. 364, Concerning the Creation of Housing Construction Savings Banks dated April 16, 2004.
[2]The monthly calculation index (MCI) equals 919 tenge (2,000 times the MCI equals 1,838,000 tenge or roughly $13,515). ❑

Subsoil-Use Rights *(from page 4)*

monthly-calculation rates (approximately $675,700). However, given the fact that the value of subsoil-use rights, as an asset, is usually quite high, it appears that the permission of antimonopoly authorities would be required for purchasing the majority of shares in almost all large companies that possess subsoil-use rights.

Under Article 18(9) of the Antimonopoly Law, failure to obtain prior approval of the antimonopoly authorities may result in the transaction or transfer of shares in a subsoil user to be declared null and void by the courts under a lawsuit of the antitrust authorities.

Note that antimonopoly legislation and particularly practice is not well developed. Accordingly, we suggest carefully considering each transaction individually to ensure compliance with the antimonopoly laws of Kazakhstan.

Draft Amendments to Subsoil Law and Petroleum Law

The Parliament of Kazakhstan is currently considering major changes to the Subsoil Law and the Petroleum Law.

Unfortunately, the draft amendments do not eliminate the ambiguity of Article 53 of the Petroleum Law. Thus, the draft amendment to Article 53 of the Petroleum Law neither removes words "including by means of an alienation of a controlling set of shares" nor adds any new norms that could enhance the sense of the discussed rule.

At the same time, the draft amendment to Article 71 of the Subsoil Law includes a new Paragraph 3 that gives the state pre-emptive right to purchase any interest, including controlling interest, in a subsoil user at the same price that the shares are being offered to others. If the draft amendment to Article 71 of the Subsoil Law is adopted, any shareholder of a company holding subsoil-use rights would be required to offer its shares to the state along with other shareholders (for certain types of legal entities). If the state refuses to purchase those shares, then the selling shareholder would be entitled to sell its shares to a third party. It appears that such requirement would apply only to oil projects, since the amendments are proposed to the Petroleum Law but not the Subsoil Law.[2]

We believe that the discussed amendment, if enacted, would materially affect the vested subsoil-use rights and place an encumbrance on their transferability.

Conclusion

It appears from the above analysis that the state is eager to control transactions on transfer of subsoil use. Over the past years, this desire has grown and is now resulting in a set of statutory norms obliging subsoil users to obtain the consent of state prior to concluding any transaction on subsoil-use rights transfer. The state is exercising such control through MEMR and antimonopoly bodies. Furthermore, if the amendment to the Petroleum Law is enacted, the state would be entitled to purchase subsoil-use rights preemptively before any other subsoil users.

[1]Subsoil-use rights mean legal rights of a particular entity to explore and/or develop mineral resources at a particular block based on a license and/or subsoil-use contract with the state.
[2]The Subsoil Law applies to all subsoil-use operations in Kazakhstan except for oil operations, which are regulated in more detail by the Petroleum Law. In case of discrepancies between these two Laws, the Petroleum Law prevails. ❑

PRACTITIONER'S PERSPECTIVE

What a Difference a Case Makes: *Forum Non Conveniens* Decisions in Russian Matters Before and After Iragorri

by David E. Miller

Under the common law doctrine of *forum non conveniens*, a federal court with jurisdiction over a case may refrain from hearing it if another, significantly more appropriate forum exists. Since the collapse of the Soviet Union in late 1991, district courts of the Second Circuit have considered motions to dismiss on *forum non conveniens* grounds in eight cases involving Russian parties. The court held for plaintiff in the first three matters, but dismissed the following five cases. One reason for this shift in outcomes is a new step in the relevant analysis, which was added by the Second Circuit in 2001 in *Iragorri v. United Techs. Corp.*, 274 F.3d 65 (2d Cir. 2001).

The *Forum Non Conveniens* Standard

Prior to *Iragorri*, courts in the Second Circuit were required to consider two issues when considering motions to dismiss on *forum non conveniens* grounds: (1) the availability of an alternate forum[1] and, (2) if another forum were available, the balance of private and public interests (Gilbert factors), as weighed against the plaintiff's choice of forum.[2]

In Iragorri, the Second Circuit added a preliminary inquiry regarding the deference to be accorded plaintiff's choice of forum to this two-step analysis.[3] One important result of this change is that it has become easier for defendants to prevail on motions to dismiss based on *forum non conveniens* grounds.

Forum Non Conveniens *Decisions Before Iragorri*

Prior to Iragorri, the Southern District denied motions to dismiss in *Firma Melodiya v. ZYX Music*, 882 F.Supp. 1306 (S.D.N.Y. 1995), *Central Principal Dwelling Board of the Ministry of Defense of the Russian Federation v. New Hampshire Ins. Co.*, 904 F.Supp. 203 (S.D.N.Y. 1995), Parex Bank v. Russian Savings Bank, 116 F.Supp.2d 415 (S.D.N.Y. 2000), and *Pavlov v. Bank of New York Co., Inc.*, 135 F.Supp.2d 426 (S.D.N.Y. 2001), vacated on other grounds, 25 Fed.Appx. 70, 2002 WL 63576 (2d Cir. 2002).

The results of these four decisions are summarized in Table 1.

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There is no apparent pattern in these results, save for the fact that plaintiff prevailed on three of the four motions to dismiss. As demonstrated below, however, the Iragorri decision appears to have tilted the analysis in defendants' favor, at least when it appears that plaintiffs' forum choice is motivated by tactical considerations.

After Iragorri

After *Iragorri*, the Southern District granted motions to dismiss on *forum non conveniens* grounds in *Varnelo v. Eastwind Transport, Ltd.*, 2003 WL 230741 (S.D.N.Y. 2003), *Base Metal Trading S.A. v. Russian Aluminum*, 253 F.Supp.2d 681 (S.D.N.Y. 2003), aff'd, 98 Fed.Appx. 47, 2004 WL 928165 (2d Cir. 2004), *Tarasevich v. Eastwind Transport Ltd.*, 2003 WL 21692759 (S.D.N.Y. 2003), and *Norex Petroleum Ltd. v. Access Industries, Inc.*, 304 F.Supp.2d 570 (S.D.N.Y. 2004).

The court noted that "plaintiff has pointedly conceded that her recovery in Russia would be, at best, a small fraction of her recovery in this forum . . . One could hardly hope for a more forthright admission of forum shopping."

In *Varnelo*, the widow of a Russian sailor brought suit against the owners and operators of a ship for negligently causing her late husband's death while the ship was in Chinese waters.

Applying *Iragorri*, the court noted that "plaintiff has pointedly conceded that her recovery in Russia would be, at best, a small fraction of her recovery in this forum….*One could hardly hope for a more forthright admission of forum shopping*."[4] The court concluded that plaintiff's choice of forum deserved little deference.

Varnelo asserted that Russia was an inadequate alternate forum because (1) Russian courts would not assert jurisdiction over defendants, even with defendants' consent, and, (2) even assuming such jurisdiction, any recovery in Russia would be inadequate. With regard to the first of these assertions, the court noted that defendants had consented to jurisdiction in writing and found

Continued on page 9

Forum Non Conveniens *(from page 8)*

that, while both parties' submissions on the issue were largely unintelligible, the court could and did condition dismissal on such consent, the Russian court's acceptance of the case, and defendants' agreement to stay any U.S. statute of limitations pending the outcome of a Russian lawsuit. As for the second assertion, the court held that "[u]nder well-settled case law, lower recovery in Russia would not render that forum inadequate….[t]he remedy in Russia is not so inadequate that it is no remedy at all."[5]

Having determined that Russia was an adequate alternative forum, the court turned its attention to the Gilbert factors and found that both private and public interests strongly favored trial in Russia. Having completed its analysis, the court dismissed on *forum non conveniens* grounds.

In *Base Metal*, plaintiffs sued defendants for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1961 et seq., intentional interference with contract, and conversion in connection with the allegedly illegal takeovers of Russia's leading producers of aluminum and vanadium. None of the original plaintiffs were United States citizens or residents. However, after the defendants had filed motions to dismiss on several grounds, including *forum non conveniens*, the original plaintiffs amended the complaint to include seven new plaintiffs, including three United States corporations, and their new claims, which were wholly unconnected to the original plaintiffs' prior claims. As a result, the court found that "[l]ittle deference should be given to the plaintiff's' choice of forum in this case. As this litigation was originally brought, not one plaintiff was a citizen or resident of the United States."[6] The court further noted that there was "scant information in the record about the American plaintiffs' ties to the United States….The submission is telling for how little information it provides about the American plaintiffs."[7] Citing *Iragorri*, the court concluded that "[t]his type of *forum shopping* is the antithesis of the bona fide connection to the plaintiffs' chosen forum that would cause the Court to defer to the plaintiffs' desires."[8]

The court then went on to determine that Russia was an available alternative forum, given that all 20 defendants had explicitly consented to jurisdiction, and that Russia would provide adequate judicial remedies, notwithstanding the alleged corruption of Russian courts.

At least in the Second Circuit, any indication of forum-shopping is almost certain to result in a dismissal.

With regard to the Gilbert factors, the court held that both the public and private interest factors favored the Russian forum. Based on its three-step analysis, the court dismissed on *forum non conveniens* grounds; the Second Circuit subsequently affirmed this decision.

In *Tarasevich*, a Russian sailor sued the owner, the manager and the management service of a ship for injuries he had incurred as the result of a boiler explosion. Applying the *Iragorri* test, the court held that "[i]n this case, there are few reasons for choosing New York, *aside from the possibility of a more favorable outcome*….deference to [p]laintiff's choice of forum falls on the lesser end of the sliding scale."[9]

The court then reviewed both sides' expert witnesses' affidavits, and concluded that Russia provided an adequate alternative forum.

Continued on page 10

Table 1: Pre-Iragorri

Name of Case	Russian Party's Position	Was there an adequate alternative forum?	Were the public interest factors decisive?	Were the private interest factors decisive?	Was the motion successful?
Firma Melodiya	Plaintiff	No	[Discussed, but irrelevant]	[Discussed, but irrelevant]	No
Cent. Principal Dwelling Bd.	Plaintiff	Yes—Finland	Yes—for plaintiff	Yes—for plaintiff	No
Parex Bank	Defendant	No	[Not discussed]	[Not discussed]	No
Pavlov	Plaintiff	Yes—Russia	Yes—for defendant	Yes—for defendant	Yes

Forum Non Conveniens *(from page 9)*

Finally, the court reviewed the Gilbert factors. Having found that neither the public nor the private interest factors favored suit in the United States, the court stressed the fact that "….the very fact that there are not practical reasons for trying the case here indicates that *[p]laintiff's choice of this forum is primarily motivated by forum-shopping reasons* and not for convenience of the plaintiff."[10] Again, the court dismissed the case on *forum non conveniens* grounds.

In *Norex*, the plaintiff, a company organized under the laws of Cyprus, having a representative office in Canada, and owned by a company organized under the laws of California, alleged multiple violations of RICO by numerous defendants, which included certain United States citizens or those who conducted business in the United States, as part of a massive racketeering and money laundering scheme to take over a significant portion of Russia's petroleum industry.

> ***"[U]nder well-settled case law, lower recovery in Russia would not render that forum inadequate."***

The court began its analysis by considering the level of deference it should give to plaintiffs' choice of forum as required by *Iragorri*. In particular, the court, having focused its inquiry on the "nexus between the plaintiff and the chosen forum," concluded that "plaintiff's choice [of law was] entitled to less than substantial deference…."[11]

With respect to the availability of an adequate alternative forum, the court began by noting that defendants had expressed their willingness to consent to the jurisdiction of the Russian courts. The court then went on to discuss the parties' expert witnesses' opinions on the adequacy of the Russian courts, and, particularly, the availability of an appropriate cause of action under Russian law. In its analysis, the court stressed the fact that in an earlier, related Russian case, "*Norex*…declined to participate in those proceedings even to contest the court's jurisdiction, and allowed the time periods for normal appeals and collateral attack to lapse before filing the instant case in this District….[12] The court noted that *Norex's* decision to forego making such a collateral attack "appears to be the product of [p]laintiff's strategic choice to allow the time to lapse" so that it could bring that attack before the Southern District.[13] Having discussed and rejected two other arguments raised by plaintiff (the adequacy of court procedures and corruption), the court held that defendants had carried their burden of showing the existence of an adequate alternative forum.

The court then turned to the Gilbert factors, and found that both the public and private interests weighed significantly in favor of the Russian forum. Having completed its three-step analysis, the court granted defendants' motion to dismiss on *forum non conveniens* grounds.

The four post-*Iragorri* cases are summarized in Table 2.

Continued on page 11

Table 2: Post-Iragorri

Name of Case	Russian Party's Position	Was plaintiff's choice of forum worthy of deference?	Was there an adequate alternative forum?	Were the public interest factors decisive?	Were the private interest factors decisive?	Was the motion successful?
Varnelo	Plaintiff	No—forum shopping	Yes	Yes	Yes	Yes
Base Metal	Defendant	No—forum shopping	Yes	Yes	Yes	Yes
Tarasevich	Plaintiff	No—forum shopping	Yes	Somewhat—limited discussion	Somewhat—limited discussion	Yes
Norex	Plaintiff	Somewhat	Yes, but plaintiffs chose to wait until certain time limits expired so that they could proceed in the Southern District, i.e., forum-shopped	Yes	Yes	Yes

Forum Non Conveniens *(from page 10)*

Conclusion

In 1994, the Supreme Court noted that "the discretionary nature of the [*forum non conveniens*] doctrine, combined with the multifariousness of the factors relevant to its application...make uniformity and predictability almost impossible."[14] In *Iragorri*, the Second Circuit added a preliminary inquiry regarding the degree of deference to be given the plaintiff's choice of forum to the procedure used in considering motions to dismiss on *forum non conveniens* grounds. While some commentators have suggested that this decision made application of the doctrine even less uniform and predictable,[15] it appears, in fact, to have had the opposite result; as the plaintiffs in *Varnelo*, *Base Metal*, *Tarasevich* and *Norex Petroleum* now know, any indication of forum-shopping is almost certain to result in a dismissal.

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[1]With regard to the first step, an alternate forum was generally considered adequate if the defendant were subject to process there and the forum permitted a satisfactory remedy. *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 254 n. 22, 102 S.Ct. 252, 70 L.Ed.2d 419 (1981), reh'g denied, 454 U.S. 928, 102 S.Ct. 1296 (1982).

[2]*Firma Melodiya v. ZYX Music*, 882 F.Supp. 1306, 1317 (S.D.N.Y. 1995), citing *Gulf Oil v. Gilbert*, 330 U.S. 501, 506-07, 67 S.Ct. 839, 91 L.Ed. 1055 (1947) and *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 241, 254 n. 22, 102 S.Ct. 252, 70 L.Ed.2d 419 (1981), reh'g denied, 454 U.S. 928, 102 S.Ct. 1296 (1982).

[3]*Iragorri v. United Techs. Corp.*, 274 F.3d 65, 73 (2d Cir. 2001).

[4]*Varnelo v. Eastwind Transport, Ltd.*, 2003 WL 230741, *9 (S.D.N.Y. 2003) (emphasis added).

[5]Id. at *17-18.

[6]*Base Metal Trading S.A. v. Russian Aluminum*, 253 F.Supp.2d 681, 694 (S.D.N.Y. 2003).

[7]Id. at 695.

[8]Id. at 697 (emphasis added).

[9]*Tarasevich v. Eastwind Transport Ltd.*, 2003 WL 21692759, *2 (S.D.N.Y. 2003) (emphasis added).

[10]Id. at *3 (emphasis added).

[11]*Norex Petroleum Ltd. v. Access Industries, Inc.*, 304 F.Supp.2d 570, 576 (S.D.N.Y. 2004), citing *Iragorri v. United Techs. Corp.*, 274 F.3d 65, 70-72 (2d Cir. 2001).

[12]*Norex*, 304 F.Supp.2d at 578.

[13]Id.

[14]*Am. Dredging Co. v. Miller*, 510 U.S. 443, 455, 114 S.Ct. 981 (1994). Some commentators have gone much further in their critique. See, e.g., Martin Davies, Time to Change the Federal *Forum Non Conveniens* Analysis, 77 Tul. L. Rev. 309, 312 (December, 2002) ("The factors are anachronistic; the test is imprecise and incoherent.").

[15]C. Ryan Reetz and J. Martinez-Fraga, *Forum Non Conveniens* and the Foreign Forum: A Defense Perspective, 35 U. Miami Inter-Am. L. Rev. 1, 2 (Winter-Fall 2003-2004) (alleging that"[i]n applying the doctrine [of *forum non conveniens*], the courts are asked to make subjective determinations of how much, if any, 'deference' to give to a plaintiff's choice of forum, and to engage in 'balancing' an only partially-articulated array of so-called 'public and private interest factors.'"). ❑

Russia's Oligarchs Merging Metals Holdings

Russian billionaire Alisher Usmanov is merging some of his steel assets with those of millionaire Boris Ivanishvili, Russian daily business newspaper *Vedomosti* reported, citing unidentified people familiar with the transactions.

Ivanishvili agreed to sell Usmanov 47 percent of Mikhailovsky, Russia's No. 2 iron ore producer, and 30 percent of pig-iron maker Tulachermet, the newspaper said. Usmanov will sell 50 percent of his steelmaker Ural Steel to Mikhailovsky, with an evaluation of the assets within three months to set a final price, the paper said. Part of the deal will be financed by Vasily Anisimov, a former owner of aluminum maker SUAL, who will become a co-owner of the new steel group, *Vedomosti* said.

Usmanov may later add to the group his other Russian steel assets—the Oskol Elektrometallurgical Plant and the country's biggest iron-ore producer Lebedinsky, the paper said. Usmanov, who runs the investment arm of Russian natural gas giant Gazprom, owns a 13.4 percent stake in Corus (UK), Europe's third-largest steelmaker.

Draft Law Would Set Term for Challenging Board of Director Decisions

by Anna Kelina

On April 29, 2004, the RF State Duma approved in the first hearing the draft law "On the Introduction of Additions to the Federal Law 'On Joint Stock Companies'" (Draft Law), which addresses the issue of challenging decisions made by the directors of a joint stock company (JSC). Under the Draft Law, shareholders and members of a JSC's board of directors would be entitled to challenge decisions of the board of directors in court if such decisions: *(i)* were made in violation of the law or the JSC's charter; or *(ii)* affect the challenging party's rights or legal interests. The Draft Law also specifically sets the term for challenging a decision of the board of directors at six months after the relevant shareholder or board member learned (or should have learned) of such decision.

Under current law, it has been unclear under what circumstances a decision of the JSC's board of directors may be challenged. Also, experts have disagreed over how long the period for challenging a decision should be. Two possibilities have been suggested: *(i)* the general three-year statute of limitations term; or *(ii)* the special six-month statute of limitations term applicable to invalidating the decisions of a general shareholders meeting.

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Draft Law Would Provide Guidelines

Due to the lack of regulations on this issue, court practice has been inconsistent. Recently, the RF Supreme Arbitration Court stated in Decree No. 19 "On Certain Issues on the Application of the Federal Law 'On Joint Stock Companies,'" dated November 18, 2003, that any decision of the board of directors may be challenged in court, irrespective of whether this right is expressly provided for by law. However, the Supreme Arbitration Court did not specify the circumstances necessary or the term during which decisions may be challenged. If the Draft Law is passed, it should provide clear guidelines on these questions.

The draft law would permit suits against directors when a Board decision affected the challenging party's rights or legal interests.

Under Russian law, the Draft Law must still pass through a second and third hearing in the State Duma before becoming law, but it is expected to be adopted after favorable reports from the RF government and State Duma committees. The RF government has suggested certain additions to the Draft Law, in particular, to specify that a board member may challenge a decision of the board of directors only if he/she did not participate in the meeting during which the vote was taken, or voted against the decision (this is similar to the rules for invalidating decisions of general shareholders meetings). The expediency of this additional basis for challenging decisions, along with all other suggestions, will be discussed during the second hearing of the Draft Law in the State Duma, which is currently scheduled for November, 2004. ❑

Wrong Way? *(from page 2)*

been subsumed into a presidential think-tank and Sergei Kolotukhin has stepped down.

In a colorful world, there are many examples of how to run an economy, ranging from the state-run lunacy of Alexander Lukashenko in Belarus to the whooping capitalism of George W. Bush's America. The hope in Mr. Putin's first term was that he was taking the one-size-fits-all IMF model for a transition economy and fitting it to the political realities in Russia. The end goal of an efficient, growing economy was the same, but the means were more rooted in Russian realism.

Resurgence of Statism

The danger is that Mr. Putin is in the process of choosing one of the many other economic models on offer. Frustration at the low levels of private investment in some industries (machinery, high-tech, banking) may be encouraging more state interference to pick winners. The inability of some sectors to compete with international firms may encourage increasing protectionism, particularly as the ruble loses competitiveness (although there is, as yet, no evidence of this). The de-emphasis of the Gref-sponsored reform agenda together with the failure of administrative reform, and the focus on such projects as the creation of a state oil giant, the increasing acquisitiveness of Vneshtorgbank in the banking sector (Guta Bank, Promstroibank SP) and the signs that Gazprom wants a greater role in the management of utility sector reform all suggest a shift towards more statism, not more stability.

With opposition voices increasingly muted, and the reformers having access cut to the only center of power, there will be both less warning of any shift in emphasis and less chance of preventing it. Private domestic investment in Russia remains low in absolute terms. Foreign

Continued on page 13

Wrong Way? *(from page 12)*

investment outside of oil refuses to increase despite continued hopes to the contrary. If current policy drives investment away, the danger exists of the Fradkov government increasingly resorting to the intervention of the state and state-run industry to generate economic growth, thereby contributing further to the exit of private investment and completing the vicious cycle.

Two years ago, it appeared that Mr. Putin had struck on the right recipe of state policy encouraging private investment, leading to micro-level restructuring, creating the conditions for growth and inspiring further reform in the economic sphere, made possible by more stable politics. Today, the risk is growing that the opposite is possible.

Strengthening the state and security forces will not improve Russia's business environment.

Perhaps the headlines are where the truth lies. A second investment grade rating, reserves approaching $100 billion and impending foreign investment from Volkswagen and Toyota may indicate that Mr. Putin's policies are still on the right track. Stability and petro-dollars may be enough to encourage the micro-level restructuring needed to ensure the continuation of economic recovery. Democracy and liberalism are not necessary conditions for economic recovery, let alone for successful portfolio investment decisions.

Moving Away from Liberal Market Agenda

However, it would be a mistake to assume that Gazprom ring-fence removal and power politics in the strategic economy signal that it is getting any easier to do business in Russia. Strengthening the state and the security forces will not improve Russia's business environment. The first six months of Mr. Putin's second term suggest that policy is shifting away from the liberal market economic agenda that seemed to compensate for the tightening of political control, and towards the sort of state-dominated economy that seems to complement it. Petro-dollars may disguise the impact of this shift for some time, but it bodes ill for the hopes of Mr. Putin's first term that Russia was on a sustainable longer-term high-growth trajectory.

At the Ukraine-Russia border, I was given a piece of Technicolor paper that allowed me a fortnight to register the car in Moscow. To do so, I needed my fully-translated driving license, my passport with correct registration stamps from both the local authority for my particular address and the local police department, and car insurance from one of the registered Russian insurance agencies (foreign insurance is unacceptable). I had to drive to the specific sub-division of the Ministry of Trade so that the car could be inspected. After collecting that piece of paper, I should have driven to the traffic police who would then have given me the right to put yellow 'foreigner' number plates on my car, which would then have meant I could get the final registration document. This entire process must be repeated every six months that the car is in Russia. On my first attempt, the Ministry of Trade informed me that my visa had to be valid for the entire six-month period of registration, which it wasn't.

On my second attempt, after flying in and out of the country to get a new annual visa, I was told by the ministry that the engine number on the car did not match the engine number on the piece of Technicolor paper given to me at the border. Although it was an error by the border guards, it was still my responsibility to drive back to the border and get the engine number re-registered. Unfortunately, that would be impossible within the two weeks originally allowed me at the border. My car is therefore illegal and is now parked in a private space at the cost of $150 per month—which is itself, incidentally, a bribe to the local parking guard to use whichever space is available when owners are on holiday. That, after fifteen years of reform, to get a car registered. Imagine starting a business. ❑

Romania's Central Bank concerned about Foreign Purchases of Domestic debt

During 2004, Romania has attracted about 1 bln euros ($1.27 bln) in speculative investments triggered by high returns on domestic debt, according to Central Bank vice governor Cristian Popa.

Foreign investors, who are prevented from buying or trading Romania's domestic debt, are setting up local companies to buy lei-denominated bills and bonds, which have yields as high as 15 percent, Popa said.

Popa said the Central Bank is prepared to buy or sell lei to make the rising currency's exchange rate less predictable and prevent large amounts of foreign currency leaving the country at once. The sudden repatriation of euros and dollars in bulk would further widen the current account deficit, which Romania wants to keep at 5.5 percent of gross domestic product (GNP) for 2004.

FOCUS ON FINANCING

Fiscal Revenues, Budget Surplus and Privatization Revenues Put Russia on Solid Financial Footing

by Julia Tsepliaeva

In 2005, fiscal performance is likely to remain solid, and we maintain our forecast of a budget surplus of 2 percent of GDP (vs. 1.5 percent of GDP set in the 2005 budget draft). Russia is likely to enjoy additional budget revenues which will reduce the demand for financing. No new Eurobond issuances are likely next year, while domestic debt issuances are expected to be modest.

On September 29, the Duma considered and passed the 2005 budget draft in its first reading, effectively approving the main budget parameters for next year. Despite the MoF having increased planned non-interest expenditure for national security after the terrorist attacks in September, the 2005 budget draft delivered a surplus of 1.5 percent of GDP. As the main macroeconomic fundamentals set in the budget draft are conservative in nature, assuming Urals to average $28/bbl and the ruble RBL/$30 on average in 2005, the government is very likely to receive additional budget revenues. This strengthens our optimism regarding next year's fiscal performance and further accumulation in the stabilization fund. With a more optimistic view regarding oil prices in 2005 (ING sees Urals at $33-34/bbl), we forecast budget revenues to be even higher. According to our estimates, each $1 increase/decrease in annual average oil price will result in a parallel change in federal budget revenues of RBL45bn ($1.5-1.6 billion).

Solid fiscal prospects in 2005 will support accumulation in the stabilization fund. The impressive fiscal results of 2004 have encouraged the government to upgrade its budget surplus forecast to 3.6 percent of GDP where the 2004 budget law set the surplus to reach 0.5 percent of GDP only. Although we are less optimistic than the government and believe that some increase in non-interest expenditures is almost unavoidable in 2004, resulting in a lower budget surplus of 3 percent of GDP, we agree with the government's position regarding stabilization fund gains in 2004. All extra oil revenues when Urals exceeds $20/bbl are channeled on a quarterly basis to the stabilization fund, which reached $9.6bn on September 1, 2004, and which we see at $18bn by the end of the year.

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Successful Privatization of Lukoil

The recent privatization deal of the government's last 7.6 percent share of Lukoil assures this forecast, with the government reaping $1.988 billion in the deal—the biggest sale in Russia's history of privatization. In addition, the deal was politically very important. The sale demonstrated that the government never intended to re-nationalize the oil industry, despite some concerns raised by the Yukos conflict.

The Lukoil sale also demonstrated that foreign investors have not been completely scared off by the uncertainty and opacity surrounding Yukos, and are continuing to consider Russia as an investment destination. As expected, the stake was sold to ConocoPhillips, the world's fourth largest international oil company. ConocoPhillips representatives said that they were planning to increase the company's share in Lukoil to 10 percent by 2004-end, which makes sense as a larger share will give ConocoPhillips the right to have a representative on Lukoil's board. However, it has not been able to negotiate the acquisition of a blocking stake, which would have been a reasonable desire from ConocoPhillips' point of view—they are only permitted to take a 20 percent stake, as the Russian government wants to limit foreign control over the oil industry.

It demonstrated that the government never had the intention to re-nationalize the oil industry, despite some concerns raised by the Yukos conflict.

Privatization Plans for 2005

Privatization plans for 2005 submitted to the Duma with the 2005 budget draft look more modest than the 2004, although there are some strategically important companies on the privatization list. The government hopes for RBL40 billion ($1.4 billion) from the privatization of its stake in some 400 companies, including the main slice of the Svyazinvest pie—75 percent minus one share.

Continued on page 15

Solid Financial Footing *(from page 14)*

Taking into account high fiscal revenues and the strong budget surplus of 2 percent of GDP forecast for 2005 on one hand, and solid privatization revenues to be used for budget financing from the other, we expect that financing demand will remain low in 2005. New Eurobond issuances are very unlikely in 2005-06, although the government plans to borrow $1.1 billion from international financial organizations (the World Bank mainly) and get foreign government credits of $0.17 billion. Domestic debt issuances are likely to be modest (see accompanying table) and government domestic debt yields are likely to remain significantly negative in real terms. ❑

Federal Domestic Borrowing Program for 2005

	RBLbn	US$bn
Net Domestic borrowing	**88.6**	**3.1**
Government securities—Net	125.1	4.3
New issues	210.9	7.3
Redemptions	85.8	3.0
Other government debt	36.2	1.2
New issues	0.0	0.0
Redemption	36.2	1.2

Source: MoF, ING Estimates

Recent Tax Developments

by Maureen O'Donoghue, Roman Guseinov, Anton Malkov and Maria Frolova

68 Percent Increase in Export Duty on Crude

On August 1, 2004, the rates of export duty for crude oil and crude oil products obtained from bituminous rock will increase from $41.60 to $69.90 per metric ton. Governmental Decree No. 354 of July 15, 2004 implemented the new rate, but the scale of the increase results from amendments to the formula for calculating export duty enacted in May. — *by Maureen O'Donoghue*

Long-Term Service Contracts: Calculation of WIP

The procedure for the calculation of work-in-progress (WIP) is addressed in Article 319 of the Tax Code. Nonetheless areas of uncertainty exist concerning the calculation. One such area that has recently been clarified should be of particular interest to companies engaged in long-term contracts for the rendering of work or services.

The Tax Code states that WIP for companies which provide services should be determined as "the proportion of orders for the performance of work (rendering of services) which have not been completed (or which have been completed but have not been accepted as at the end of the current month) to the total volume of orders for the performance of work (rendering of services) which are performed during the month,"[1] i.e.: Value of incomplete (not accepted) orders ÷ Value of the total volume.

The Tax Code is silent as to how the term "orders" should be interpreted.

Let us assume a situation where a company has a long-term service contract which envisages a stage-by-stage delivery of services (each stage has its own terms of delivery and price). A literal reading of the Tax Code suggests that the term "order" in the above formula should be treated as an entire contract. This approach would result in profits in each reporting (tax) period against which the company would not be able to deduct any expenses until all stages within a contract were complete, since all expenses would be treated as WIP until that time.

The tax authorities have not issued any official letters or clarifications on this matter. However, in a recent edition of the magazine *Russian Tax Courier*, Ms. Elena Popova, Deputy Head of the Department within the Tax Ministry, shed some welcome light on this issue. She explained, that if a contract envisages a stage-by-stage delivery of services and each such stage is separate from other stages (which presumably means that it can be consumed by a customer as a stand-alone product without waiting for other stages to be completed), then it would be logical to use the value of a particular stage as the denominator in the above formula for the calculation of WIP. This is of course merely Ms. Popova's personal opinion. We believe that this is a reasonable interpretation of the provision in question and fully complies with our understanding of the procedure for the calculation of WIP for long-term contracts with a stage-by-stage delivery of services. — *by Roman Guseinov*

Retroactive Effect of Relaxation of Currency Control

Under Article 4.4 of the Currency Law, acts of currency legislation and acts of currency regulation bodies which repeal restrictions with regard to currency operations or otherwise improve the position of residents and non-residents may have retroactive effect only if they specifically provide that this is the case. Since neither the

Continued on page 16

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Tax Developments *(from page 15)*

Currency Law itself nor the regulations issued by the Central Bank to date include any provision for such benefits to apply retroactively, it has been unclear whether any retroactive benefits actually arise under Article 4.4 in practice.

However, we have obtained a letter from the Central Bank which confirms the availability of retroactive application of improvements. The basis for this conclusion is section 1.7(2) of the Code on Administrative Offenses, which states that a law reducing or repealing administrative liability or otherwise improving the position of an offender will have retroactive effect; i.e., will apply to those who committed administrative offenses before the law entered into force or to those on whom the punishment has not been imposed. — *by Anton Malkov and Maria Frolova*

[1]Paragraph 4 of Article 319.1 of the Tax Code.

Update of Russian Legislation

by Eric Michailov

Federal Authorities

On October 13, 2004, the president issued Decree No. 1315 "On Issues of Federal Registration Service."

The Federal Registration Service (*Rosregistratsiya*) was established in March, 2004, by Presidential Decree No. 314. The main functions of the Service include:

- state registration of rights to immovable property and transactions involving immovable property;
- rendering decisions on the state registration of public associations, political parties, religious organizations and branches of foreign not-for-profit organizations in Russia;
- legalization and apostilization of documents issued in Russia;
- issuance of licenses to carry out notary public services;
- acting as a regulatory authority by virtue of the Federal Law "On Bankruptcy (Insolvency)" and maintenance of the register of arbitrazh managers; and
- maintaining the register of foreign advocates practicing in Russia.

The Service reports to the Ministry of Justice. It is not empowered to issue regulations, unless directly authorized to do so by federal law or the president.

The Decree will come into force on October 30, 2004.

On September 2, 2004, the Federal Service for Financial Markets issued Order No. 04-445/pz-n "On Territorial Departments of the Federal Service for Financial Markets."

The Order was registered with the Ministry of Justice on October 19, 2004.

Tax: Court Practice

On October 11, 2004, the Secretariat of the Constitutional Court distributed a press release "On Constitutional Court Resolution No. 169-O of April 8, 2004, concerning the unconstitutionality of Section 2 of Article 171 of the Tax Code regarding the offsetting of input VAT."

In its Resolution No. 169-O, the Constitutional Court offered some general statements on when, and under what conditions, a taxpayer is entitled to offset input VAT. The Constitutional Court stated, in particular, that a taxpayer is entitled to offset input VAT only if, and insofar as, the input VAT is actually paid and the taxpayer has incurred real expenses in connection with this payment. Specifically, the Constitutional Court stated that:

- if the taxpayer expends his/her own property as payment for a purchase (and the relevant input VAT), he/she can be regarded as having incurred a real expense only if such property was acquired for consideration and the taxpayer had no outstanding payment obligations with respect to the property; and
- if the taxpayer pays for a purchase (and the relevant VAT) with borrowed funds (including cash loans), he/she can be regarded as having incurred a real expense only upon repayment of such loans.

Even though Resolution No. 169-O has not been officially published, the Federal Arbitrazh Court of the North-West District has, in a few cases, followed Resolution No. 169-O and upheld the tax authorities' position. Following discussions and comments from various business associations, the press release from the Secretariat of the Constitutional Court of October 11, 2004, clarifies that Resolution No. 169-O relates to the specific case of payment of the purchase price (including the relevant input VAT) by offsetting with a counterclaim (purchased but not yet paid for by the taxpayer).

The press release repeated the statements of the Constitutional Court on the offset of input VAT with borrowed funds and stated that *(i)* these interpretations, although of a doctrinal nature, are to be considered within the context of the specific case referred to in Resolution No. 169-O and that *(ii)* payments made with the use of borrowed funds or funds received without consideration were not subject to this Resolution (but were mentioned as pos-

Continued on page 17

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Legislation Update *(from page 16)*

sible examples of an area where transactions could be concluded without a reasonable business purpose).

According to the press release, when reviewing a particular case, the tax authorities and arbitrazh courts should not merely consider whether the input VAT was paid from borrowed funds, but must assess the validity of the relevant transaction and its reasonable business purpose; they must also make certain that the taxpayer acted in good faith and did not abuse his/her rights.

The press release also indicates that the transactions must not only be formally consistent with the laws, but must also be in line with the prohibition on abuse of taxpayers' rights, and suggested that a "good faith" principle be generally used by the tax authorities and arbitrazh courts as a criterion for resolving tax disputes.

Formally, a resolution of the Constitutional Court may be officially clarified by another resolution of the Constitutional Court. Still, the position expressed in the press release may, in practice, be recognized by the tax authorities and arbitrazh courts.

Tax

Tax Clarifications

On September 21, 2004, the Ministry of Finance issued Letter No. 03-02-07/39 "On the Competence of Tax Authorities to Provide Clarifications of Tax Legislation."

The Letter clarifies the right of taxpayers to obtain from the tax authorities written clarifications of Russian tax legislation.

Under the Letter, in order to obtain clarifications on tax assessments related to specific business transactions or situations, a taxpayer should apply to the local tax authority at the taxpayer's place of registration. Furthermore, the taxpayer is entitled to apply to the Ministry of Finance and to the corresponding regional and municipal authorities for clarification of federal tax legislation and tax regulations adopted by regional and municipal bodies (respectively). Written clarifications signed by the head (or deputy head) of the relevant tax authority will be treated as clarifications obtained from duly authorized state officers.

The Letter refers to Article 111 of the Tax Code, according to which a taxpayer may not be held liable (and, consequently, may not be subject to fines) if he/she acts in accordance with written clarifications received from a duly authorized tax authority. At the same time, the Letter emphasizes that the taxpayer must follow the rule of law in the first instance and may also rely on clarifications obtained from the tax authorities.

Deductibility of Expenses

On September 29, 2004, the Ministry of Finance issued Letter No. 02-5-11/162 "On the Application of Tax Legislation."

The Letter confirms that expenses may be deducted for maintenance of fixed assets used for production of a seasonal nature.

The Letter is worth mentioning because it provides certain clarifications on the general conditions for deductibility of expenses set forth in Article 252 of the Tax Code (such as the requirements that the expenses are properly documented and reasonable).

In particular, the Letter states that reasonable expenses are those that are economically justified, and the economic justification of such expenses is to be considered in the context of the taxpayer's business activities. For example, an expense may not directly lead to the generation of income, even though it may be necessary for conducting the activity that generates income.

Further, the Letter clarifies that the Tax Code does not require income and expenses to match. On the contrary, the taxpayer is entitled to deduct expenses when they occur regardless of income generation in this period, provided that the taxpayer generally engages in income-generating activities.

The above Letters do not have legal force but will serve as a guideline for taxpayers and tax authorities.

Money Laundering

On August 19, 2004, the Central Bank issued Telegram No. 103-T "On the Central Bank's Control Over Lending Organizations' Compliance with Federal Law 'On Countermeasures with Respect to Laundering Revenue Derived from Criminal Activity […].'"

The Telegram addresses issues related to the examinations carried out by the Central Bank to control compliance of lending organizations (or their branches) with anti-money laundering regulations. Pursuant to the Telegram, apart from a general examination of lending organizations, the Central Bank may conduct an examination of a particular aspect of their activities (so-called "theme" examinations) or of the due performance and record-keeping of individual bank transactions. In particular, the following issues are monitored in the course of such examinations:

- availability in a lending organization of duly approved internal control rules and procedures relating to anti-money laundering measures and whether the relevant compliance controller meets the Central Bank's qualification requirements;
- compliance with client identification procedures and requirements for regular update of client information;
- compliance with the prohibition on opening bank accounts on a no-names basis and opening bank account for individuals in their (or their representatives') absence; and
- compliance with the prohibition on maintaining relations with non-resident banks that do not have permanently operating management bodies in the states where such non-resident banks are registered.

The Telegram was published in the Central Bank Herald on August 25, 2004. ❑

SLOVAKIA

Slovak Government May End Power Utility Sale Talks with Enel

PRAGUE (Dow Jones)—The Slovak government said October 26 that it may cancel talks with Italian utility Enel SpA (EN) on the sale of Slovak power company Slovenske Elektrarne. "We aren't satisfied with the position of our Italian partners that has led us nowhere in the past two weeks while the talks have been going on," Economics Ministry spokesman Maros Havran told Dow Jones Newswires in a telephone interview.

Earlier in October, the Slovak government picked Enel to buy the Slovak state's 66 percent stake in Slovenske Elektrarne, after the Italian company submitted the best offer in a privatization tender.

The government began talks with the Italian utility, setting November 2 as a deadline to complete the negotiations. The government also said it would like to hold its final vote on the sale in late November. However, the talks have become mired in disagreements over some details of the contract, Havran said.

"If there isn't a significant change in the way the Italian party carries out the negotiations by November 2 and if there's no sign that a compromise is possible, we can't rule out that the tender will be canceled or talks will have begun with other participants in the tender," Havran said.

According to local market participants, Enel offered EUR840 million for the state's 66 percent stake in the company, beating the rival bid of EUR690 million by Czech electricity company CEZ AS (BAACEZ.PR).

Havran said the government still views Enel's offer as the most attractive but isn't ready to sell the utility unless all the details have been worked out. Enel officials weren't immediately able to comment. ❑

UKRAINE

Making Certain Your Ukrainian Contract is Valid

by Tanya Timchenko and Richard Smith

Like many countries, Ukraine enshrines the principle of freedom of contract in its laws. But companies doing business in Ukraine may be surprised to learn exactly how rigid and formalistic are Ukraine's requirements. Because of these requirements, businesses need to keep several factors in mind to ensure that their contracts intended for use in Ukraine are enforceable.

Electronic Transactions

Ukrainian laws on electronic transactions and electronic digital signatures have not yet been finalized (except for electronic banking transactions). Until such laws are passed, businesses that execute contracts in electronic form should also formalize the contract in a separate, "hard copy" form.

Use Standard Clauses

The passage of a new Commercial Code and a revised Civil Code have created uncertainty about the terms that must be put in a contract in order for it to be valid. Both Codes require that a contract state its object, relevant price information and the term of the agreement. The Codes also require the inclusion of "other conditions that are mandatory under the civil law." Lacking certainty as to what the other conditions are, when in doubt, it's best to put everything in the contract.

One solution to this problem is to make use of standard conditions whenever such clauses exist. From time to time, Ukraine publishes various standard clauses for use in various types of contracts. These clauses are not mandatory, but they are more likely to be considered valid than similar clauses, independently drafted, if a contract is challenged in court.

Ukraine law also has mandatory provisions that must be included in certain types of contracts, and that cannot be varied by an agreement between the parties (e.g., requirements for making payments in hard currency in a foreign economic contract[1]).

Make Sure the Signer is Authorized

Those who sign the agreement on behalf of legal entities (enterprises) must be "authorized persons," as defined by law, the legal entity's founding documents or a valid power of attorney. When signing a contract with a legal entity, parties to the agreement would do well to make certain the person is properly authorized to sign the contract.

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Continued on page 19

Contracts *(from page 18)*

Corporate Seal

In Ukraine, a legal entity has not validly signed a contract until the signer's signature is imprinted with the legal entity's corporate seal. (Although the law permits signing contracts with "faxed" signatures, electronic digital signatures and other substitutes for handwritten signatures, the exact procedure for using such "substitute signatures" remains unclear.)

Notarization and/or State Registration

To be valid, some contracts, such as mortgages, must be notarized.

[1]If the goods or services exported from Ukraine are paid for in hard currency, the law requires hard currency to be deposited in the Ukrainian resident's bank accounts within 90 days after the date of customs clearance or the moment of signing a statement certifying the completion of the relevant works, provision of the relevant services or transfer of the relevant intellectual property rights. Non-receipt of the hard currency leads to a fine imposed on the Ukrainian resident and possible economic sanctions against foreign counterpart. ❑

Market Opportunities *(from page 5)*

Chernobyl. The government will send a group of energy specialists to Brussels to discuss ways to avoid any crisis in the region's electricity grid after the closure, Adamkus said. During the negotiations on joining the EU, Lithuania pledged to close one reactor at its Ignalina plant by 2005 and the other in 2009. The European Commission (EC) has proposed giving Lithuania 815 mln euros ($1.03 bln) in financial aid between 2007 and 2013 to help close the nuclear reactors.

Slovakia

Little progress on Enel purchase of Slovenske Elektrarne. Slovak Economy Minister Pavol Rusko stated that little progress has been made in talks with Enel (Italy) about a sale of Slovenske Elektrarne (SE), Slovakia's biggest power producer. Rusko noted that discussions had been taking place for two weeks, saying that the negotiation mandate would extend only one further week. Rusko added that, if no change takes place in the Enel position, there would be no point in extending the negotiating period. Should there be no improvement, Czech power leader CEZ could be invited to start talks, Rusko said.

Oil and Gas

LUKOIL sees transport cost increase because of pipeline capacity problems. Leonid Fedun, deputy CEO of Russian crude oil production leader LUKOIL, said the company's transport costs will rise to $2.5 bln in 2004 from $2.05 bln last year because of insufficient pipe capacity. Transport costs may rise to $3 bln in 2005, Fedun said. "The problem of the oil industry in Russia is not one of the resource base or investment, the problem is transportation," Fedun said. "Russian companies are spending more and more to bypass Transneft's network." Transneft is Russia's state-run oil pipeline monopoly. Russian Industry and Energy Minister Viktor Khristenko also said on October 26 that Russian pipeline capacity for crude oil exports will rise by almost a third by 2010, allowing exports to increase as much as 56 percent by 2020.

Rotterdam eyeing Gazprom LNG terminal. Rotterdam, the world's largest cargo port, may invite Russian natural gas leader Gazprom to build a liquefied natural gas (LNG) terminal, according to Pieter van Essen, the port's commercial manager. The Dutch port is interested in attracting Russian oil and gas companies, van Essen said. Gazprom is the world's largest natural gas producer. The terminal would initially have a capacity of 6 bln cu m and may be used to ship LNG to the U.S., van Essen said.

Privatization

Poland

Government may again miss annual asset sale target. Treasury Minister Jacek Socha stated that Poland may miss its state asset sale revenue goal for a fourth straight year as money from a stake in PKO Bank Polski, the country's biggest lender, would not compensate for shortfalls earlier in 2004. Poland planned to raise more than 8.8 bln zloty ($2.6 bln) from state-asset sales in 2004. The government, however, has received only 2 bln zloty from sales through August. Revenue from the sale of one-third of PKO may be 6.1 bln zloty, Socha said. The shortfall in revenue from asset sales may hurt Poland's efforts to improve the competitiveness of its economy as it works to adopt the euro currency by 2010. Poland was the lowest-ranked of the 25 EU states in a study of competitiveness released by the World Economic Forum on October 13.

Real Estate

Slovakia

BSR Europe to invest in residential housing. BSR Europe, the real estate unit of Leader Holdings & Investment (Israel), announced it plans to invest 100 mln euros ($127 mln) to build a housing project in Slovakia. The residential complex will have 1,200 to 1,500 units in Bratislava. Slovakian banks will cover about 80 percent of the costs of the project, which represents BSR Europe's largest investment in Slovakia. BSR reported earlier this year that it had sold most of its 85 percent holding in a company that owns a business center in Bratislava to the Heitman Real Estate Investment Management Fund (U.S.). ❑