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Russian Legal Update

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Russia Finally Establishes a Central Securities Depository Increasing Transparency in the Russian Securities Market



by **Laura Brank**, **Evgenia Korotkova** and **Kirill Skopchevskiy**

Russia's ambitious goal of transforming the country into a leading global financial center by 2020 has finally gained momentum. Among the recent measures aimed at radically improving the investment climate in Russia is the Federal Law on the Central Securities Depository (the CSD). The CSD is a fundamental institution that has been lacking from the Russian securities market infrastructure, and has been long anticipated by Russian and foreign investors. Once the CSD Law (as defined below) comes into full force on July 1, 2012, it should help allay the fears of many investors by ensuring the transparency and finality of settlement of transactions with certain Russian securities. However, there is still considerable confusion surrounding the new system as we will discuss in this article.

After almost a decade in the making, then-Russian President Dmitry Medvedev finally signed Federal Laws No. 414-FZ "On the Central Securities Depository" (the CSD Law) and No. 415-FZ "On Amendments to Laws in Connection with the Law on the Central Securities Depository" (the Law on Amendments) in December 2011 into Law. Most provisions of these laws came into force on January 1, 2012, with the remainder due to come into force on July 1, 2012, subject to several exceptions.

Moreover, the CSD will most likely meet the requirements of Rule 17f-7 of the United States Investment Company Act of 1940, as the CSD will not only be subject to independent annual audits of its records, but will also be required to undergo organizational audits and to ensure the transparency of its fees.

Establishment and Functions of the CSD

The CSD is a non-banking credit institution, to be formed as a joint-stock company, duly authorized to act as the CSD by the Federal Service for Financial Markets (the FSFM), the Russian securities regulator, on the basis of an implementing regulation that is being developed jointly by the FSFM and the Russian Ministry of Finance. The CSD Law sets out a list of requirements that a legal entity (existing depository) must comply with in order to be considered a candidate for CSD status. Among other requirements, a prospective CSD must have net assets of no less than RUB 4 billion and be duly licensed by the FSFM to act as a depository in the securities market, as well as a solid track record as a depository of no less than three (3) years. It is widely speculated in the Russian media that the primary contender for the CSD role is the settlement depository of the MICEX group (a leading Russian stock exchange), CJSC National Settlement Depository. It is anticipated that the regulation on granting CSD status will become effective this month, after which the FSFM will have four (4) months to review the applications. Accordingly, the market expects that the CSD will be created by the end of summer 2012.

According to the CSD Law, the CSD will have certain exclusive rights; in particular, it will be the only entity authorized to open depository accounts in the registers of securities owners of the following issuers:

Issuers that must disclose information under Article 30 of the Russian Federal Law "On the Securities Market" (Securities Market Law), i.e.

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almost all Russian public companies. These include issuers that have registered a securities prospectus and are, therefore, required to disclose certain information to the FSFM, their shareholders and the general public; and Issuers of "investment units" (for example, in a Russian investment fund), or the issuers of mortgage certificates, if these instruments may be traded on a stock exchange.

The CSD will have one (1) year from its foundation to become the nominee in the registers of these issuers. Thus, in effect, the CSD will become the only settlement organization for publicly traded Russian companies and investment funds in Russia. At the same time, it should also be noted that the CSD Law will not apply to all issuers of securities in Russia.

The creation of the CSD should radically improve and simplify the existing market structure where settlement is performed either directly on the books of the registrars of Russian issuers of securities acquired by investors in the OTC market and held through local custodians, or, in case of exchange transactions, settlement is performed through two settlement depositories: National Settlement Depository Closed Joint Stock Company (for trades on the MICEX) and Depository Clearing Company Closed Joint Stock Company (for trades on the RTS).

From July 1, 2012, the CSD Law will also allow for the creation of **nominee accounts** for global custodians, foreign brokers and foreign banks in the form of:

- foreign nominee holder (FNH) accounts, if a foreign organization is authorized to register and transfer rights to securities under its domestic legislation (i.e. foreign global custodians, custodians, banks and broker-dealers); and

- foreign authorized holder (FAH) accounts if a foreign organization is authorized to act in its own name on behalf of other persons under its domestic legislation (i.e. foreign trustees).

These changes will significantly improve the protection of foreign investors, as the current securities laws do not recognize foreign nominees, and therefore, global custodians and brokers are considered the ultimate owners of securities that they hold for their clients. In practice, this has meant that, for example, votes at shareholders meetings represented by shares held by custodians on behalf of foreign investors cannot be split to reflect different investors' views, since the custodian is obliged to vote with its entire stake. Also, investors that are expected to accumulate an aggregate of 25% or more in a Russian company through their custodian are obliged to apply to the Russian anti-monopoly authority, or make a mandatory tender offer to all remaining shareholders if the stake exceeds 30%, even though the investors' individual holdings may be well below the respective thresholds of 25% and 30%. Although, in practice, parties have tended to circumvent this requirement, the new law will resolve this inconsistency. Once foreign investors are allowed to open FNH and FAH accounts under the CSD Law, these and other obstacles to investing in Russian securities should clear up.

Further, the new laws are also widely expected to enhance the Russian federal bond market by allowing foreign investors to settle ruble bond trades through international clearing houses such as Euroclear and Clearstream, thus having a positive impact on the spreads between ruble-denominated federal debt and Eurobonds.

Disclosure Obligations

Significantly, the Law on Amendments introduces new disclosure obligations on foreign nominees. Specifically, as of January 1, 2013, foreign nominee holders of securities will be obliged to disclose information on their ultimate beneficiaries to:

- the CSD, and/or

- other Russian custodians, where foreign nominees have opened depo accounts.

It is not yet clear to what degree of ultimate ownership this disclosure must be made. The Law on Amendments is not specific on this point and the regulation on how and in what form this information needs to be provided has yet to be adopted by the FSFM.

Further, the same information on ultimate beneficiaries must be disclosed by foreign nominee holders of securities upon demand of a Russian issuer, courts, judges, the FSFM and/or enforcement agencies (investigators). This provision will come into legal effect on July 1, 2012.

Depository Receipts Programs

The CSD Law will also facilitate the creation of accounts in a special Depository Receipts Program. Specifically, the issuers of foreign securities that are derived from Russian securities (for example, various DR programs) (Institutional Issuers) will be allowed to open special depositary program

accounts with Russian depositaries, which, in turn, will be obliged to open nominee accounts with the CSD. The CSD Law requires Institutional Issuers to disclose the actual holders of depositary receipts on a quarterly basis in a manner to be promulgated by the FSFM. Failure to comply with this disclosure obligation may result in the suspension of operations for the applicable depositary program accounts. Institutional Issuers will also be obliged to disclose the holders of depositary receipts on an ad hoc basis, in order to exercise the voting rights attached to the underlying securities and to receive dividends.

Additional Considerations

As mentioned above, the CSD will be subject to annual financial and operational audits. The CSD is also obliged to establish an internal oversight department, which will be responsible for regulatory compliance. In order to ensure transparency of operations and non-discriminatory treatment of its members, the CSD will be obliged to publicly disclose a number of its internal documents and regulations, including (but not limited to) its charter, audited year-end financial statements and the terms, conditions and fees for the CSD's services.

The Law on Amendments also implements a range of important changes to other Russian securities legislation, most notably by introducing the concept of a "transfer-agent" into the Law on the Securities Market. A number of revisions necessitated by the CSD Law are also being introduced in the Joint Stock Companies Law, the Law On Enforcement Proceedings and the Bankruptcy Law.

The new legislation is widely expected to improve the efficiency and increase the transparency of the Russian securities market. It should enhance liquidity, lower settlement costs and ensure that domestic broker-dealers and international investors are operating on the same post-trading platform and in the same fashion. Combined with the recent merger of the two leading Russian trading platforms – RTS and MICEX – there is a lot of enthusiasm that once the CSD is fully functional, it will improve the appeal of purchasing Russian-issued securities.

Laura Brank
Moscow
+7 499 922 1100
laura.brank@dechert.com

Evgenia Korotkova
Moscow
+7 499 922 1160
evgenia.korotkova@dechert.com

Kirill Skopchevskiy
Moscow
+7 499 922 1164
kirill.skopchevskiy@dechert.com

Enforcement Procedure for Pledged Property Modified

by **Andrey Dukhin** and **Ruslan Koretski**

The enforcement procedure for pledges and mortgages, covering movable and immovable property, has recently been amended to clarify and streamline the enforcement procedure, including for out-of-court enforcement, which was initially introduced by Federal Law No. 306 - FZ on December 30, 2008.

On March 7, 2012, Federal Law No.405 - FZ "On Introduction of Amendments to Certain Legislative Acts of the Russian Federation in Part on Improvement of an Order of Enforcement of Pledged Property" came into force (Law on Amendments). The Law on Amendments introduced a number of changes and clarifications to the previous legislation as described below:

- Although the wording of the Law on Amendments is not crystal clear, the most likely interpretation of the new law is that out-of-court enforcement is now possible only upon first securing a notary's executive endorsement, which, in turn, may only be granted if the security agreement is certified by a notary. This would need to be confirmed by practice. The only exception to this law is when the collateral is held by the pledgee, in which case the notary's executive endorsement will not be required for enforcement out-of-court;

- Pledge and mortgage agreements may now set out a detailed procedure on the levy of execution, which courts must apply;

- It is no longer necessary to obtain the notarized consent of a mortgagor for out-of-court enforcement; and

- The term for registering a mortgage agreement has been reduced to 15 days. If the mortgage agreement is notarized, the term for registration is 5 days.

The following are some of the key clarifications provided by the Law on Amendments:

- Out-of-court enforcement of a participation interest pledge of a limited liability company has been expressly confirmed; and
- The right to include several options on the procedure of sale of pledged property in a pledge agreement has been expressly confirmed.

In accordance with the Law on Amendments, the notary's executive endorsement is required to apply an out-of-court enforcement procedure to mortgage agreements concluded before the Law on Amendments came into force. However, no such requirement is provided by the Law on Amendments in relation to pledges of movable property.

Andrey Dukhin
Moscow
+7 499 922 1170
andrey.dukhin@dechert.com

Ruslan Koretski
Moscow
+7 499 922 1161
ruslan.koretski@dechert.com

Investment Partnerships Now Recognized Under Russian Law, but the Disadvantages May Outweigh the Advantages


by **Evgenia Korotkova** and **Andrey Dukhin**

In an effort to respond to investors' concerns about the lack of a simplified legal structure for carrying out joint investment activity, a new law was adopted on November 28, 2011, introducing a new legal structure called an Investment Partnership, which is established and operated based on an investment partnership agreement (IPA). An investment partnership is designed to work like a limited partnership in other countries.

Before this new law, Federal Law No. 335-FZ "On Investment Partnership" (IP Law), came into effect, the law already recognized two different types of partnership – simple partnership (простое товарищество) and trust partnership (товарищество на вере). Although not legal entities they could be used to make collective investments. However, due to a number of legal peculiarities, these legal forms have never gained momentum with Russian and foreign investors engaged in joint investment activity.

Under an IPA, two or more persons undertake to combine their contributions and conduct joint investment activity without incorporating a legal entity for the purposes of deriving profit. An IPA may regulate a broad scope of the activity of the Investment Partnership, including rights and obligations of the partners, their contribution obligations and liability for breaching such obligations, the procedure and rules of the management of the general activities by the managing partners, as well as other rights and obligations provided for by the IP Law.

Major Advantages

The IP Law establishes a clear framework for Investment Partnerships, while at the same time allowing broad flexibility as to the terms that may be agreed/specified between the partners in an IPA.

Clear Framework. According to the IP Law, investment activity that may be conducted jointly by partners on the basis of an IPA include purchase and sale of "non-publicly" traded shares, bonds of commercial companies and partnerships, financial instruments of forward deals (derivatives) and shares in the share capital of economic partnerships. The IP Law spells out the type of organizations that may be parties to an IPA, namely: (i) Russian and foreign commercial organizations, (ii) non-commercial organizations once they are granted such status by relevant law and once the investment activity serves the purpose for which it was established, (iii) individuals (Russian or foreign citizens) registered as individual entrepreneurs under Russian law, and (iv) foreign organizations that are not legal entities under foreign law, functioning under the terms and conditions established for such organizations by international treaties and Russian law. Partners may be parties to an unlimited number of IPAs; any limitation of this right is not permissible, including under a contract. Advertising the activities conducted under an IPA, as well as public offers to third parties to join an IPA are prohibited by law.

Flexibility. According to the IP Law, parties to an IPA have the right to agree on a broad range of issues including, the amount and structure of contributions, the terms of their payment, the share size of each partner in the jointly owned property of the Investment Partnership and the procedure for

changing such share size, provisions on running the business activities of the partnership, transferring rights by a partner under an IPA, profit distribution, etc.

An IPA should also include a policy for conducting partnership activities (investment declaration), which, *inter alia,* would set out the parameters for investments under the IPA (the Policy).

The IP Law further provides that:

- the IPA should be concluded for a specific term or for a period necessary to achieve a specific goal, with an absolute maximum term of 15 years;
- the number of partners entering into an IPA cannot exceed 50;
- an individual (Russian or foreign citizen) cannot be a party to the IPA unless he/she is registered as an individual entrepreneur under Russian law;
- the IPA should have a name, which should contain the words "investment partnership";
- the IPA, including the Policy and all annexes and addenda to it, any agreements on full or partial transfer of rights and obligations of the partners under the IPA and the power of attorney for partners to carry out partnership activities should be notarized by a Russian notary;
- the IPA cannot provide that its existence should not be disclosed by the partners to third parties; any agreement restricting this provision is void;
- the IPA may be amended based on the agreement of all partners or based on a court decision (*inter alia*, in case of breach of material terms of the IPA by one of the partners); and
- the IPA may be terminated based on a court decision upon a claim of a partner(s), *inter alia*, in case of a breach of material terms of the IPA; upon expiration of its term, achievement of its goal, or if only one partner is left in the Investment Partnership.

Disadvantages

There are certain features of the Investment Partnerships that are unlikely to contribute to their popularity among investors. One of the downsides is the limitation on investing in publicly traded shares, which is typically an important segment of investment activity for investors. Also, among other things, the IP Law over-legislates what needs to be in IPA and who can be a party to it.

Another disadvantage is that all partners (including the managing partners) may be jointly and severally liable under non-contractual obligations (except for tax obligations) as well as under contractual obligations in relation to "non-commercial" parties (those which do not conduct entrepreneurial (commercial) activity). However, given the flexibility of the provisions, subject to specification by the partners in an IPA, it may be possible to limit/prohibit an Investment Partnership's activity *vis-a-vis* non-commercial persons/entities.

Types of Partners and their Contributions

There are two types of partners provided for under the IP Law in an Investment Partnership: (i) partners that are not responsible for the activities of the Investment Partnership (Partners), and (ii) partners that are responsible for the activities of the Investment Partnership (Managing Partners). In an Investment Partnership, any Partner has the right to earn part of its income from participating in the Investment Partnership, access all documents of the Investment Partnership, receive a refund of its share in the Investment Partnership if the IPA is terminated, and to participate in making decisions as provided by the IP Law.

Partner. A Partner cannot manage the general activities of the Investment Partnership. A Partner may only make cash contributions to the Investment Partnership's general business (***вклад в общее дело***). Unless otherwise provided by the IPA, a Partner is entitled to assign its rights and obligations under the IPA to another Partner or to a third party. A Partner cannot prematurely exit the Investment Partnership unless otherwise provided by the IPA (in such case, the IPA should provide for terms, conditions, and consequences of such exit).

Managing Partner. A Managing Partner (solely or together with other Managing Partners) is responsible for managing the affairs of the Investment Partnership. A Managing Partner has the right to make cash and in-kind contributions to the Investment Partnership's general business. In-kind contributions can be made, *inter alia*, by contributing

proprietary rights and other rights having monetary value, professional and other knowledge, skills, abilities, and business reputation of a Managing Partner. However, it should be noted that the IP Law prohibits contribution of excisable goods (e.g. alcohol or tobacco products). In addition, an IPA may provide for the obligation of the Managing Partner to make contributions to the property (*вклад в имущество*) of the Investment Partnership. The Managing Partner is not entitled to assign its rights and obligations under the IPA to any third party (any agreement allowing such assignment is void). A premature exit of a Managing Partner from the Investment Partnership is allowed only with the written consent of all Partners. Any agreement establishing another procedure for the premature exit of a Managing Partner from an Investment Partnership is void. If a Managing Partner terminates its participation in an IPA, provided that the IPA is not terminated, such Managing Partner shall be liable under the obligations of the Investment Partnership, which occurred during the period of the Managing Partner's participation in the Investment Partnership, for a period of 3 (three) years after termination of the IPA.

Managing the Common Affairs of an Investment Partnership

All Partners. Decisions on the general activity of the Investment Partnership are made by the unanimous consent of all Partners, unless otherwise provided by the IP Law or the IPA. The IPA may provide that such decisions may be made by a special vehicle, such as an investment committee (Investment Committee).

Investment Committee. If the IPA provides for an Investment Committee, the IPA should also provide for the related procedure for its establishment, convocation, and decision making rules. The Investment Committee would consist of the duly authorized representatives of the partners. Unless otherwise provided in the IPA, the competence of the Investment Committee includes the following authorities: (i) modifying and changing the Policy, (ii) approving transactions entered into by the Managing Partner(s), without the authority to do so, etc. Each member of the Investment Committee has one vote. Decisions are adopted by a simple majority of the votes cast by the members, unless otherwise provided in the IPA.

Managing Partners. Management of the general activity of the Investment Partnership may be conducted by one or several Managing Partners, appointed by a simple majority of all Partners of the Investment Partnership and cannot be carried out by Partners who are (i) not Managing Partners or (ii) foreign entities without a permanent representative office (*представительство*) in Russia. Any agreement that allows a non-Managing Partner to participate in the management of the Investment Partnership is void. The IPA must contain detailed provisions related to the activity, cooperation and authority of the Managing Partners responsible for managing the general activities of the Investment Partnership. In the course of managing the general activities of the Investment Partnership, the Managing Partner(s) acts based on a power of attorney issued by all other Partners. The IPA may establish specific rules/restrictions with respect to transactions entered into by the Managing Partners and their affiliates. The authority of the Managing Partners to manage the general activities of the Investment Partnership may be terminated by a court, based on a claim of one or several Partners or by a simple majority decision of all of the Partners of the Investment Partnership, if so provided by the IPA (such termination, the IPA with such Managing). If provided by the IPA, the Managing Partners may be compensated for their management activity.

Authorized Managing Partner. In accordance with the terms of the IPA, one of the Managing Partners should be appointed as an unauthorized Managing Partner, who is responsible for accounting matters, establishment of bank and depositary accounts for the Investment Partnership, and maintenance of tax records. It should be noted that only a legal entity may be an authorized Managing Partner under the IP Law. Based on the procedure and timeframe provided by the IPA, an authorized Managing Partner should provide the other Partners with information on expenses incurred in the interest of the Investment Partnership, the amount of remuneration of the Managing Partners, and the share of each Partner in the property of the Investment Partnership.

Summary

Investment Partnerships represent a new promising tool for joint investment activity in Russia that could someday become useful and convenient for investors. However, there are a number of concerns and potential disadvantages that need to be clarified by further amendments to the IP Law before the Investment Partnership could become attractive to investors.

Evgenia Korotkova
Moscow
+7 499 922 1160
evgenia.korotkova@dechert.com

Andrey Dukhin
Moscow
+7 499 922 1170
andrey.dukhin@dechert.com

Russia Continues to Adopt New Anti-Bribery Measures


by **Olga Watson**, **Evgenia Gaysinskaya**

In January 2012, Russia took another significant step to strengthen its legal framework for fighting corruption by ratifying the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which was originally adopted on November 21, 1997, by the member countries of the Organization for Economic Co-operation and Development (OECD) in Istanbul (the Convention).

Russia and the OECD have been negotiating the ratification of the Convention for three (3) years and, as noted by one OECD working group at the negotiations stage, the Russian legislation in force at the time of ratification already reflected the main guidelines of the Convention. Even so, ratification of the Convention is one of the conditions for Russia's entry into the OECD. Russia is the 39th member of the Convention, joining the USA, UK, Canada, Germany, France, Switzerland, Italy, Spain, Japan and other OECD members, as well as four non-member countries.

What is Active Corruption

The Convention addresses "active corruption" or "active bribery," which is a promise to give or actually giving a bribe to a public official, as contrasted with "passive bribery," which is the act of receiving a bribe.

Bribery is not only about money, and is broadly defined as the promise to give or giving any undue benefit or other advantage to a public official, directly or through intermediaries, in order to influence that official to act or refrain from acting in his/her official capacity, or in order to obtain or retain business or some other advantage.

Bribery is an offence irrespective of the value of the advantage, whether it worked, whether the local authorities routinely tolerate such payments, or the alleged necessity of the payment in order to obtain or retain business. However, the following actions are NOT regarded as an offense in accordance with the Convention:

- giving an advantage that is permitted or required by the *written* law or regulations of the foreign public official's country, including case law. A foreign public official is any appointed or elected person holding legislative, administrative or judicial office in a foreign country or in an international organization or any person exercising a public function or task in a foreign country; and

- "facilitation" payments to persuade public officials to perform their mandated official functions, such as, for example, issuing licenses or permits. The developers of the Convention assume that such payments are generally illegal, and therefore the Convention does not address those payments, reasoning that criminalization of these actions is not a practical or effective measure. Under Russian legislation, payments to public officials in exchange for a given act or an omission, whether or not the act of omission is the official's duty (i.e., including facilitation payments), are illegal.

Measures Against Corruption and Bribery

In addition to criminal measures against corruption, the Convention mandates fighting corruption with administrative and civil sanctions against legal entities if they are not already subject to criminal liability (as in Russia), including: exclusion from entitlement to public benefits or aid; temporary or permanent suspension from participating in public procurement or from engaging in other commercial activities; placement under judicial supervision, judicial winding-up, and others.

The Convention also imposes accounting, recordkeeping and disclosure requirements, needed to prevent companies from engaging in corrupt practices. These requirements are (1) prohibiting companies from making off-the-books transactions or keeping off-the-books accounts; (2) disclosing the full range of material contingent liabilities in a company's financial statements; (3) adequately sanctioning accounting omissions, falsifications and fraud; (4) maintaining adequate standards to ensure the independence of external auditors, so that the external auditors can provide objective assessments of company accounts, financial statements and internal controls. Independently, member countries should require auditors who discover indications of possible bribery to report their findings to management and, as appropriate, to corporate

monitoring bodies. Member countries should also consider requiring the auditor to report indications of a possible illegal act of bribery to the competent authorities; and (5) adopting adequate internal company controls, including standards of conduct.

Impact of the Convention

The Convention is meant to serve as a framework that consolidates guidelines for national legislation to combat bribery in member countries. The liability for particular acts of bribery must be set and applied in accordance with the national legislation of each member country, taking into account the Convention rules for liability that would apply to acts of transnational violations. Therefore, countries that have jurisdiction over a given transnational offence must negotiate with the corresponding authorized bodies of other involved jurisdictions to determine the appropriate jurisdiction where the guilty party will be held liable. In Russia, the General Prosecutor's Office is responsible for these negotiations.

By ratifying the Convention, Russia could be viewed as having officially recognized the legitimacy of the Foreign Corrupt Practices Act of the USA and the UK Bribery Act, since Article 2 of the Convention provides that "*each Party shall take such measures as may be necessary, in accordance with its legal principles, to establish the liability of legal persons for the bribery of foreign public officials.*"

Since ratifying the Convention, Russia has taken steps to further develop its campaign against corruption. On March 13, 2012, then-President Medvedev adopted a new Anticorruption National Plan (National Plan), which provides for a series of anticorruption measures to be implemented in 2012-2013. The National Plan provides for various legal and technical measures, including: (1) expanding the anticorruption standards that currently only apply to public officials to officials who are not regarded as public, but work in state organizations that are incorporated in accordance with Federal Laws; (2) developing a law on social control, which would officially give civil society the authority to conduct social control of the activities of the state authorities; (3) developing a law requiring public officials to report gifts/presents that they receive; (4) using the reports from oversight bodies and the mass media as new grounds to verify information about the property and income of public officials and their family members; (5) creating a unified website of the Russian government budget system to make it open to public oversight; and (6) providing the oversight agencies with modern programs that would allow them to verify information about property and income of public officials and their family members.

The latest amendments to Russian anticorruption legislation reflecting the requirements of the Convention were adopted in May 2011. The amendments were made to (i) the Russian Criminal Code, subjecting foreign officials to criminal liability for taking bribes and imposing liability for parties giving bribes to foreign officials; and in (ii) the RF Code on Administrative Offences, subjecting legal entities to administrative liability for giving illegal rewards to foreign officials.

Russia is now implementing strict anticorruption legislation reflecting these international standards and ensuring a more transparent system for addressing the problematic bribery of public officials and accounting standards. Currently, corruption is seen as the greatest impediment to investment into Russia. To the extent that the Convention helps ensure that Russian anti-bribery legislation is being enforced, investors in Russia will have more confidence in Russian institutions and will be keener to enter the market. We at Dechert will be closely following – and updating our friends and clients – on these developments.

** Elvira Danilova, a paralegal in Dechert's Moscow office, contributed to writing this article.*

Olga Watson
Moscow
+7 499 922 1100
olga.watson@dechert.com

Evgenia Gaysinskaya
Moscow
+7 499 922 1116
evgenia.gaysinskaya@dechert.com

Russian Courts on Whether Corporate Disputes May be Subject to Arbitration


by **Yuri Makhonin** and **Alexander Lazarev**

There has been some debate as to whether corporate disputes (claims involving the establishment, management or participation in a Russian company) may be resolved by arbitral tribunals in Russia, and not only courts. This issue moved to the forefront after amendments against illegal takeovers were

introduced into the Arbitrazh Procedure Code of the Russian Federation in 2009.[1]

The authority of arbitral tribunals to resolve corporate disputes in Russia depends on the interpretation of Articles 33, 38 and 225.1 of the Arbitrazh Procedure Code of the Russian Federation, which stipulate that state arbitrazh (commercial) courts in a company's locale have special jurisdiction over all corporate disputes involving that company, including:

- disputes over the title to shares and participating interests in Russian companies, including encumbrances and the execution of rights to such shares/interests;
- disputes about claims by founders and participants of Russian companies for reimbursement of damages caused to a company and for invalidation of that company's transactions; and
- disputes over the appointment or election, or termination or suspension of the authority and/or the liability of members of managing and oversight bodies of a Russian company.

Under existing Russian procedural law, corporate disputes are referred to the *special* (but not exclusive) jurisdiction of Russian state arbitrazh courts. In practice, referring cases to *special* jurisdictions means that those disputes may not be resolved by Russian state courts of general jurisdiction. Consequently, Russian law does not directly specify that corporate disputes may not be resolved by an arbitral tribunal.

Clearly, the issue of whether corporate disputes may be arbitrated is of great practical importance both for Russians and foreigners conducting business in Russia. Major transactions with shares and interests in Russian companies frequently provide for the resolution of disputes in arbitral tribunals including such esteemed international arbitration centers as ICC, LCIA, SCC and ICAC. However, if a corporate dispute is deemed non-arbitrable, it may entail setting aside or refusing to enforce an arbitral award in Russia. It is also evident that a strong argument that corporate disputes are not subject to arbitration may also be used in an attempt to set aside or block enforcement of an arbitral award outside of Russia.

Unfortunately, the ambiguity of the wording with respect to whether a matter may be resolved in arbitration leaves the issue open to be determined on a case by case basis. Unfortunately, judicial practice in Russia in this respect is inconsistent.

There have been cases in which Russian courts have ruled that the special jurisdiction of state arbitrazh (commercial) courts over corporate disputes does not exclude arbitral tribunals from considering these disputes, depending on the nature of the dispute, the legal relations of the parties and consequences of granting the arbitral award. For example:

- The Federal Arbitrazh (Commercial) Court of the Moscow District in its Resolution No. KG-A41/11095-06, dated December 14, 2006, declined to grant a motion by Angstrem-T LLC to set aside an award of the Regional Arbitration Court that invalidated a sale and purchase agreement for 49.2% of the participating interest in the charter capital of Angsterm-T LLC between Russian Auditing Company CJSC and Sphera LLC;
- In the proceedings of Case No. A50-17264/2008-G34 on July 20, 2009, the Arbitrazh (Commercial) Courts of the Ural Judicial District approved the transfer of a claim from Consulting-Service LLC to an arbitral tribunal to recognize its title to 98.2% of the participating interest in the charter capital of BM LLC, provided that no rights and/or obligations of third parties were affected by this transfer;
- The Federal Arbitrazh (Commercial) Court of the North-West District in its Resolution, dated December 19, 2011, regarding Case No. A42-4871/2011 upon a request by Bank Vozrozhdenie OJSC refused to dismiss an award by the Arbitration Court for the Resolution of Economic Disputes at the Northern Chamber of Commerce and Industry to recognize the title of Mr. Mikhail Smurov, an individual entrepreneur, to 100% of the shares in the Murmansk Sewing Factory OJSC.[2]

[1] See Federal Law No. 205-FZ "On Introduction of Amendments into Certain Legislative Acts of the Russian Federation," dated July 19, 2009.

[2] Mr. Smurov appealed this resolution. On March 6, 2012, the judges of the court of the higher appelate refused to transfer this dispute to the Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation for resolution. In these proceedings, the judges of the Supreme Arbitrazh (Commercial) Court of the Russian Federation did not directly address the issue of the arbitrability of a corporate dispute in their judicial opinion.

However, there have also been a range of cases where Russian judges concluded that corporate issues may only be resolved in Russian state arbitrazh (commercial) courts. For example:

- The Federal Arbitrazh (Commercial) Court of the West-Siberian District in its Resolution, dated April 12, 2012, regarding Case No. A33-14556/2011 declared it had the authority to review a claim by Mr. Sergey Grushchak against a foreign company, Federna Investments Limited, for the termination of a sale and purchase agreement and return of 100% of the shares in the charter capital of EvrazLesComplex LLC in a state arbitrazh (commercial) court on the merits, notwithstanding the arbitration clause in the agreement that referred disputes to the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (ICAC) and the motion by the defendant to do so;[3]

- The Federal Arbitrazh (Commercial) Court of the Moscow District in its Resolution of December 6, 2011 in Case No. A40-26424/11-83-01 set aside a ruling of the Arbitrazh (Commercial) Court of Moscow dismissing a claim by Novolipetsky Metallurgic Plant OJSC (NLMP) seeking the invalidation of a sale and purchase agreement with Mr. Nikolay Maximov for the shares in Maxi-Group OJSC and to recover RUB 7,329,840,000 (approximately USD 250 million), notwithstanding an arbitration clause in the agreement that referred disputes to the ICAC and the motion by the defendant challenging the jurisdiction of the Russian state court to hear this dispute.[4]

To date, the most prominent case on the arbitrability of a corporate dispute in Russia involves another dispute between NLMP and Mr. Nikolay Maximov. On October 10, 2011, the Federal Arbitrazh (Commercial) Court of the Moscow District passed a resolution in Case No. A40-35844/11-69-311, which supported a decision of the Arbitrazh (Commercial) Court of Moscow on setting aside an ICAC award that ordered NLMP to pay RUB 9,578,997,942.88 (appr. USD 325 million) to Mr. Maximov on the basis of a sale and purchase agreement for the shares in Maxi-Group OJSC (Maxi-Group Case). In its resolution, the court clarified that disputes alleging failure to pay the cost of shares are private law disputes and are arbitrable, while disputes about a failure to transfer title to shares are not arbitrable. Moreover, a court of cassation specified that the special jurisdiction of Russian arbitrazh (commercial) courts over corporate disputes excludes the jurisdiction of arbitral tribunals over such disputes.

In the Maxi-Group Case, the final judgment on whether a corporate dispute may be subject to arbitration could have been granted by the Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation or the Russian Constitutional Court. However, the judges of the Supreme Arbitrazh (Commercial) Court of the Russian Federation who considered Mr. Maximov's supervisory appeal supported the lower courts' conclusions and chose not to transfer the case to the Presidium of the court for supervisory review. The Russian Constitutional Court, which recently adopted a revolutionary pro-arbitration resolution,[5] recognizing the arbitrability of disputes relating to the transfer of rights to real estate (the arbitrability of which was traditionally controversial), refused to consider Mr. Maximov's claim.

Although in general, Russian courts are free to ignore precedents (except for those adopted at the level of the Plenum and/or Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation),[6] the position in the Maxi-Group Case will certainly be taken into account on the arbitrability of corporate disputes. However, we believe it is still early to predict whether the decisions on other matters between Mr. Maximov and NLMP will have a decisive impact in deciding on the arbitrability of corporate disputes in Russia.

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3 This dispute was transferred to the trial court for reconsideration and is currently being heard by the Arbitrazh (Commercial) Court of the Krasnoyarsk Krai.

4 Mr. Maximov appealed this resolution to the court of supervisory instance. On March 5, 2012, the judges of the court of supervisory instance refused to transfer this dispute to the Presidium of the Supreme Arbitrazh (Commercial) Court of the Russian Federation for resolution. In the proceedings, the judges of the Supreme Arbitrazh (Commercial) Court of the Russian Federation did not directly address the issue of the arbitrability of a corporate dispute in their judicial opinion. This dispute is currently being heard at the Arbitrazh (Commercial) Court of Moscow.

5 Resolution of the RF Constitutional Court No. 10-P of May 26, 2011, see our 2nd Quarter 2011 *Dechert OnPoint* article, Russian State Commercial (Arbitrazh) Courts Lose Monopoly on Real Estate Disputes.

6 Subclause 5, Clause 2, Article 311 and Clause 4, Article 170 of the Arbitrazh Procedure Code of the Russian Federation.

Until a unified approach on the arbitrability of corporate disputes is formed in Russia, it is advisable to weigh all the pros and cons of including arbitration clauses for corporate disputes in sale and purchase agreements for shares or participating interests in Russian companies, or in shareholders' agreements relating to management of Russian companies as well as any other corporate documents.

Each case should be considered as to whether a given arbitration agreement will be considered valid in Russia from the initial stage of entering into a corporate transaction. Moreover, in a corporate dispute, both the claimant and the respondent should understand that enforcing the potential arbitral award in Russia may be challenging, and consider referring the dispute to a Russian state arbitrazh (commercial) court.

Yuri Makhonin
Moscow
+7 499 922 1106
yuri.makhonin@dechert.com

Alexander Lazarev
Moscow
+7 499 922 1103
alexander.lazarev@dechert.com

Jackson-Vanik Jeopardizes Competitiveness of U.S. Businesses in Russia

by **Ruslan Koretski**

U.S. businesses are eager to benefit from Russia's accession to the World Trade Organization (WTO) once the Russian State Duma ratifies the membership terms, as expected this summer. As various U.S. Senate Committees are holding hearings to decide whether to support graduating Russia from the controversial Jackson-Vanik Amendment (Section 402 of the Trade Act of 1974, as amended; 19 U.S.C. 2432) (Jackson-Vanik Amendment) and to extend to Russia permanent normal trade relations status, a number of major U.S. companies (including GE, Boeing, Caterpillar, Ford, GM and Deere), trade organizations (including the U.S. Chamber of Commerce, the U.S.-Russia Business Council and the American Chamber of Commerce in Russia) and even Russian political opposition leaders are lobbying Congress to remove Russia from the outdated Soviet-era trade restrictions. If the Jackson-Vanik Amendment is still on the books when Russia officially becomes a member of the WTO, U.S. companies risk missing out on the benefits and protections that the liberalization of trade relations with the world's ninth-largest economy brings, especially as U.S. companies are eagerly looking to expand into new markets amid slow growth at home and in other developed markets.

The Jackson-Vanik Amendment mandates a policy of free emigration as a condition to the extension by the U.S. of certain economic benefits to a "nonmarket economy" (NME) country. The Jackson-Vanik Amendment provides that (i) products of an NME country "shall not be eligible to receive nondiscriminatory treatment" (i.e., normal trade relations or most favored nation status), (ii) an NME country "shall not participate in any program of the Government of the United States which extends credits or credit guarantees or investment guarantees, directly or indirectly," and (iii) the U.S. President "shall not conclude any commercial agreement with any such country" if he/she determines that the NME country, among other things, "denies its citizens the right or opportunity to emigrate." An NME country has generally been considered to be any communist country, including the Soviet Union. Historically, the enactment of the Jackson-Vanik Amendment was a U.S. reaction to the Soviet Union's highly restrictive emigration policy of the time (including the assessment of education reimbursement fees on its citizen wishing to emigrate to non-socialist countries), which, for the most part, affected Soviet Jews wishing to emigrate to Israel or to the U.S. The Jackson-Vanik Amendment was approved by Congress even though the Soviet Union had ceased assessing the fees by that time.

The President of the United States has the power to waive, under certain conditions, the application of the Jackson-Vanik Amendment to an NME country, provided that he/she certifies to Congress in an annual report that (i) the waiver will substantially promote free-emigration objectives of the Jackson Vanik Amendment and (ii) the emigration practices of that NME country will lead substantially to the achievement of the objectives of the Jackson Vanik Amendment. There are still about a dozen countries that are subject to the Jackson-Vanik Amendment, including Russia, which has been certified as being in compliance with the free-emigration policy by successive U.S. administrations every year since 1994.

Although the Jackson-Vanik Amendment has largely been symbolic and has had little impact on U.S. – Russia trade relation, Russia's expected accession to the WTO has called attention to the Jackson-Vanik

Amendment once again as this law contradicts a fundamental principle of the WTO that requires each member state to grant unconditional most favored nation (MFN) status to all other members of the WTO. This means each WTO member must offer the same level of market access to other members without attaching special conditions to that access. Given the free migration condition imposed by the Jackson Vanik Amendment, which requires periodic assessment of its compliance, the U.S. would not be able to extend unconditional MFN status (or "normal trade relations" status, as provided by the U.S. law) to Russia. In turn, Russia would be under no obligation to extend MFN status to the U.S. and, thus, would continue to apply high tariffs on U.S. products and maintain other barriers to trade on U.S. imported businesses.

In fact, Igor Lavrov, Russia's Foreign Minister, has already suggested that Russia is contemplating using this reciprocity right in full against countries, such as the U.S., which do not extend MFN status to Russia. This would obviously impede U.S. companies trading, or looking to expand their trade relationship, with Russia, putting those U.S. companies at a considerable disadvantage in the Russian market compared to their competitors from other WTO countries that would be able to take advantage of the WTO. In addition, the U.S. would not be able to take advantage of the WTO dispute resolution procedures and other mechanisms to resolve its trade disputes with Russia and to enforce Russia's market access commitments.

The U.S. business and legal communities involved in Russian trade consistently oppose the Jackson-Vanik Amendment as a lose-lose proposition, particularly once Russia officially joins the WTO. In an election year where some wrongly view a vote for Russian trade as a vote against the U.S. economy, one can only hope that more rational minds prevail and Jackson-Vanik is finally abolished for Russia.

Ruslan Koretski
Moscow
+7 499 922 1161
ruslan.koretski@dechert.com

Legislative Update

Bankruptcy

On March 5, 2012, new rules came into force for credit cooperatives in bankruptcy proceedings; the new rules feature:

- additional grounds for implementing preventive bankruptcy measures;
- special priority of creditors;
- subsidiary liability for board members, the auditing body and the sole executive body; and
- holding self-regulating organizations accountable for subsidiary liability when the organizations fail to comply with the requirement to file an application on appointing a temporary administration or a bankruptcy petition.

Currency Regulations and Currency Control

On June 5, 2012, changes in currency control rules will come into force. These changes are meant to simplify currency control procedures for parties doing business outside of Russia; the new rules feature the following:

- introducing the obligation for residents to notify banks about certain conditions of their foreign currency transactions, such as:
  - the expected maximum terms for non-residents to perform obligations under agreements to transfer money in accordance with the conditions of such transactions; and
  - the proposed terms for non-residents to perform contractual obligations (such as transferring goods, information and intellectual property rights, performing works, rendering services).

The notification rules will be developed by the Central Bank of Russia.

The notification requirement will release residents from the responsibility of reissuing a "transaction passport" if the provisions of the transaction indicated in the transaction passport are changed during the transaction, including:

- determining the information to be indicated in the transaction passport:
  - number and date of formulation;
  - information about the resident and its foreign counterparty;
  - information about the cross-border transaction (date, number (if any), amount of transaction (if any), transaction currency, the date of performance of the obligation under the transaction;

- information about the acquiring bank; and
- information about reissuing the transaction passport and grounds for closing the transaction passport.

- introducing the principle that documents need only be submitted once to controlling authorities except in certain cases; and
- provisions focused on arranging the electronic exchange of information between companies and agents of currency control.

Disclosure of Information

In December 2011, Prime Minister Putin signed Order No. VP-R 13-098 (the Order) setting forth strict disclosure requirements for state companies and banks.

The Order requires state companies and banks to disclose information on all owners and beneficiaries of their counterparties, as well as property and the obligations of their management (including family members).

The Order also requires state companies and banks to terminate existing agreements with companies that refuse to disclose information and to amend their corporate documents to allow executing new agreements only with companies that are ready to disclose information about their owners and beneficiaries.

On March 6, 2012, Prime Minister Putin met with Deputy Prime Minister Sechin on the results of carrying out the Order. Deputy Prime Minister Sechin reported that not all companies disclosed the information that was required.

On April 15, 2012, Prime Minister Putin ordered that officials that don't disclose the required information be subject to penalties and established a new deadline for disclosing information on the owners and beneficiaries of counterparties.

Compliance with these requirements are however very difficult as many Russian enterprises have hundreds of counterparties.

Prime Minister Putin also instructed the RF Ministry of Finance, Ministry of Foreign Affairs and Federal Tax Service to consider amending the current double taxation treaties to provide for the obligation to disclose the final beneficiaries of companies that are regarded as non-residents in Russia.

Recent News

Recent Promotions

We are very pleased to announce that Alexander Volnov and Yuri Makhonin have each been promoted to the position of Senior Associate effective April 1, 2012.

Alexander Volnov advises on mergers and acquisitions, capital markets, banking and finance, and real estate transactions in Russia and the CIS. *Chambers Global* (2012) notes that "Alexander Volnov has advised on significant mandates throughout Russia and the CIS. According to interviewees, 'he is excellent, very thorough, and timely in his feedback.'" Alexander is part of the team that opened Dechert's office three years ago.

Yuri Makhonin advises clients on commercial, real estate, construction, corporate, debt recovery, bankruptcy, and administrative disputes. In 2012, Yuri was recognized for his commitment to providing pro bono legal services and was the first Russian lawyer to receive the Samuel E. Klein Pro Bono Award. He is recommended for Dispute Resolution in Russia in *The Legal 500 EMEA* (2012).

Recent Major Deals

A team from Dechert represented an international construction company on the sale by its Dutch holding company and one of its Russian subsidiaries of a network of grocery stores in Moscow to the Russian subsidiaries of a European retailer for over Euro 100 million. The deal involved 13 different real estate objects.

The Dechert team was led by Shane DeBeer (partner) and included Evgenia Korotkova (national partner), Kirill Skopchevskiy (associate) and Irina Kulyba (associate).

Recent Dispute Resolution

During the retrial of a complex tax case, Dechert successfully represented a Russian subsidiary of a well known German automotive manufacturer in the state arbitrazh court of appeal.

The appellate court upheld the decision of the State Arbitrazh Court of the City of Moscow invalidating the decision of the tax inspectorate that denied tax deductions and expenses paid by the client to the Russian contractor. The tax inspectorate also charged the client for participating in abusive tax schemes and the fictitious nature of the contract.

The dispute has been ongoing for over three years and during the first trial both the court of first instance and the court of appeal ruled against the client. However, owing to the successful advocacy of the Dechert team, the Federal Arbitrazh Court of Moscow District overruled the decisions adopted by the lower courts in full and remanded the case for a retrial.

The Dechert team was led by Oxana Peters (national partner) and included Timur Djabbarov (associate) and Maryana Batalova (associate).

Recent Honors

Dechert was ranked by *Mergers & Acquisitions in Russia Journal*/***Слияния и Поглощения*** for average value of M&A deals involving a controlling stake in Russia in 2011, value of M&A deals closed in Russia in 2011 and number of M&A deals involving a controlling stake closed in Russia in 2011.

Five attorneys in the Moscow team as well as their practice groups were ranked for Banking and Finance, Corporate/M&A, Dispute Resolution, Energy and Natural Resources, Real Estate and TMT in *The Legal 500 EMEA* (2012), which noted that Dechert ensures "consistency and stability for clients as well as high-quality work."

Five lawyers in the Moscow office were ranked in *Chambers Global* (2012) for Banking and Finance, Corporate/M&A, Dispute Resolution or Projects, with the entire team also ranked for Corporate/M&A and Dispute Resolution.

Four lawyers in our Moscow team were listed in the fourth edition of *Best Lawyers,* a selection of the rankings from which was published in *Vedomosti* on April 23, 2012. Our lawyers were ranked for Corporate, Mergers & Acquisitions, Antitrust, Banking and Finance Law, Energy and Natural Resources, Project Finance, Development and Real Estate, and Government Relations.

Recent/Upcoming Events, Seminars and Speaking Engagements

April 3, 2012: Alexander Egorushkin gave a presentation on "Third Antimonopoly Package Issues in the Context of Harmonizing Russian and EU Competition Law" at the MGIMO European Law Conference.

Dechert Expands Energy Practice and Opens Office in Almaty, Kazakhstan

Dechert announced on April 5 that Kenneth E. Mack has joined the firm as partner and has established an office for the firm in Almaty, Kazakhstan. Mack, who focuses his practice on transactions primarily in the energy and natural resources sectors, joins with a team of lawyers, all previously with Chadbourne & Parke LLP in Almaty.

Resident in Kazakhstan for over a decade, Mack has extensive experience advising clients on transactions in the energy, natural resources, telecoms, capital markets and bank and project financing sectors throughout Central Asia and Russia. He also acts as counsel to multinational companies on a variety of investment disputes in Kazakhstan. He is the President of the American Chamber of Commerce in Kazakhstan, and has been ranked by the *Chambers Global* and *The Legal 500 EMEA* directories as a leading lawyer for energy and corporate/commercial matters, as has the whole office in the top tier.

Among the corporations Mack and his team have advised on transactional, regulatory and litigation matters are ExxonMobil, Shell, China National Petroleum Corporation and Conoco Phillips.

In addition to Ken, Dechert also welcomes the following ten Almaty lawyers: national partners Victor Mokrousov, Sergei Vataev, and Mukhit Yeleuov; and associates Ainur Abdalova, Abzal Kassymzhanov, Yevgeniya Nossova, Nadezhda Oparina, Benjamin Paine, Elshat Seksembayeva and Asel Yermekova.

Dechert's Expansion Continues with New Emerging Markets Team and Dubai Office

We are pleased to announce the addition of a leading emerging markets team to Dechert's global Corporate and Securities Practice. Led by Camille Abousleiman, who will be Head of the firm's Middle East and Africa Practice, the team also includes new partners Louise Roman Bernstein, Simon Briggs, Chris P. Sioufi, Gavin B. Watson and Nicola Mariani. As part of this latest expansion, Dechert has opened an office in Dubai and bolstered our international corporate, mergers and acquisitions, and capital markets practices.

Camille Abousleiman, Louise Roman Bernstein and Simon Briggs, who are based in Dechert's London office, significantly enhance the firm's capabilities in international capital markets and emerging market corporate finance, particularly in the Middle East and North and Sub-Saharan Africa. The team also complements Dechert's existing strengths in the CIS and Central Asia, particularly in Kazakhstan and Russia.

The team practices in the areas of capital markets, corporate finance, private equity, fund formation and restructuring across Europe, the Middle East and Africa. The team members have broad experience across a range of sectors, including energy, finance, metals and mining, real estate, telecoms and transportation, as well as an extensive practice representing sovereigns in the regions they serve. The group brings substantial synergies and enhanced client service opportunities to Dechert.

The Dubai office is headed by Chris P. Sioufi and Gavin B. Watson. Mr. Sioufi focuses his practice on private equity, mergers and acquisitions, fund formation and structured and Islamic finance. Mr. Watson advises clients on cross-border commercial transactions, with a particular emphasis on energy, including oil and gas, and infrastructure projects.

Nicola Mariani is resident in Tbilisi to capitalize on important relationships in Georgia's public and private sectors. He focuses his practice on cross-border mergers and acquisitions and has extensive experience in international arbitrations. In addition, Mr. Mariani has experience in the financial institutions, energy, fashion and sports sectors.

Dechert also welcomes the following lawyers to our emerging markets team: national partners Samer Amro, Chris Harran and John Podgore in Dubai; counsel Nabeel Ikram in Dubai; associates Charbel Atallah, Cyrille El-Amm, Lynsey Murning, Simon Nicholls, Greg Nixon, Rodolphe Pellerin and Tom Renwick in Dubai; and associates Giles Belsey, Jennifer Buckett, Rebecca Flanagan, Patrick Lyons and Adam Silver in London.

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We welcome your feedback. Please let us know if there are any topics you would like to see covered in future issues.

If you or your colleagues would like to receive Dechert's *Russian Legal Update*, other *DechertOnPoints*, or copies of the articles or presentations referred to herein, please contact Anastasiya Shaposhnik (+7 499 922 1163; anastasiya.shaposhnik@dechert.com) or Kieran Morgan (+44 20 7184 7853; kieran.morgan@dechert.com). You can also subscribe at www.dechert.com.

Practice group contacts

For more information, please contact the authors, the Dechert lawyer with whom you regularly work or Moscow Managing Partner Laura Brank. Visit us at www.dechert.com.

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Laura M. Brank
Moscow
+7 499 922 1100
laura.brank@dechert.com

Dechert LLP

www.dechert.com