



Is the legal environment changing for Russia-related transactions? What new challenges will parties face and how should they address them?

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A dynamic market

Russia is a dynamic, developing growth market, with a constantly changing legal environment. Right now Russia is seeing an upturn of activity in corporate transactions of all kinds: mergers and acquisitions and joint ventures (JVs); public listings; and also restructurings and consolidations. At the same time, we have also seen a number of high profile disputes involving Russian parties, who appear to favour the English courts or arbitration in London, as well as other venues outside Russia, as the forum for the resolution of disputes.

Changing legal environment

Changes both to Russian legislation and in the attitude and position of Russian courts are becoming evident. The legislative changes are likely to develop existing concepts under Russian law and introduce new ones, which may assist with structuring Russian corporate transactions. However, the new concepts (which are described further below) may also provide stronger grounds for Russian parties (particularly state parties) to insist on Russian law or on using Russian entities as joint venture vehicles. This, together with clear messages that Russia does not appreciate what it regards as interference by foreign courts, is likely to mean that a good understanding of the local practical, legal and procedural issues will become increasingly important for companies wishing to enter into transactions relating to businesses in Russia.

Trends in respect of joint ventures and other transactions in Russia

In Q1-Q3 2012, there were 59 deals with a deal value in the region of US\$26.6 billion according to *mergermarket's* Russian M&A roundup. The most active sectors for corporate activities were TMT and energy, mining and utilities. JVs are particularly common in Russia, reflecting the benefit for any business operating in Russia of having a blend of local knowledge and external investment and expertise. However, despite its popularity for Russian transactions, the JV structure is not without its issues. According to Andrei Dontsov, Moscow Partner at White & Case, "the joint venture is one of the easiest and one of the most complicated transactions" especially when dealing with Russia.

This article follows a White & Case seminar held in November 2012 in London and includes quotes from panelists on the day:

David Crook

London Partner, White & Case LLP

David Goldberg

London Partner, White & Case LLP

Jason Yardley

London Partner, White & Case LLP

Andrei Dontsov

Moscow Partner, White & Case LLC

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Andrei Dontsov

Moscow Partner, White & Case LLP

The key decision for such transactions is whether the JV vehicle should be inside Russia or there should be a JV holding company in an offshore jurisdiction. Historically, the preference has been for parties to use an offshore JV company. Offshore JVs are usually governed by an English law shareholders agreement. "Out of 150 deals I've seen in the last 10 years, there have only been about five or six where the shareholders agreement was governed by any other law" comments Andrei Dontsov. However, we anticipate there may be an increase in the use of Russian companies as JV vehicles, especially in transactions involving Russian state-owned or state-influenced organisations. Offshore JV arrangements obviously still have to comply with any mandatory rules of Russian law relating to the Russian operating companies. However, a shift in favour of Russian companies as JV vehicles would clearly increase the influence of Russian law, necessitating the involvement of lawyers familiar both with international and local issues who can navigate the complexities involved in implementing international JV concepts in the Russian legal environment.

Upcoming changes in Russian law

Significant amendments to the Russian Civil Code are currently being considered by the Russian parliament. The amendments aim to introduce new legal concepts which will be familiar to lawyers from other jurisdictions, such as: options, liquidated damages/indemnities, representations, 'good faith' negotiation and framework agreements, as well as developing existing ones, such as shareholders agreements (Russian law has recognised shareholders agreements since 2009, but this concept is in the process of being developed and is still untested by the courts).

It is envisaged that the proposed amendments will further develop the rules applicable to corporate transactions and in particular to JV arrangements. However, at present, it seems that we are still a long way from a situation where parties to a JV can be confident that they are able to implement all of their desired commercial arrangements comprehensively and reliably under Russian law.

Enforcing your rights in respect of Russia-related transactions

It is also relevant for those doing business in Russia to have an eye on developments that may impact their ability to enforce their rights should disagreements between the parties arise. Parties doing business in Russia often choose to resolve their disputes outside the Russian court system either by way of arbitration or in foreign courts, but how effective is this approach in the event you need to enforce against assets located in Russia?

In a speech earlier this year Mr Ivanov, the Chairman of the Supreme Arbitrazh (Commercial) Court in Russia, voiced a number of concerns in respect of the negative effects on the Russian legal system from "unnecessary interference" by foreign courts into its domestic affairs. The message was clear – such interference was not appreciated. Mr Ivanov highlighted a number of possible measures aimed at addressing the perceived interference of foreign courts, the majority of which had a rather protectionist flavour.

It remains to be seen whether Mr Ivanov's comments will signal the direction of change of the Russian legal environment for the resolution of Russia-related disputes over the coming years.

Enforcement against assets within Russia

Enforcing foreign arbitral awards in Russia is easier than enforcing foreign court judgments due to Russia's participation in the New York Convention. However, enforcement of arbitral awards in Russia is not always straight-forward.

Exemplifying the pros and cons of the Russian legal system, David Goldberg, international arbitration Partner at White & Case London/Moscow, said: "The New York Convention was signed and ratified by Russia (then, the USSR) long before the United Kingdom and long before Switzerland. Arbitration is a well-established concept in Russia. Whether it works and to what extent, is a question that remains to be answered."

Historically, the Russian courts were renowned outside of Russia for refusing to enforce foreign arbitral awards on public policy grounds. This situation is now changing, and there are more instances of foreign arbitral awards being enforced in Russia. However, there are a number of issues it is important to be aware of when contingency planning for the unfortunate event of a dispute arising with your counterparty. Two issues in particular were highlighted by Jason Yardley, dispute resolution partner at White & Case London, and David Goldberg.

The first issue relates to whether disputes can properly be resolved by arbitration (and therefore whether any arbitration award obtained outside Russia will be enforced by the Russian courts). This is of particular relevance when it comes to Russia-related transactions, as commented on by Jason Yardley, "parties are commonly quite prepared to refer disputes to foreign courts or arbitration". The Russian courts are sending mixed signals in respect of enforcement of foreign arbitral awards. Two recent decisions respectively found that (i) corporate disputes are not arbitrable;¹ and (ii) property disputes are arbitrable.² Enforcement against assets located outside of Russia will remain preferable (where such assets exist) until the Russian courts develop a consistent approach to issues of enforcement.

The second issue relates to one-sided optional dispute resolution clauses. These provisions are usually found in finance transactions and operate to give the parties differing rights in respect of dispute resolution. For example, to allow the party providing funding to commence proceedings either through arbitration or in a relevant state court, but restrict the party receiving funding to arbitration. In a recent decision, *RTK v Sony Ericsson*³, the Presidium of the Supreme Arbitrazh (Commercial) Court determined that such

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David Goldberg

London Partner, White & Case LLP

1 *Nikolai Viktorovich Maximov v. Novolipetsk Steel Plant OJSC* (Case No. A40-35844/2011): Ruling of the Supreme Commercial Court of the Russian Federation No. 15384/11 dated 30 January 2012; Resolution of the Federal Commercial Court of the Moscow District dated 10 October 2011.

2 Resolution of the Constitutional Court of the Russian Federation No. 10-P dated 26 May 2011 "In the matter of examination of constitutionality of the provisions of Paragraph 1 of Article 11 of the Civil Code of the Russian Federation, Paragraph 2 of Article 1 of Federal Law "On Arbitration Courts in the Russian Federation," Article 28 of Federal Law "On State Registration of Rights to Immovable Property and Transactions Therewith," Paragraph 1 of Article 33 and Article 51 of Federal Law "On Mortgage (Pledge of Immovable Property)" in connection with the request of the Supreme Commercial Court of the Russian Federation."

3 *Russkaya Telfanaya Kompaniya v Sony Ericsson Mobile Telecommunications Rus LLC* (Case No. BAC-1831/12 and 2665/12).

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“The only safe option is to provide for arbitration without alternatives”.

Jason Yardley

London Partner, White & Case LLP

dispute resolution provisions were contrary to the concept of fairness and equality of parties and therefore unenforceable. Although this decision has generated some criticism it is in force and, interestingly, similar decisions have been reached in Bulgaria and France. Parties should avoid using dispute resolution provisions of this type for Russia-related transactions, if arbitration is the preferred method of dispute resolution then, as Jason Yardley put it: “The only safe option is to provide for arbitration without alternatives”.

As the famous Russian poet Tutchew said: “You cannot grasp Russia with your mind...”, the Russian legal environment remains peculiar, understandable only with the assistance of a local guide. Make sure you have your guide with you if you decide to explore the wonders of this country’s great wilderness.

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