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Russian Legal Update

In this issue

Russia Acts Quickly to Restore the Right of Employers to Register Foreign Nationals: the Visa Regime for Highly Skilled Foreign Professionals is Fleshed Out

by **Tatiana Kozlova**

Few aspects of Russian law affect foreign investors so viscerally as the visa and immigration rules. For that reason, recent developments in the visa, immigration and registration rules and procedures should be especially welcomed, both by foreign businesses and Russian businesses that employ foreigners.

Summary

Amendments to Russia's immigration laws (the "March Amendments") came into force on March 25, 2011.[1] The March Amendments follow substantial criticism from the foreign business community of the legislative amendments to Russia's immigration laws of December 23, 2010 (the "December Amendments"), which shifted the burden of registering foreign nationals onto residential landlords and away from employers.[2]

The March Amendments restored the previous registration regime, and now both employers and landlords will be entitled to register foreign nationals. This has avoided the potential nightmare situation affecting foreign nationals who rent property from private landlords in Russia who are unwilling to take on the extra responsibility of registering their tenants' travel to, from and within Russia.

However, the December Amendments also set out important details about the new highly qualified foreign professional visa regime, which was not revised by the March Amendments. The new visa regime was introduced in the summer of 2010, as part of Russia's modernization agenda, and we analyzed it in detail in our Third Quarter 2010 edition of *Russian Legal Update*. Further guidelines on what constitutes a "highly qualified foreign professional," how employers must notify immigration authorities about such professionals, and what benefits the family members of such professionals can receive, were set out in the December Amendments and remain in place.

Employers Now Once Again Able to Register Foreign Nationals

The March Amendments provide that employers can still register foreign nationals and report their travels to, from and within Russia, after the December Amendments had previously provided that only landlords could perform these registration formalities. The December Amendments came into force on February 15, 2011, but in practice most foreign nationals had continued to be registered by their employers. This is because the Federal Migration Service had not been enforcing the December Amendments, as it soon realized that the changes would need to be revisited.

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1 Federal Law No. 42-FZ of March 20, 2011 "On the Amendments to the Federal Law 'On Immigration Registration of Foreign Citizens and Stateless Persons in the Russian Federation' and to Certain Legislative Acts of the Russian Federation."

2 Federal Law No. 385-FZ of December 23, 2010 "On the Amendments to Certain Legislative Acts of the Russian Federation."

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In practical terms, the December Amendments would have caused a number of problems for foreign nationals whose landlords, for a variety of reasons, were unable or unwilling to perform such registration formalities, especially on a frequent basis (e.g., for regular business travelers or expats with families remaining in their home countries). Many landlords are individuals who lack experience with immigration formalities and who are reluctant to get involved with a state agency or live far away from where the property is rented. As a result, many foreign nationals would have been forced to move to new residential rental accommodation to ensure compliance with Russian law. Even where foreign nationals rented properties from professional property management companies, the extra responsibility on those companies to register their tenants would very likely have led to increased rental rates or other fees. Although potential workarounds had been identified, including using a power of attorney executed by a landlord in favor of the employer, to allow the employer to retain the registration responsibilities, these workarounds would have been costly and inconvenient.

Extension of Registration Deadlines

A further positive development in the March Amendments is that the period of time after which foreign nationals are required to be registered upon their arrival into Russia has been increased from three days to seven days. This eases the burden on HR departments who are keen to avoid late penalty fines. Although in practice many foreign nationals visiting Russia are registered by their hotels, this will benefit those foreign nationals who visit Russia and stay with friends and relatives, or rent accommodation for frequent visits. In many cases, a time-consuming visit to the local registration office will no longer be necessary.

Further Details of the Highly Skilled Foreign Professional Regime Emerge

Turning to the highly skilled foreign professional regime, the December Amendments preserved the position that foreign citizens who earn more than RUB 2 million (approximately USD 70,000) per annum, provided that they have a basic level of professional qualifications, skill or experience, are eligible for the new regime. However, for the first time, teachers and scientists working in accredited institutions are also eligible for the regime provided that their annual salary is above RUB 1 million (approximately USD 35,000) per annum. A further exemption has been provided to those foreign nationals who will work at the Skolkovo Innovation Project, who will qualify for the new regime without any salary threshold. Reporting requirements have also been put in place for employers of highly skilled foreign professionals. In particular, every quarter, the employers of highly skilled foreign professionals must provide details of the employees' total salary and any terminations of employment or extended absences from employment of over one month to the Federal Migration Service.

Among the greater benefits afforded to highly skilled foreign professionals, prominent is the benefit that family members (spouse, children, parents, grandchildren, grandparents or the spouses of any children or parents), are now also entitled to be issued with residence permits and work visas for the same time period as the professional to whom they are related. Another benefit is a relaxed registration procedure under the regime, for travel both within and outside of Russia.

A new provision that will benefit employees, but may add costs for employers, is that it is now mandatory to provide medical insurance or other similar medical benefits to highly qualified foreign professionals (and their family members living in Russia) under the regime.

Russia Keen to Attract Highly Qualified Foreign Nationals

There has been recent press speculation that Russia may cancel visa requirements for foreign nationals of the EU and the U.S. in the near future. Unfortunately, the changes are indeed still in the realm of speculation, but it is clear that Russia is keen to attract more foreign talent and investment, whether from business persons, scientists, teachers, other professionals or tourists, and Russian law is finally beginning to reflect this policy.

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Mediation Framework Adopted in Russia


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

A set of mediation laws[3] came into effect in Russia on January 1, 2011, creating a framework for the extra-judicial mediation of disputes, using independent parties as mediators, with the aim of reducing the burden on the Russian judicial system.

Mediation is defined as an out-of-court procedure for settling disputes, conducted with the consent of the disputing parties. Mediation must be conducted according to the principles that it is voluntary and confidential, the parties must be cooperative and be treated equally, and the mediator must be impartial and independent.

Mediation is not a new development in Russia, but the Law on Mediation has institutionalized mediation through a comprehensive legal framework, which is a welcome new development. The Arbitrazh Procedure Code previously set out the possibility of using an intermediary for settling disputes, as well as the possibility of settling disputes through conciliation procedures. However, the Law on Mediation is designed to set out the basic regulation of mediation activities in Russia and to create benchmarks for further developing the procedures.

What Disputes Can Be Resolved through Mediation?

The Law on Mediation does not set out an exhaustive list of disputes where mediation may be used, although it does stipulate that disputes in civil matters (including those associated with entrepreneurial activities), labor relations or family issues may be resolved with the help of mediation.

The Law on Mediation states that mediation may not be used with respect to:

- collective labor disputes;
- civil, labor or family disputes that affect or involve rights of third parties not participating in the mediation; or
- disputes affecting or involving "public interests."

Mediators, therefore, are only entitled to consider private law disputes, where a party is not a public authority and which generally do not involve administrative, tax or other relationships of a public law nature.

If a dispute is currently being heard by a state or arbitration court, the parties are not restricted from using mediation as an alternative procedure.

Legal Basis for Mediating

Mediation may occur if the parties agree in writing (in a standalone agreement or within a mediation clause of a larger agreement) and the parties may agree to mediation either before or after a dispute emerges.

When drafting a mediation agreement or clause, the parties are entitled to state that if a dispute arises under such an agreement or clause, the parties agree not to file suit in court for a certain period of time, in order to attempt to resolve the dispute via mediation. As a general principle in Russia, a party to a dispute is entitled to file a claim with a state court if the party believes that it is necessary to protect its rights. Unfortunately, Russian legislation currently does not clearly define whether a state court can remand or decline a claim that is filed in violation of a mediation clause.

It is important to note, however, that a dispute may not be transferred to an arbitration court in Russia if an agreement contains a mediation clause.

Mediation can also be agreed by a party accepting a written proposal for mediation from the other party to a dispute. However, if one of the parties to a dispute has proposed, in writing, that mediation be carried out, without a response from the other party within 30 days, mediation is deemed not to have been agreed upon. A participant to a dispute may also ask a mediator, or a special organization that

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[3] Federal Law No. 193-FZ "On an alternative procedure for settling disputes with the participation of an intermediary (mediation procedure)" dated July 27, 2010 (hereinafter, the "Law on Mediation") and Federal Law No. 194-FZ "On amending certain legislative acts of the Russian Federation in connection with the adoption of the Federal Law 'On an alternative procedure for settling disputes with the participation of an intermediary (mediation procedure) dated July 27, 2010.'"

acts to promote mediation,[4] to make a proposal to the other party detailing the reasons why mediation should be used.

The mediation procedures start when the parties to a dispute sign an agreement (subsequent to the initial mediation agreement or clause) to subject their dispute to mediation procedures. The agreement must be made in writing and contain the following information:

- subject of the dispute;
- mediator, mediators or the organization acting to ensure that mediation is carried out;
- procedure for conducting the mediation;
- terms of the parties' agreement for the allocation of expenses associated with conducting mediation; and
- deadline for conducting the mediation.

Note that from the moment the parties enter into an agreement to mediate, under the amendments made to the Civil Code,[5] any statutory limitation period is stayed while the mediation is carried out.

Procedure and Terms for Mediating

The Law on Mediation does not set out detailed rules for resolving disputes out of court. Everything is determined by the participants to the dispute. In a mediation clause the parties may:

- independently establish the procedure for the mediation;
- refer to the mediation rules approved by the organization conducting the mediation; and
- authorize a mediator to independently determine the procedure for the mediation, considering the circumstances of the dispute, the desires of the parties and the need to resolve the dispute as quickly as possible.

The Law on Mediation stipulates that throughout the entire mediation procedure, the mediator may meet and maintain contact either with all parties together or with each of them separately. However, the mediator must maintain neutrality in its actions and may not give preferential treatment by ignoring the rights and legal interests of any party. Neither is the mediator entitled to make proposals regarding settling the dispute (though the parties may agree on granting the mediator such authority). If the mediator receives information from a party that relates to the mediation, it may disclose the information to the other party only with the consent of the party that provided the information.

The mediation period may be determined by the parties in the mediation clause, but may not exceed 180 days. At the same time, the law encourages the mediator and the parties to take all possible measures such that the procedure is finished within no more than 60 days.

It should be noted that if mediation is initiated by the parties after the dispute is transferred for consideration by a court, the period for conducting the mediation must not exceed 60 days. Moreover, by a joint petition of both parties, the court is entitled to postpone the proceedings in the case for the mediation period.

Mediation Results

If a mediation results in the parties finding a mutually acceptable means of resolving the dispute, they should sign a mediation agreement. This agreement must be entered into in writing and must contain the parties, details, subject of the dispute, mediation conducted and mediator, as well as the agreed obligations and the terms and conditions for fulfilling them. A mediation agreement does not need to be notarized.

Depending on the manner in which the mediation agreement is adopted, there are significant differences in its legal structure.

In particular, if a mediation agreement is entered into by the parties after a dispute has been transferred for consideration by a court, it may be approved by the court as an amicable agreement under procedural law, the law on arbitration courts or the law on international commercial arbitration.

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4 The most respected organization that acts to promote mediation in Russia is the Autonomous Non-Profit-Organization Scientific and Methodological Center for Mediation and Law.

5 See Article 1 of the Federal Law dated July 27, 2010 No. 194-FZ "On amending certain legislative acts of the Russian Federation in connection with the adoption of the Federal Law 'On an alternative procedure for settling disputes with the participation of an intermediary (mediation procedure).'"

If a mediation agreement is reached by the parties without the dispute being transferred for consideration by a court (including an arbitration court), the agreement is treated as a civil transaction (an agreement) aimed at establishing, altering or terminating the rights and obligations of the parties. Such a transaction may be subject to the usual rules of civil law on termination fees, novation, debt forgiveness, offsetting of uniform counterclaims and compensation for damages. In the event that the agreement is not performed, the other party may file a suit in a court and make a claim, for example, for compensation for losses, ordering specific performance of the obligations or for payment of penalties and/or interest for the use of another party's money.

Qualification Requirements for Mediators

The Law on Mediation provides that a mediator is an independent individual that the parties engage as an intermediary in settling a conflict, and assisting the parties to reach a decision regarding the merits of the dispute.

The independence of a mediator is expressed primarily in that he/she may not:

- represent the interests of any party;
- provide the parties with legal, consulting or other assistance;
- act in this capacity if he or she is personally (directly or indirectly) interested in the outcome, including being a blood relative of any of the parties;
- make public statements regarding the merits of the dispute without the consent of the parties; or
- be a state or municipal employee.

The mediator for a particular case may be one or several persons. Special organizations may offer mediation services.

The activities of a mediator may be carried out both on a professional or a non-professional basis by persons that have reached the age of 25 who have a higher professional education and have completed training under a program for training mediators.

Mediation may be performed by a mediator both on a paid or an unpaid basis, but special organizations acting to promote mediation may only mediate on a paid basis. Mediators and specialized organizations are paid for their services by the parties to the dispute in equal proportions, unless they agree otherwise.

Confidentiality of Mediation

To ensure fairness and confidentiality, the Law on Mediation prohibits a mediator from disclosing, without the parties' consent, any information pertaining to a mediation procedure which has become known to him/her in the course of conducting the mediation.

A mediator is not subject to questioning in a civil or arbitrazh procedure about the circumstances that have become known to him/her in performing the mediation. However, these guarantees of confidentiality do not apply to the questioning of a mediator in connection with a criminal investigation or trial.

The Law on Mediation also prohibits demanding any information that the mediator or the organization conducting the mediation may have in connection with the mediation. Exceptions to this rule are permitted only by federal law or an agreement between the parties.

The confidentiality of information associated with mediation must be observed not only by the intermediary but by the parties as well. Unless the parties have agreed otherwise, at any court proceedings the parties and other attendees in a mediation are not entitled to refer to any:

- proposals of one of the parties to use mediation or a party's readiness to participate in it;
- opinions or proposals expressed by one of the parties concerning the possibility of settling the dispute;
- acknowledgments made by one of the parties in the course of mediation; or
- readiness by one of the parties to accept a proposal for settling the dispute.

Therefore, if the parties do not reach an agreement on resolving the dispute in the course of the mediation procedure, the acknowledgements, opinions or proposals expressed during the mediation procedure may not be disclosed to the court. However, during the hearing for the dispute, the court must explain to the parties their right to settle the dispute via mediation.

Advantages and Disadvantages of Mediation

There are a number of advantages to using mediation compared to resolving disputes in state courts, listed below.

- **Confidentiality.** In contrast to court proceedings, which are public, mediation allows the parties to resolve a conflict without exposing the facts/dispute to the media and other parties.

- **Fast and efficient means of settling disputes.** Mediation may last no longer than six months, unlike judicial proceedings, which may be drawn out for several years.

- **Attention to detail.** General purpose courts in Russia are generally not as capable of considering the many nuances of a dispute and rely exclusively on the law. Judicial proceedings do not allow for factoring in the broader spectrum of the conflict as well as a chosen mediator can.

- **The mediator's lack of authority to render prescriptive decisions.** Since the final decision is made by the parties to the conflict, the dispute resolution process preserves the prospect of further collaboration between the parties. Moreover, as mediation is not oriented towards deciding in favor of one party, but to a mutually constructive search for solutions, with the mediator's assistance the parties can focus on resolving the issue.

- **Anti-corruption element.** Since the mediator does not make the final decision on the dispute, there is less likelihood that the mediator will be influenced by "outside factors."

- **Voluntary implementation of the decision reached based on the results of the mediation.** When a dispute is resolved using mediation, the arrangements reached generally last longer and correspond to the actual state of affairs, which makes implementing them mutually acceptable to the parties, unlike judicial decisions, towards which the parties often remain hostile after they are pronounced.

However, there are also certain disadvantages to mediation as an alternative method to dispute resolution, compared to litigation or arbitration, such as:

- **Impossibility of enforcing an out-of-court mediation agreement.** Because a mediation agreement entered into by the parties without transferring the dispute to court, is treated as a civil transaction, an interested party is not entitled to enforce the agreement without initiating judicial or arbitration proceedings. However, this does not refer to mediation agreements concluded in the course of judicial proceedings, which possess the legal force of an amicable agreement.

- **Uncertainty regarding the significance of a mediation clause for court proceedings.** Russian law does not address the issue of whether a mediation clause may be an obstacle to transferring a dispute directly to court. Given such legal uncertainty, there is a risk that a mediation clause may be simply ignored by one of the parties in favor of a court proceeding.

Conclusions

We do not expect strong growth in the use of mediation in Russia in the short term. However, we would recommend considering the possibility of using mediation, particularly in corporate and labor disputes, where mediation has been successful in the UK and the U.S. The growing popularity of mediation in Russia may also help Russian companies reduce the reputational damage that is often associated with litigation.

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Planning Can Ease Burden of U.S. Cross-Border Estate Tax Rules and Reporting Requirements

by **Arthur R. G. Solmssen, Jr.**

While recent changes to the U.S. estate tax—a tax on assets transferred at death—have reduced or eliminated the financial burden on U.S. citizens and domiciliaries, the rules applying to persons who are neither U.S. citizens nor domiciled in the U.S. remain unchanged

and can exact a heavy toll, particularly on residents of countries with which the United States does not have a transfer tax treaty.

Nevertheless, some very basic planning—if done in advance and with care—can help to minimize the impact of the U.S. estate tax on foreign nationals living in non-treaty countries, including Belgium, China, Luxembourg and Russia. Advance planning can also eliminate the risk of non-compliance with reporting requirements pertaining to gifts or bequests from outside the United States to persons or trusts inside the United States.

U.S. estate taxes have temporarily been made far less burdensome for U.S. citizens and non-citizen domiciliaries. Between January 1, 2011, and December 31, 2012, there is no federal estate tax on assets of less than $5 million because the exemption from tax has been increased to $5 million. This means that a U.S. married couple can effectively shield up to $10 million from estate tax. For decedents with assets greater than $5 million, the maximum federal tax rate has been reduced to 35%.

However, there has been no similarly favorable increase in the exemption for persons who are domiciled outside of the United States and who are not citizens of the United States. Instead, the exemption from estate tax for them remains at only $60,000.

The United States imposes an estate tax on "U.S. situs" property even if it is owned by a non-U.S. citizen domiciled outside of the U.S. An obvious example of a U.S. situs asset is real estate located in the United States. A less obvious—but equally taxed—U.S. situs asset is stock in a corporation organized in the United States. If, for example, a non-citizen non-domiciliary dies owning $10 million of stock in General Electric, that person's estate would owe approximately $3.5 million in U.S. estate tax because the new $5 million exemption from estate tax does not apply to non-U.S. citizens domiciled outside of the United States. Instead, as noted above, U.S. law still only allows a $60,000 exemption from the estate tax per individual.

It is important for individuals who are neither U.S. citizens nor domiciled in the United States and who own U.S. situs property to understand the U.S. rules relating to those assets. Custodians, brokers and transfer agents can be required to assist in the collection of the U.S. tax. For example, in the above scenario, unless the decedent appointed a U.S. executor, the transfer agent, custodian or broker holding the decedent's U.S. company stock could in some circumstances become subject to liability if it transferred the stock to a new owner without first receiving written clearance from the U.S. taxing authorities.

While the U.S. estate tax applies to ownership interests in U.S. corporations, it does *not* apply to most U.S. bonds and bank accounts and, through 2011, to some U.S.-organized mutual funds. It is also important to note that while some countries, such as the United Kingdom, France and Germany, have estate tax treaties with the United States that eliminate or reduce U.S. estate tax exposure, most do not. In fact, only 17 countries have estate tax treaties with the United States, and, many countries that one might expect to have tax treaties with the U.S., such as Russia, Belgium, Luxembourg and China, do not.

In most cases, careful planning can reduce or eliminate the effect of U.S. estate tax on the assets of a non-citizen, non-domiciliary.

U.S. Reporting Requirements

The United States also has reporting rules that apply to gifts or bequests of assets from a person outside the United States to a person or a trust inside the United States—a scenario that has become much more common in recent years as more children of non-citizen, non-domiciliaries attend college or graduate school in the United States and then remain in the United States. These reporting rules apply even if *no tax is due* to the United States, and the penalty for failing to file the report can be as much as 25% of the total amount of the property transferred.

Finally, U.S. citizens or income tax residents who have bank and other financial accounts outside of the United States are required to report the existence of these accounts annually. The wilful failure to report such accounts can lead to civil penalties of up to $100,000 or 50% of the assets held in the foreign account (whichever is greater), and criminal penalties of up to $250,000 and five years' imprisonment. Although the mechanics of complying with these reporting requirements is not difficult, many individuals are simply unaware of these rules, or discover them when it is too late. The U.S. Internal Revenue Service recently announced a second special voluntary disclosure initiative ("OVDI") for taxpayers who come forward before August 31, 2011 to report previously undisclosed accounts outside the United States. Taxpayers taking advantage of the OVDI may avoid criminal penalties and receive reduced civil penalties for

failure to previously report assets in non-U.S. accounts.

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Russia Competition Law: Legislative Developments, Enforcement Practice, Trade Law, Merger Control and Notification versus Approval in Intra-Group Transactions


by **Igor Panshensky** and **Alexander Egorushkin**

Legislative Developments

The Third Antimonopoly Package: Key Developments

According to the Federal Antimonopoly Service (FAS), amendments to the Law on Competition (the "Competition Law," the Code of Administrative Offenses and the Criminal Code, comprising the so-called "third antimonopoly package," have been substantially agreed with the Russian government and will soon be submitted to the State Duma. FAS estimates that the package will be adopted before the State Duma's 2011 summer recess.

On balance, these amendments will add clarity, and, consistent with other government initiatives, will eliminate criminal liability in certain cases, which should improve the business environment for M&A in Russia.

We set out below some of the key developments in the third antimonopoly package that have been approved by the Russian government.

Changes to the definition of "concerted actions." A new mandatory criterion has been added to the definition of a concerted action, namely that actions deemed "concerted actions" must be "known in advance to each of the business entities participating in them, due to one of them publicly announcing that such actions were being carried out." This should at least partially change the judicial interpretation of concerted actions, in which courts held them to be practically equivalent to the concept of "parallel conduct" by market participants. The amendments also introduce a "safe harbor" for concerted actions where the combined market share of the participants is less than 20%, provided that no participant's individual share exceeds 8% of the relevant market.

Changes in the evaluation of anticompetitive agreements and concerted actions. An absolute prohibition has been proposed on such agreements and actions, albeit only if they are concluded among competitors (i.e., against cartels). However, in vertical agreements, it is still prohibited to set resale prices and enter into exclusive distribution arrangements. Under the current law, any agreements and concerted actions between companies in the same corporate group (connected through actual control, for example, between a parent and a direct or indirect subsidiary) cannot be deemed to be anticompetitive. Finally, it is proposed to remedy the shortcomings of the so-called "impermissibility mechanism" related to coordinatory and other technical discrepancies in the current law.

Changes in merger control regulations. Acquisitions of foreign companies that have no assets in Russia but sell their products in Russia, where the Russian sales of such companies exceed RUB 1 billion, will be subject to a new clearance criterion. The list of documents required to be submitted when making applications or notifications to FAS has also been updated. The requirement for financial organizations to provide FAS with copies of all agreements they have concluded with each other will also be completely eliminated.

Procedural innovations. The clarifications recently issued by FAS in relation to its decisions and prescriptions are to be formalized and a mechanism for reissuing FAS decisions and prescriptions in the event of newly-discovered circumstances will be formulated.

Mitigation of liability. The new amendments will eliminate criminal liability for concerted actions and vertical agreements. In addition, "turnover-based fines" will now only apply to cases of abuse of a dominant position that result in (or may result in) the prevention, restriction or elimination of competition. If this abuse results in the infringement of a third party's rights and is not related to the restriction of competition, then the maximum fine for such abuse will be RUB 1 million.

We can provide more detailed information on each of the developments mentioned above as required, as well as the other developments proposed as part of the third antimonopoly package.

Law Enforcement Practice

Interaction of FAS and the Ministry of Internal Affairs in the Initiation of Criminal Cases regarding the Violation of Antimonopoly Legislation

Amendments to Article 178 of the Criminal Code entered into force on October 30, 2009. Before being amended, this article was rarely used due to its clumsy wording. We will not address the issues related to the new wording of Article 178 here but rather will focus on issues related to its application following the enactment of the amendments.

At the end of 2009, FAS prepared internal instructions on applying Article 178. According to these instructions, FAS's legal department is obliged to gather information from all the Russian regions and use it to maintain a database of company officials upon whom administrative liability has been imposed for the abuse of a dominant position. Any case in the database that FAS opened to impose administrative liability for abusing a dominant position on officials on whom such liability had already been imposed twice within the preceding three years, is to be closed and FAS is to transfer the file to the Economic Security Department of the Ministry of Internal Affairs in order for the Ministry to open a criminal case under Article 178 of the Criminal Code.

Should FAS decide, after closing an antimonopoly case, that an anticompetitive agreement was concluded or that concerted actions were taken, the file for that case will be transferred to the Economic Security Department of the Ministry of Internal Affairs to open a criminal case if (i) the decision in the FAS antimonopoly case is not challenged within three months of being issued; or (ii) a court decision upholding FAS's decision in the case has entered into force.

Should the Economic Security Department of the Ministry of Internal Affairs refuse to open a criminal case, FAS must open a case in relation to the applicable administrative offense. In order to facilitate interaction between FAS and the Ministry of Internal Affairs, FAS regional departments must develop joint orders with the regional internal affairs authorities to regulate the procedures for interaction.

Despite the interaction procedures developed by FAS and set out above, the internal affairs authorities remain formally independent when opening criminal cases. As a result, the internal affairs authorities can open criminal cases and conduct investigations before FAS issues a decision establishing a violation of antimonopoly legislation. There are precedents for this: for example, in a recent case opened by FAS against the coal producers SUEK, Russky Ugol, and Stroiservice, FAS's finding that there was collusion between these companies was based on conversations between representatives of the companies recorded and provided to FAS by the internal affairs authorities (see, for example, http://www.fas.gov.ru/solutions/solutions_31954.html). Another example is the case opened by FAS's Chelyabinsk office regarding collusion at auction. The antimonopoly authorities proved collusion on the basis of recorded conversations between auction participants, obtained by the internal affairs authorities as part of an ongoing criminal case (see http://chel.fas.gov.ru/news.php?id=675).

The Novo Nordisk Case: Selection of Distributors

In October 2010, FAS issued a decision in relation to Novo Nordisk LLC, held to be dominant in the wholesale market for certain medicines, which is an important factor in FAS's practice under Article 10 of the Competition Law. This decision may impact the practice of many companies selling products through a selective distribution network, even if they are not held to be dominant.

The background to this case is that in 2008 Novo Nordisk LLC ("Novo Nordisk") a Russian subsidiary of Novo Nordisk A/S, a Danish, pharmaceutical company) restructured its distribution network, reducing the number of distributors from 20 to five and conferring the status of permanent partner on the distributors. The selection of these distributors was based on their conformity to the requirements of a Novo Nordisk policy (including compliance with anticorruption laws) and was subject to a complex screening procedure. All other wholesale buyers—including its former distributors—not selected as permanent partners were invited by Novo Nordisk to enter into contracts with Novo Nordisk's permanent partners, and, if these potential buyers insisted upon a direct contract with Novo Nordisk, Novo Nordisk proposed that the buyers undergo the screening procedure. None of the applicants, other than the five permanent partners, successfully completed the screening.

FAS reviewed this case and concluded that Novo Nordisk had infringed Clauses 5 and 8 of Article

10.1 of the Competition Law (unjustified refusal to enter into contracts and the creation of discriminatory conditions). FAS's conclusion was based in particular on FAS's view that Novo Nordisk did not have any criteria for assessing potential distributors in terms of their conformity to its requirements and some of those requirements (e.g., regarding the transportation and storage of products) duplicated the requirements for the issuance of a license for pharmaceutical activities, which each of the applicants already held, meaning that Novo Nordisk was thereby effectively arrogating the functions of the licensing authority to itself. FAS believed that applying these requirements created the possibility that Novo Nordisk would evade concluding agreements with wholesale buyers other than its five permanent partners. FAS issued a prescription to Novo Nordisk requiring Novo Nordisk to repeal any requirements Novo Nordisk had imposed on distributors that are "not provided for by [Russian] law."

It is noteworthy that FAS deemed it impermissible for a dominant supplier to include in its distribution agreements requirements for distributors to provide sales reports or forecasts. FAS stated that this was a service "which can be rendered on the basis of separate service contracts and shall be subject to 18% VAT." It could be argued that FAS was thereby arrogating to itself a fiscal function that does not properly belong to it.

Based on its review of the case, FAS imposed a fine on Novo Nordisk in the amount of 1.6% of the total proceeds from sales in the markets to which the violation applied (1.5% of total sales proceeds), which amounted to RUB 85,934,025.

FAS's decision in the Novo Nordisk case left open the question of whether FAS permits the use by a dominant undertaking of any legitimate criteria for selecting distributors. This decision might have become a precedent not only in the context of dominance but also in the context of applying Article 11 of the Competition Law to interaction between manufacturers and distributors, because Article 11 bans an activity analogous to that banned in Clause 5 of Article 10.1 of the Competition Law (unjustified refusal to enter into agreements). Nevertheless, there remain reasons to believe that clear and well established selection criteria and transparent procedures for assessing compliance mitigate the risk of violating Article 10 and/or Article 11 of the Competition Law.

Trade Law

Article 9 of the Trade Law: Discounts

One of the many controversial issues regarding the 2009 law "On the Fundamentals of the State Regulation of Trade Activity in the Russian Federation" (the "Trade Law") is the question of whether one can use discounts not tied to volume of sales in food product supply agreements. This issue has been raised and discussed on multiple occasions in both expert committees and inquiries to FAS and the Ministry of Industry and Trade ("Minpromtorg") without any clear resolution.

In response to an inquiry by the Alcoholic Beverages Committee, Minpromtorg stated in September 2010 that "the question of [the permissibility of] the grant of discounts for the performance of obligations arising from the terms of a supply agreement is not addressed by the Trade Law"; in other words, there are no restrictions on using discounts. Earlier, in February 2010, FAS had expressed its position on this issue to the effect that it is permissible to include unconditional fixed discounts in food product supply contracts "provided that the price of the food product supply contract is set in the contract as of the moment (date) of the contract's conclusion based on the price of the total shipment (quantity) of goods to be supplied, taking into account the discounts granted to the buyer." In other words, any conditional discounts (except for volume-based discounts) must be excluded. Obviously, such a loose construction of Article 9 of the Trade Law is at odds with the position of Minpromtorg.

Subsequently, FAS effectively retracted this interpretation by invoking its lack of authority to interpret Article 9 of the Trade Law. However, it seems that now the situation is being reversed. In late December 2010, changes were introduced into the Code of Administrative Procedure according to which FAS was designated as the agency in charge of enforcing Article 9 of the Trade Law, which implies that FAS is now vested with the authority to provide guidance on the application of Article 9. This in turn may mean that FAS interpretative statement quoted above is becoming de facto the official interpretation. However, FAS's by-laws do not yet provide for this authority, so the overall position remains somewhat unclear.

Merger Control

Acquisition by PepsiCo of the Wimm-Bill-Dann Group of Companies

The most notable event in the M&A and merger control area in Russia in early 2011 was the completion of the acquisition by PepsiCo, Inc. ("PepsiCo") of control over the group of companies known as Wimm-Bill-Dann for approximately $3.8 billion. This transaction, the purchase of shares of open joint stock company Wimm-Bill-Dann ("WBD") from its shareholders, as well as the purchase of related ADRs and GDRs on foreign stock markets, was approved by FAS on January 27, 2011. In fact, FAS approved the acquisition of 100% of WBD, taking into account that PepsiCo was obliged to make a mandatory offer to the remaining shareholders of WBD to purchase their shares in accordance with the Law on Joint Stock Companies. FAS also issued two prescriptions, one in relation to the resultant entity's juice business, and one in relation to its dairy business.

The transaction is noteworthy in the context of merger control and the Competition Law for two reasons. First, FAS approved the deal very quickly, particularly when one considers that two companies of the WBD group met the criteria to be considered strategic companies under Federal Law No.57-FZ and so the deal also required the approval of the Commission for Foreign Investments. FAS decision coincided with the start of the World Economic Forum in Davos, and the speed of the regulatory review can be explained primarily by the Russian government's positive reaction to the deal and resultant desire that the deal close quickly.

The second noteworthy aspect was the substance of the prescriptions issued by FAS to PepsiCo. It should be noted that the transaction was potentially problematic since both PepsiCo (through its subsidiary Lebedyansky) and WBD had sizable juice businesses with an aggregate market share close to 50% at the federal level. By contrast, there was no overlap between the companies in the dairy market, since PepsiCo did not operate a dairy business in Russia prior to its acquisition of WBD and indeed was acquiring WBD primarily for WBD's dairy business. Despite the different situations in the two lines of business, FAS issued prescriptions in relation to them both. If issuing a prescription in relation to the juice business was inevitable (in the event that the deal was approved), since the deal was going to lead to a substantial increase in PepsiCo's market share and a reduction of the number of independent players in the juice market (and thereby constitute a restriction of competition under Russian law), the rationale for the prescription in relation to the dairy business was not obvious.

In fact, FAS's only written rationale for issuing the prescription to PepsiCo in relation to the dairy business was a reference to the possibility of PepsiCo's share in the dairy market increasing as a result of its future investment into the target, which is not a compelling argument in light of the fact that WBD's share in the federal market for any dairy product did not exceed 25%. Although WBD was included in the regional section of the Registry of Undertakings as having a market share of over 35% in the market for the procurement of raw milk in two regions (i) this fact was in no way related to or affected by the deal, and (ii) the prescription was issued to PepsiCo in relation to the entire federal market and not just the regional markets in question.

Moreover, the two prescriptions issued by FAS to PepsiCo de facto impose on PepsiCo a legal regime analogous to that applicable to a dominant entity without PepsiCo's having established a dominant position in any market in Russia. Even if dominance is established or strengthened as a result of an M&A transaction, FAS is only entitled to issue a prescription with the objective of securing competition in the market but not to protect certain categories of parties or to obtain general control over the acquirer's group. There are already many precedents involving companies successfully challenging FAS prescriptions in court on the grounds that they are not in compliance with this framework.

Applying Post Factum Notification Procedures (as opposed to Preliminary Approvals) with Respect to Intra-Group Transactions

Transactions involving shares, participatory interests, or assets executed within one group of entities fall under antimonopoly control provided that certain economic thresholds are met. Before the amendments that comprise the so-called "second antimonopoly package" entered into force in 2009, all such transactions had to be approved in advance by FAS, except in cases where the structure of the relevant group had been disclosed to FAS earlier in accordance with a certain procedure. After the "second antimonopoly package" was enacted, transactions between parties where one party owned more than 50% of the shares or participatory interests of the other were excluded from the scope of preliminary approval procedures: these transactions now merely required that FAS be notified. According to a formal interpretation of this

new rule, this exception only applies to transactions between subsidiaries and a direct parent company.

The limitations of this interpretation were evident, and FAS officially clarified that this exception also extends to companies within a chain of companies owning a more than 50% stake of participatory interests or shares in each other. In other words, following a literal reading of the FAS clarification, transactions where each company owns more than 50% in the other and the companies are in the same vertical shareholding chain of control within a group are eligible for exemption from the need to seek FAS's preliminary approval.

However, it remains unclear how to treat transactions among companies within parallel branches of the same group, i.e., between "sister" companies. In effect, such transactions in no way differ from transactions among companies within the same vertical branch of the group. Neither the law, nor FAS's clarification mentioned above, provide a direct answer to this question. Meanwhile, in practice, several transactions between "sister" companies have undergone the notification procedure successfully, i.e., FAS de facto acknowledged that they are exempt from any requirement for preliminary approval. The rationale for applying the notification procedure, rather than the preliminary approval procedure, was that these transactions are in effect transactions among companies within the same chain of companies where each company holds more than 50% of the others, the chain between the parties to the transaction being formed by a combination of direct and or indirect parent companies (i.e., the chain is V-shaped).

Although this justification has been accepted by FAS on more than one occasion, it is still advisable to apply to FAS for preliminary consent for intra-group transactions among "sister" companies, as there is no guarantee that FAS's practice will not change, as has occurred previously. In these situations, we would suggest using the notification procedure only when there is no realistic possibility of obtaining preliminary approval from FAS for the transaction.

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Recent News

Recent Promotions

Among other promotions, Dechert announced on January 24 the promotion of two Moscow-based attorneys to the status of national partner. Vasily Kuznetsov and Oxana Peters are both members of Dechert's litigation and arbitration practice based in the Moscow office.

Vasily Kuznetsov specializes in international arbitration and litigation, including commercial cases involving the recognition and enforcement in Russia of foreign judgments and awards. He has successfully represented Enka, The Bank of New York Mellon, Gazpromexport, Société Générale, Tenex and Erdenet Mining Corporation in high-value disputes in Russia and abroad. Mr. Kuznetsov has been repeatedly recognized by *Chambers* and *The Legal 500*, *Chambers Global* (2011) noting that he is "a rising star, who is personable and hard-working."

The "'knowledgeable'" Oxana Peters (*The Legal 500 EMEA* (2011)) specializes in tax, construction, product liability, and commercial disputes as well as defending against hostile takeovers in Russia. Ms. Peters has successfully represented a leading Austrian retail group, a number of leading German investors and other Russian and multinational clients in the arbitrazh courts and courts of general jurisdiction on a broad range of matters. She also advises clients on investigative matters in Russia and the CIS.

Recent Major Deals

Dechert represented PepsiCo, Inc. ("PepsiCo") in its approximately $3.8 billion acquisition of a majority stake in Russia's leading branded food and beverage company. PepsiCo announced on February 3 that it had completed the previously announced acquisition of approximately 66% of the outstanding shares of Wimm-Bill-Dann Foods OJSC (Wimm-Bill-Dann) from certain selling shareholders of Wimm-Bill-Dann. The acquisition increased PepsiCo's total ownership of Wimm-Bill-Dann's ordinary shares to approximately 77%. It will also make PepsiCo the largest food and beverage business in Russia.

Dechert advised on competition, corporate and strategic issues related to the transaction. Igor Panshensky, a corporate and antitrust partner in the firm's Moscow office, led the team on competition matters, assisted by antitrust associate Alexander Egorushkin. Laura M. Brank, the head of Dechert's Russia Practice, and Olga Watson, senior associate,

advised on corporate and strategic issues. Brank, Watson and other Dechert attorneys previously advised PepsiCo and the Pepsi Bottling Group on their $1.4 billion acquisition of a 75.53% stake in JSC Lebedyansky, a juice producer in Russia. That deal closed in 2008.

After the most recent deal signed on December 2, Dechert assisted in obtaining the necessary antimonopoly approvals for the transaction in Russia, Ukraine and Kazakhstan. Dechert also advised in relation to the crucial issue of approval by the Russian Federal Government Commission for Control over Foreign Investment in Russia, headed by Prime Minister Putin, which must approve acquisitions in so-called strategic companies in Russia.

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Dechert represented Kinross Gold Corporation ("Kinross") on its $350 million acquisition of a 25% stake in Chukotka Mining and Geological Company ("CMGC"), the 100% owner of the Kupol gold and silver mine in the Chukotka Autonomous Okrug of the Far East Region of the Russian Federation. Prior to the acquisition, CMGC was owned 75% by Kinross and 25% by the State Unitary Enterprise of the Chukotsky Autonomous Okrug (Chukotsnab). The acquisition – which closed on April 27 – brought Kinross's total stake in CMGC to 100%, and, like the PepsiCo deal above, required the approval of the Russian Federal Government Commission for Control over Foreign Investment in Russia.

The consideration is subject to adjustments equal to the amount of the attributable dividend payments. Kinross intends to finance the acquisition costs in part though a non-recourse debt facility of approximately $200 million, on which Dechert is advising CMGC.

The team advising Kinross was led by Moscow office managing partner and head of the Russia Practice Laura M. Brank, assisted by senior corporate associate Olga Watson and associates Alexander Volnov, Evgenia Gaysinskaya, Alexander Egorushkin, Elena Ivankina, Kirill Skopchevskiy, Tatiana Kozlova and Irina Kulyba.

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Dechert advised Delightful Hill, part of China's Winsway Group Holdings Ltd, on its $90 million acquisition of a 60% stake in Divalane Holdings Ltd, a Cyprus holding company that owns Russian coal company LLC Arkticheskie Razrabotki with operations in the Apsat deposit in Chita Oblast, Eastern Siberia. The Apsat deposit has coal resources estimated at over 2.2 billion tons. The deal, which closed on May 24, was subject to approval by Russian antimonopoly authorities and was one of the first major Chinese acquisitions in the Russian coal sector.

The team advising Delightful Hill on the acquisition was led by partner Shane DeBeer and national partner Evgeniya Korotkova, assisted by associates Ruslan Koretski, Evgeniya Gaysinskaya, Alexander Egorushkin and Kirill Skopchevskiy. Dechert also advised on the regulatory approval aspects of the deal.

Recent Dispute Resolution

Among other representations, Dechert is pleased to announce that Dechert teams have recently won two major cases.

Firstly, we achieved a major victory in a complex multimillion euro tax case for the Russian subsidiary of a major European automotive manufacturer. The state arbitrazh courts had ruled at first instance and on appeal against our client but on June 6 the Court of Cassation (third instance) overruled the decisions of the lower courts in full and remanded the case for a new trial. It is very unusual for the Court of Cassation to overrule the decisions of lower courts in Russia in a tax dispute. The Dechert team representing the client consisted of Moscow national partner Oxana Peters and Moscow associate Timur Djabbarov.

Secondly, on June 7, we won a major case for a leading Austrian retail group in bankruptcy proceedings in Saratov in which a regional Russian bank tried to challenge the rights of our client to certain equipment in three supermarkets in Moscow. This case lasted for more than a year in the trial court and should be the final case in a sequence of more than 35 disputes handled in the last three years for this client by the Dechert attorneys involved. In total, the cases relate to equipment in more than 30 supermarkets in Moscow and Tula. The Dechert team representing the client consisted of Moscow national partner Oxana Peters and Moscow associates Yuri Makhonin and Alexander Lazarev.

Dechert Opens Los Angeles Office

Dechert announced on April 7 that it has opened an office in Los Angeles and that four partners have joined the firm in that office in the Litigation practice.

Moving to Dechert is Edwin V. Woodsome, Jr., a former national chair of Orrick, Herrington & Sutcliffe LLP's Litigation Group, along with William W. Oxley, Christopher S. Ruhland and Andrew S. Wong.

"The decision to establish an office in Los Angeles results from our assessment of our clients' current and potential business interests," Dechert Chairman and CEO Barton J. Winokur said. "This is an extremely talented team of lawyers with a vibrant national practice, and we are very pleased that they are joining Dechert and will help us build our Los Angeles presence."

Recent/Upcoming Events, Seminars and Speaking Engagements

June 23, 2011: Laura Brank, Shane DeBeer and Ivan Marisin will present a webinar, "Top 10 Legal Issues for Exporting into Russia," hosted by Export Development Canada.

June 9, 2011: Laura Brank will speak on a panel about shareholder rights and corporate governance in Russia and Ivan Marisin will speak on a panel about international arbitration as it relates to Russian disputes at the 3rd Annual Russia Legal Forum held by the U.S.-Russia Business Council, the first time this event has been held in London.

May 26, 2011: Ivan Marisin spoke on "Raising a fraud defense in international arbitration" at the LCIA Symposium in Moscow.

May 25, 2011: Laura Brank spoke on "The Russian Legal Environment: The Facts and Myths about Investing in Russia – A Lawyer's Perspective" at UFG's Annual LP Conference in Moscow.

May 24, 2011: Laura Brank participated as a panellist in the panel presentation at "Developing and Sustaining a Rewarding and Successful Legal Career," an event hosted by American Women Lawyers in London.

May 17-19 and April 19-21, 2011: among other Dechert attorneys, Ivan Marisin and Shane DeBeer presented a seminar on arbitration, EU competition and energy regulation, English contract law and U.S. and UK anticorruption legislation to invited attendees from Gazpromexport.

March 28, 2011: Laura Brank participated in a panel discussion at a Russo-British Chamber of Commerce parliamentary lunch program.

April 13, 2011: among other Dechert attorneys, Igor Panshensky spoke at the Annual Spring Seminar hosted by Dechert's Antitrust/Competition Practice in Philadelphia.

March 17, 2011: Laura Brank presented on "Doing Business in Russia – Mitigating Risks and Addressing the Practical Aspects of Investing from Establishing a Presence to Litigating Disputes in Russian Courts," at The Conference Board's Council of Senior International Attorneys in Washington, DC.

February 1, 2011: Laura Brank and Olga Watson led and presented "Legal Update on the Strategic Sectors Law and Key Issues when Investing in LLCs," an EBRD Lunchtime Seminar in London.

Honors

Dechert was ranked for Corporate/M&A: Moscow, Dispute Resolution, Energy and Natural Resources, Real Estate and TMT in Russia in *The Legal 500 EMEA* (2011), variously earning the plaudits: "[the team's] advice is very appropriate and commercially targeted [and] good value for money;" "a talented team;" and "just outstanding."

In addition to rankings for Corporate/M&A, Dispute Resolution, Energy and Natural Resources, members of the team also received rankings in areas including Banking and Finance and Competition in *Chambers Europe* (2011) and PLC *Which Lawyer?* (2011).

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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.

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