Frequent Legal Issues for Contractors on Sakhalin Oil and Gas Projects

Construction of the complex offshore oil and gas projects on the island of Sakhalin is gaining momentum as the operators of the Sakhalin I and II projects, Exxon Neftegas Ltd. and Sakhalin Energy Investment Company, continue awarding contracts for the completion of installations currently estimated to reach a total cost of $22 Billion. Contractors and subcontractors of diverse nationalities are now participating in these gigantic undertakings that include such varied construction as oil and gas pipelines, offshore drilling platforms, icebreakers and oil tankers, harbor facilities, the world's largest LNG plant, airport improvements, oil spill containment facilities, office buildings, employee housing, medical facilities and hundreds of kilometers of road construction with multiple river crossings.

Each contractor and subcontractor is faced with certain legal issues that are unique to the specialized work required by its contract. But at the same time, there are many common issues encountered by most of the companies operating on Sakhalin. The Sakhalin office of Russin & Vecchi International Legal Counsellors has assisted clients in meeting these requirements on repeated occasions. This day-to-day experience with common legal concerns was collected and presented at the Sakhalin Oil and Gas Conference in London in November 2003 by six attorneys from the Russin & Vecchi Russian Practice Group.

The following articles summarize the materials presented at Russin & Vecchi's Sakhalin Oil and Gas Post-Conference Legal Workshop.[1] Readers who would like to discuss any of the issues presented in these papers are invited to contact Russin & Vecchi attorneys at the coordinates listed immediately after the articles.

[1] The contents of these papers should not be construed as legal advice, and readers are cautioned from applying this summary information to concrete factual situations without further legal consultation. Due to space limitations, the information contained in these articles is not exhaustive. There are therefore likely additional applicable legal requirements with regard to most factual circumstances.

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I. Legal Theory and Sakhalin Practice

Presented by Jonathan Russin, Managing Partner of the firm's Russian Practice Group. Mr. Russin is resident in Moscow, from where he directs the firm's offices in Moscow, Yuzhno-Sakhalinsk and Vladivostok. He has been advising clients about Russian legal issues since 1988. In 1997, Mr. Russin became counsel to Mobil New Exploration & Production Ventures for the development of offshore oil and gas resources under the Sakhalin III PSA. He and the Russian Practice Group now provide advice to the PSA operators and their contractors and suppliers doing business on Sakhalin. Mr. Russin specializes in international commercial and investment matters and practiced law in Latin America for two decades before establishing the firm's Russian operations. He is a graduate of Yale College and Yale Law School.

Pre and Post 1998: Developments in the Russian Legal System

The period from the break-up of the Soviet Union in 1991 until roughly the time of the financial crisis in the summer of 1998 may be characterized as the Structural Period for Federal Legislation. The current Constitution of the Russian Federation dates from 1993. The state planning apparatus disappeared in 1992 and a wholly unregulated and chaotic market immediately began to appear. Transactions happened, buyers and sellers made deals, but the absence of a legal framework characterized this as a period of legal uncertainty.

Gradually, the State Duma began to function, and laws designed to accommodate and regulate a market economy took shape. By 1998, most of the principal laws governing the functioning of a market economy were in place, including Parts I and II of the Civil Code, the statutes governing open and closed Joint Stock Companies and Limited Liability Companies, the law on Bankruptcy, a Federal Securities Commission to regulate share sales and the functioning of a stock market, the law on Production

Sharing Agreements for the exploitation of natural resources, Antimonopoly legislation, to mention only a few.

The period since 1998 has been characterized by amendment, refinement and attempts to correct abuses that have arisen as the laws began to function in practice. The tax laws have been modified on a regular basis. In May 2003, President Putin, in his annual address to the Federal Assembly of both houses of the Russian Parliament, stated:

> Tax reforms in Russia are unfortunately becoming a constant and ongoing process. Yes, the measures proposed by the Government to reduce the tax burden are of course a move in the right direction. But the frequency of amendments to tax legislation clearly exceeds the allowable level.

The Duma continues to tinker with the implementing legislation necessary to put the Production Sharing Law fully into effect. Changes are being proposed to the Bankruptcy Law to correct abuses that have allowed shrewd and unscrupulous players to strip assets from supposedly bankrupt companies. So we are now in the period of usual legislative activity that characterizes the work of legislatures in most market economies.

Current Conditions

What are the peculiarly Russian characteristics of today's legal and administrative environment? The Russian bureaucracy at all levels – Federal, Regional and Municipal – is characterized by multiple approval and extensive document requirements. President Putin pointed to this fact again in his annual address last year:

> . . . the Russian bureaucracy has proved itself poorly prepared to develop and implement the decisions our country needs today. At the same time, it has proved itself good at obtaining benefits and revenues through use of its powers and position[2] . . . The Russian bureaucracy today still has enormous power. But the quantity of power it has does not correspond to the quality. I must stress that to a large degree, this power has its source in nothing more than the superfluous functions of state bodies.

The Russian Federation is made up of 89 States, known within Russia as "Subjects of the Federation." Sakhalin is one of the Subjects and has its own Governor and legislature. In too many instances, administrative decisions – such as licensing a company to carry out construction activities – require both local and federal actions. For this reason, the ability to coordinate the governmental requirements of companies between Sakhalin and Moscow is often crucial.

The Government is attempting to reduce the role of the bureaucracy. Recent legislation has reduced the number of commercial activities subject to mandatory licensing, and following last year's annual address, President Putin tasked Prime Minister Kasyanov with forming an inter-ministerial commission on administrative reform. According to one published source: "Putin's goal of improving the investment climate by weakening the base of the state mafia and general corruption is now at last reflected in practical government action under the determined leadership of Prime Minister Kasyanov and his

[2] In his 2002 address the President directly called for limitations on corrupt bureaucrats.

deputy Boris Aleshin who is chairing a special commission set up in July to cut back the powers of the bureaucracy."[3]

Corruption Issues and Avoiding Dispute Resolution in the Courts

Corruption in the bureaucracy remains an ever-present problem. Transparency International released its annual report in October 2003 and ranks Russia number 88 out of 133 countries.[4] On a scale of one to ten, with ten indicating the least corruption, Russia scored 2.6, slightly worse than last year at 2.7.[5]

And what about corruption among judges and court personnel? In June 2003, at a conference of Russia's top judges the chief judge of the Supreme Court of the Russian Federation, Vyacheslav Lebedev, spoke out against corruption in the Russian judiciary. He noted that in 2002 some 60 judges were stripped of their powers "for actions disgracing honor and dignity."[6] In our experience as a firm, it is difficult to predict when and if a court or a particular judge may be suborned. The fact that Russian law allows a right of appellate review in almost all cases increases the chance that a particular matter will eventually get a fair hearing. But generally, we advise clients to adopt strategies that will avoid the need to resolve disputes in court.

One technique to diminish the possibility of litigation is to structure relations with the other party to your contract in a way that creates a continual balancing of risks. As lawyers, we are trained to look at contract obligations and ask: "If the obligation is breached by the other side, what remedies are available to my client?" The answer is often: sue for damages, seek an injunction, or go to arbitration. But all of these remedies rely on a dependable, efficient and honest judicial system. Instead, we now advise our clients to analyze the terms of their contracts on a time basis, so that each exposed step by one party is balanced by a reciprocal exposure to the other.

To use a simple example, in a construction contract the obligation of the owner to make an advance payment should be balanced by the presentation of purchase invoices by the contractor, indicating the materials that will be obtained through the advance payment. Better still would be to make the advance payment directly to suppliers rather than to the contractor. The idea is to analyze contract performance by structuring a CPM or PERT[7] chart to insure that a risk exposure assumed at any given moment by one party is balanced by similar exposure of the other party. It is not always possible to structure a project so as to achieve a continuing balance of risks, but even so, this exercise will alert a party to particular points at which exposure is unbalanced, and it may be possible to require other kinds of guaranties from the other party to cover such contingencies. Again, the point of the exercise is to minimize the risk to resort to litigation or arbitration to remedy a contractual default.

Our experience indicates at least one bright spot in looking at the objectivity and honesty of the court system. In tax litigation we have found that the courts have acted in most cases based directly on the law and evidence before them. One could assume that regional courts are beholden to regional authorities and likely to favor the local tax

[3] United Financial Group, Russia Morning Comment, October 10, 2003.
[4] For reference purposes, Finland is number 1, the U.S. is number 15 and Bangladesh is number 133.
[5] The Moscow Times, October 8, 2003, page 5.
[6] Pravda, June 16, 2003.
[7] Critical Path Method (CPM) and Project Evaluation Review Technique (PERT). These are technologies often used to plan the synchronization of activities required in complex construction.

administrators, but our experience indicates the contrary, and we have seen numerous instances where over zealous actions by the tax police have been remedied upon review in the courts.

II. Management and Control of a Russian Enterprise

Presented by Jonathan Russin, Managing Partner of the firm's Russian Practice Group.

Bidders for contracts awarded by the Sakhalin I and II operators must consider the benefits of meeting Russian Content requirements, that is to bid through a company the equity of which is at least 50% held by Russian natural or juridical persons. Meeting Russian Content requirements is discussed in further detail below, but often entails the creation of a 50:50 joint venture. The usual corporate form to comply with the 50% Russian ownership requirement is the formation of a Russian[8] limited liability company or LLC (sometimes known by its Russian initials as an "OOO"). One of the principal issues confronted by the non-Russian shareholders in this situation is how to deal with control and direction of the 50:50 joint venture company. In our experience there are three main approaches to this question.

Mutual Sharing of Control

Russian law governing the formation and operation of LLCs is relatively extensively detailed and sets out a number of requirements that cannot be varied by the parties. One of the fundamental rules is that obligatory requirements of Russian law cannot be avoided by an agreement between the shareholders that attempts to override them. The type of Shareholders Agreement often used in the United States and England, in which the shareholders agree in advance on the division of seats on the Board of Directors, on the selection of the Managing Director, and on the budgeting and financing of future operations of the LLC has frequently been found by Russian courts to be unenforceable. Russian law requires that these issues remain open for review and decision by the shareholders at the yearly meeting or at the times established in the company bylaws.

The standard Russian LLC, with relations between shareholders subject to review and decision at regular shareholder meetings, and with control shared in proportion to equity ownership, is probably best suited for a situation where the Russian and foreign parties are making equal contributions to the management and operations of the joint venture company. Both parties will look to Russian company law to regulate the mutual control features of their joint venture.

It should be noted, however, that Russian custom and tradition gives substantial authority to the Managing Director of a Russian LLC. Although the authorities of the Managing Director can be limited by the bylaws and by narrow delegations of authority from the shareholders or the Board of Directors, much operational discretion will still rest with the Managing Director. The choice of this officer will be a major decision for the joint venture partners.

Disproportionate Control Via Management Agreement

[8] The use of an offshore company with 50% Russian ownership is also permitted; however, Russian companies and individuals are restricted in investing in companies outside Russia, making the use of an offshore joint venture more theoretical than realistic.

One of the classic solutions used in situations where a foreign shareholder is in fact providing a disproportionate part of the financing and expertise of the LLC is to have the shareholders unanimously agree in the charter of the LLC that the management functions of the company will be contracted to a third party. A Management Contract between the LLC, usually approved by unanimous vote of the shareholders, and the foreign shareholder, conveys operating responsibility on the foreign party. The Management Contract can be for an extended period and can be drafted to allow for termination only by decision of the shareholders (where a 50:50 structure could block any decision in which the shareholders are divided) or for breach by the management company confirmed by a court decision.

Delegation of control under a Management Contract does not remove all aspects of participation of the Russian partner. Russian company law requires that changes in the structure of the LLC, such as decisions to amend the bylaws, to increase or decrease authorized capital, to reorganize or liquidate, and to pay dividends, are in the exclusive competence of the shareholders and cannot be delegated through a Management Contract.

One additional technique used to address a situation where there is an imbalance between the contributions of the two partners in a 50:50 joint venture is to create different attributes to the shares held by each partner, for example, by establishing that the shares held by the partner making the disproportionate contribution are entitled to a greater percentage of dividends.

In general, the solution to problems associated with disproportionate contributions by the partners is to address the issues presented through structures permitted by and consistent with Russian company law, rather than to attempt solutions through the use of standard U.S. or English style Shareholders Agreements, which run the risk of being ruled unenforceable by Russian courts.

Undivided Control Through Two-Tiered Structures

The third approach to the issue of control, which may be useful in the context of meeting the Sakhalin PSA Russian Content requirements discussed below, is to create a Russian structure that avoids the participation of a local partner. For this purpose it is necessary to incorporate two Russian companies. For example, Company A is established as a Russian LLC and is 100% owned by foreign shareholders. Company A then incorporates a Russian subsidiary, Company B, that is 100% owned by Company A.[9] Company B is eligible to bid on Sakhalin I and II projects because it is a Russian company, the shares of which are at least 50% owned by a Russian shareholder. Although this structure meets the legal requirement for Russian Content, it also results in the creation of two companies, both subject to the payment of Russian taxes on their operations.

There are obviously advantages and disadvantages to each of these three approaches. The choice will depend on an assessment of all the circumstances involved in each tender offered by SEIC and ENL. Relevant issues will include: Will the services required be performed in Russia or offshore? How much of the required work will be

[9] In this situation Russian company law requires that one of the two Russian companies have more than one shareholder. In this case, the assumption is more than one foreign shareholder of Company A. In the alternative, Company A could have one foreign shareholder and Company B would then need two shareholders.

subcontracted? To which partner? What will be the resultant cash flow and tax structure? The control issue will be an important, but not the sole factor determining the structure of the Russian LLC.

III. Meeting Russian Content Requirements

Presented by Jonathan Russin, Managing Partner of the firm's Russian Practice Group.

Sources of the Rules

There are at least three legal sources that have a bearing on this question: the Production Sharing Agreement for Sakhalin II signed by Sakhalin Energy in 1994, the PSA for Sakhalin I signed by Exxon Neftegas and its partners in 1995, and the Law on Production Sharing Agreements and its amendments, originally signed into law by President Yeltsin on December 30, 1995. Although the two PSAs antedate the passing of the PSA law, and are therefore "grandfathered," it is clear that Russian authorities also look to the definitions in the PSA law as setting the standards they wish to achieve. In addition to the Sakhalin II PSA, SEIC's Russian Content rules stem from its Supervisory Board Resolutions and Agreed Procedures.

Defining a Russian Enterprise

There are two distinct and often confused aspects of Russian Content. The PSAs for both Sakhalin I and II and the PSA law itself provide that the operators (ENL and SEIC) will grant "Russian Enterprises" a "priority right" or "preference" over non-Russian enterprises in awarding contracts.

What then is a "Russian Enterprise?" The PSA Law defines it as a "Russian legal entity," which appears to mean that any company incorporated in Russia, even if all of its shares are owned by non-Russians, will be recognized as a Russian Enterprise. As stated above, however, for the purposes of the Sakhalin I and II projects, the PSA law does not apply as they have grandfathered PSAs, which control. Although ENL has interpreted Russian Content in the same manner as the PSA Law, its PSA defines a Russian Enterprise in the following manner: "If Russian natural persons, legal entities or government organizations own at least fifty percent of the stock of such organization."[10]

Similarly, the SEIC PSA provides that a Russian Enterprise is defined as a company in which "at least fifty percent of its equity is held directly or indirectly by Russian natural or juridical persons or by any [Russian] governmental authority." SEIC does not require that the bidding entity be formed at the time of its bid, but the founders must commit to form a compliant entity thereafter. The entity, once formed, must provide proof of compliance in the form of a certificate of incorporation and a list of its major shareholders evidencing at least 50% Russian ownership. If Russian Content is lost post-award, the company must notify SEIC and may be at risk for loss of its contract.

Measuring Russian Labor and Russian Materials

[10] Although the ENL PSA is a confidential document, the Russian Content provisions have been discussed publicly in order to assist contractors in meeting these requirements.

Although the Sakhalin I PSA does not contain specific percentage requirements, ENL requires its contractors to meet specific requirements similar to the 70% targets employed by SEIC.

SEIC's requirements are specific and state that the company is to make its best efforts to maximize Russian Content each year with a target of reaching 70% Russian labor, materials, equipment, and services over the project life. SEIC considers materials and equipment to be Russian if they are procured by a Russian entity or individual, or by an entity otherwise compliant with Russian Content ownership requirements. Contractors must report on both Russian and Non-Russian material volume and man-hours. SEIC must track the number and US Dollar value of contracts awarded to Russian Enterprises.

Although it is relatively clear that Russian Labor means the employment of Russian citizens, which can be tracked by man-hours, the definition of Russian Materials is not as self-evident. For SEIC, the determining factor is the legal status of the source of procurement, without specific express regard to the country of manufacture. The PSA Law requires operators on an annual basis, to procure at least 70 percent of the total value of specified types of materials in the form of goods of "Russian origin."[11] Pursuant to the PSA Law, the Russian origin requirement is satisfied where materials are produced by Russian legal entities and/or Russian citizens on the territory of the Russian Federation, from parts that are at least 50% (based on total value) produced in Russia by Russian legal entities and/or Russian citizens.[12] The 70% also only applies to materials, the expenses for the procurement and use of which are recoverable to the operator through its production share.[13] Thus, the PSA Law's definition for Russian materials actually requires that a percentage of procured goods be manufactured in Russia, using Russian-manufactured parts. As stated above, however, this is not a requirement for the Sakhalin I and II projects as these PSAs enjoy grandfathered status.

IV. Drafting a Company Charter: What to include and what to avoid

Presented by Sergei L. Lazarev, Partner of the firm's Russian Practice Group and Executive Director of the firm's Moscow office. A specialist in Russian civil and corporate law, tax and labor law, as well as in litigation and dispute resolution, Mr. Lazarev has over 10 years experience in advising foreign and Russian companies on structuring and operating investments in Russia. Together with other Russin & Vecchi attorneys, Mr. Lazarev has worked on numerous issues related to Sakhalin oil and gas exploration and extraction projects, including: obtaining government approval of a PSA for a Sakhalin off-shore development project, and assisting with complex permit and licensing requirements for large-scale equipment delivery and beaching operations. Mr. Lazarev has assisted clients in reconciling the latest state of the art drilling waste disposal technologies with Russian environmental law and PSA-related requirements, and advised on Russian and international oil spill containment requirements. He is a 1983 graduate of the Law Faculty at Moscow State University and in 1990 defended his dissertation "Arbitral Settlement of Interstate Disputes" and earned a Ph.D. from Moscow State University. In 1993, he completed his study at The George Washington University National Law Center (USA) under the Edmund S. Muskie Graduate Fellowship Program.

[11] Federal Law No. 225-FZ "On Production Sharing," December 30, 1995, as amended by Federal law No 19-FZ , as amended June 6, 2003 ("Law on Production Sharing"), Article 7(2).
[12] Law on Production Sharing, Article 7(2).
[13] Law on Production Sharing, Article 7(2).

Foreign investors should be aware of several fundamental requirements regarding the structure and function of Russian limited liability companies. These include obligatory forms for management structures, the role of the General Director, procedures for transfer of shares, participant withdrawal, distribution of profits, and investments in the property of an LLC. As LLCs are the most widely used type of commercial legal entity in Russia, this article will cover issues related to LLCs, rather than Joint-Stock Companies, although in many instances, they are similar.

Russian law provides little freedom in drafting LLC charters.[14] Most LLC activities are set forth by law and can be varied only in cases specifically provided for by the law. In this regard, many schemes that are successfully employed in foreign practice, may be unenforceable in Russia.

The main law regulating activities of LLCs in Russia is the Federal Law On Limited Liability Companies No. 14-FZ dated February 8, 1998 (the "Law on LLCs"). Although the Law on LLCs is not new, court practice in interpreting its provisions is still quite limited. The main court act which clarifies provisions of the Law on LLCs is the joint Enactment of Plenums of the Highest Arbitrazh Court and Supreme Court of Russia No.90/14 dated December 9, 1999 "On Some Issues of Applying Provisions of the Federal Law On Limited Liability Companies."

Management

For the majority of foreign investors operating in Russia, the most critical question usually pertains to control, or who is playing the management role. Russian law provides a detailed scheme of LLC management structure, which include the following bodies:

1. General Meeting of Participants (GMP) - the supreme body
2. Sole executive body - General Director or President - executive body
3. Collective executive body – Executive Committee (EC) - optional second executive body
4. Board of Directors (BD) – optional observing body
5. Audit commission (Auditor) – optional controlling body[15]

Most LLCs may successfully operate without forming optional bodies. If a company has many participants or anticipates conflict, then it may be advisable to consider forming optional bodies.

Russian legislation stipulates that a participant of an LLC is not its body and can take part in its management only through a GMP. In this regard, granting to some participants the right to appoint general directors, members of the BOD or the EC, is unenforceable. However, Russian law provides the possibility to grant additional rights or obligations to some LLC participants, subject to unanimous consent of the other participants. Whether a grant of additional rights or an imposition of additional obligations is appropriate should be verified in every specific case, in light of other imperative norms of Russian law, which may not be deviated from, even with consent of the participants.

[14] There is little freedom in drafting Joint-Stock Company charters as well.
[15] An audit commission is obligatory in an LLC with more than 15 participants.

General Meeting of Participants (GMP)

The GMP's decision-making procedures are defined in detail in the Law on LLCs. Every participant has equal authority to propose issues for the GMP agenda and to vote on all issues.[16] In this regard, charter provisions that empower one participant to nominate a general director are void and unenforceable as limiting the rights of other participants. The GMP generally forms all other bodies of the company.

Although the GMP adopts most decisions by a simple majority of votes of all participants of the LLC rather than by a majority of those participants who attend the GMP, the charter may provide for a qualified amount of votes for some or every GMP decision.[17] According to the Law on LLCs, decisions to amend a foundation agreement or to liquidate or reorganize an LLC must be adopted unanimously, and decisions to amend a charter must be adopted by a 2/3 majority of votes. The charter may not reduce these qualified amounts of votes, which are established by law. Despite these limitations with regard to voting, upon unanimous decision of the participants, a charter may provide for a division of votes disproportional to shareholding.[18]

Russian law sets forth extremely strict requirements regarding the procedure for calling a GMP. A GMP may be called by other bodies of the LLC or by participant(s) who have invested at least 10 of the charter capital of the LLC.[19] A body or person calling a GMP is obligated to notify all participants at least 30 days prior to holding the GMP, unless the charter provides for a shorter term.[20] All participants have the right to propose additional issues to the GMP's agenda at least 15 days prior to the GMP, unless the charter provides for a shorter term.[21] Such proposals must be included in the agenda unless they contradict Russian legislation or do not fall within the GMP's competence. Other participants must be notified regarding such additional issues at least 10 days prior to holding the GMP. Shortening the notice period for calling the GMP (and all related deadlines) rather than applying the legal defaults affords participants greater control over the timing of decision-making.

Sole Executive Body

The sole executive body, which is the general director or president (GD), conducts the day-to-day operations of the company. Only the GD may sign agreements, hire employees and operate the monetary assets of the company without a power of attorney. The GD's powers are limited by the Law on LLCs with respect to the conclusion of large-scale transactions (valued at least 25% of the company's assets) and transactions in which he is an interested party (with affiliated persons).[22] The charter may also limit the GD's power, for example, by prohibiting the GD from concluding transactions exceeding a certain sum without the GMP's consent. However, transactions concluded in breach of such charter provisions can only be declared void within one year of their conclusion, and only if the company or its participants can prove that another party to the transaction knew or should have known about such limitations.[23]

[16] Law on LLCs, Articles 8(1) and 36(2).
[17] Law on LLCs, Article 37(8).
[18] Law on LLCs, Article 32(1).
[19] Law on LLCs, Article 35(2).
[20] Law on LLCs, Article 36(1).
[21] Law on LLCs, Article 36(2).
[22] Law on LLCs, Articles 45, 46.
[23] Russian Federation Civil Code dated November 30, 1994 No. 51-FZ, Article 174 ("Russian Civil Code").

A GD's rights may also be assigned to a Managing Company by a decision of the GMP, as long as the possibility to do so is clearly established in the Charter.[24]

Collective Executive Body

The Collective Executive Body, or the Executive Committee (EC), is used very rarely in an LLC. Russian law regulating the EC is not well defined, other than to state that it should conduct its activities in accordance with the charter. Thus, participants have much freedom in respect to this body. The EC Chairman is the GD, who retains his main authorities and signatory powers. As a result, the EC, which is considered an optional body, is in most instances not necessary.

Board of Directors (BOD)

The Board of Directors is also an optional body. If a BOD is established in the charter, however, the following issues may be granted to its consideration: electing and terminating executive bodies of the company (GD, EC or Managing Company), the conclusion of large-scale or interested transactions, and issues related to preparing, calling and holding the GMP.[25] Members of the BOD have no signatory powers and are elected by the GMP. Granting participants the right to nominate specific numbers of BOD members is unenforceable.

Establishing a BOD is not necessary and makes sense only in specific cases, such as, for example when participants seek to have greater control over the GD.

Audit commission (Auditor)

The audit commission conducts inspections of the LLC's financial activities. This body is optional unless an LLC has more than 15 participants, in which case, an audit commission is obligatory. We generally do not recommend using this body unless there are certain fears with respect to other participants or the executive bodies of the LLC.

Role of the General Director of an LLC

As mentioned above, the GD is responsible for the day-to-day management of the LLC. In particular, the GD concludes transactions, issues powers of attorney on behalf of the LLC and conducts other activities, which are not transferred to the competence of the BOD or EC. The GD's powers may be limited only by the charter and not by a decision of the LLC's participants.

The GD must have signatory power with regard to the LLC bank account and must sign the bank cards enabling an account to be opened. Russian banks have different, and sometimes contradicting, policies with respect to signatures on the bank cards, specifically regarding whether the bank will accept documents certifying the GD's signatory powers abroad. In this regard, if at all logistically possible, it is advisable to have the general director present to open the LLC bank account.

[24] Law on LLCs, Article 42.
[25] Law on LLCs, Article 32(2).

The LLC charter should provide a term of validity for the GD's authorities.[26] There are no limitations for such term and in practice this term generally varies from 1 to 5 years. During this time, the GD may transfer his powers based on a power of attorney and at any time revoke such power of attorney.

The GMP (or BOD, if it is provided for in the charter) may at any time terminate the GD's powers. However, due to the somewhat complicated procedures for calling a GMP, such termination usually cannot be accomplished immediately.

Alienation of shares

By default, any participant of an LLC may alienate its shares to another participant or to third parties. According to Russian law, the sale of a participant's share to third parties is not subject to the consent of the LLC or other participants. However, other participants, and the LLC itself, if provided for by the charter, have the right of first refusal to purchase the share being sold, in proportion to the shares held by remaining participants.[27] Russian law provides the following options in this regard, provisions for which must be expressly included in the charter:

1. Alienation of shares to other participants may be made subject to approval of the LLC or other participants.[28]

2. Alienation of shares to third parties may be prohibited.[29]

3. Alienation of shares to third parties in a manner other than through a sale may be made subject to approval of the LLC or other participants.[30]

Unless otherwise provided in the charter, the transfer of shares to heirs and legal successors of a former LLC participant is not subject to the consent of other participants.[31]

A participant may mortgage its shares to other participants without limitation, however, a mortgage of shares to third parties requires approval of the GMP and may be prohibited by the charter.[32]

The methods set forth above for limiting the manner in which shares may be alienated may be recommended in instances where the founders would like to maintain control over the entry of other participants to the LLC.

Withdrawal

The founding participants of an LLC should be aware that participants have the right to withdraw from the company at any time. Within six months from the time of the withdrawal, the LLC is obligated to pay the withdrawing participant the actual value of its share.[33] The right to withdrawal can be a double-edged sword. On one hand, the

[26] Law on LLCs, Article 40(1).
[27] Law on LLCs, Article 21(4).
[28] Law on LLCs, Article 21(1).
[29] Law on LLCs, Article 21(2).
[30] Law on LLCs, Article 21(5).
[31] Law on LLCs, Article 21(7).
[32] Law on LLCs, Article 22.
[33] Law on LLCs, Article 26.

foreign investor enjoys the freedom to withdraw from the company at any time. On the other hand, if the foreign investor established an LLC with a Russian partner, one day this foreign investor could find himself alone in the joint venture if his Russian partner decides to suddenly withdraw. If the Russian partner was needed for Russian Content purposes in the context of the Sakhalin PSAs, the Russian partner's withdrawal could result in the loss of a contract. The right to withdraw from the LLC cannot be prohibited by the charter.

Distribution of profits

By default, LLC profits are distributed in proportion to the participants' share ownership. Upon unanimous decision of the participants, this procedure may be amended. Russian law affords opportunities to establish shares with varying attributes, including profit distribution that differs from shareholding. Amending or deleting such provisions from a charter must also be accomplished by unanimous decision.[34]

Investments to LLC property

The LLC's charter may include a provision obligating the participants to make additional investments to the LLC's property. Respective provisions of the charter should be adopted by unanimous decision of the GMP. Decisions on each additional investment must be adopted by a qualified 2/3 majority of votes, if the charter does not provide a greater amount of votes.[35]

Unless the charter provides otherwise, investments must be made proportionally to share ownership. The charter may also specify a maximum amount of investment applicable to all, or to specific individual, LLC participants.[36] If participants plan to invest assets in the company, in addition to those contributed to the charter capital of the company, it is reasonable to include such provisions in the charter.

List of Company Activities

According to Russian legislation, an LLC may perform any activity not prohibited by law. Although a charter need not provide a list of planned activities, it is general practice to include them.

Conclusion

Although impossible to analyze all aspects of Russian LLC law in the confines of a short article, this article is intended to provide a general overview of some of the main aspects of legal practice related to LLCs, which should be considered by foreign investors who plan to enter a JV with a Russian partner. Where foreign investors set up Russian subsidiaries with 100% foreign ownership of one participant, some of the issues described above are less significant.

V. Antimonopoly Considerations of Investments in Sakhalin Projects

[34] Law on LLCs, Article 28(2).
[35] Law on LLCs, Article 27(1).
[36] Law on LLCs, Article 27(2).

Presented by Sergei L. Lazarev, Partner of the firm's Russian Practice Group and Executive Director of the firm's Moscow office.

Types of Antimonopoly Control

The predominant Russian legislation governing transactions that may influence competition is a law passed during Soviet times entitled, "On Competition and the Limitation of Monopolistic Activities on Commodity Markets" ("Antimonopoly Law").[37] Particularly noteworthy is the fact that in addition to defining certain events as potentially influencing competition on Russian markets, the Antimonopoly Law provides for the extraterritorial effect of its rules, expressly covering instances where the actions of foreign entities outside of the Russian Federation may potentially limit competition within Russian markets.[38]

The Russian government, through the Ministry of Antimonopoly Policy ("Ministry"), exercises two major forms of antimonopoly control over typical corporate transactions. Depending on the type of activity and the amount of assets involved, a company seeking to perform an activity may need to either seek prior governmental approval of the transaction, or notify the government about the transaction after it is completed.

Of the two forms of control, prior approval, is from a timing and planning perspective, the more burdensome, as it requires filing a motion with antimonopoly bodies before a transaction is commenced. The Ministry considers the motion in view of the transaction's potential effect on competition. If there is no negative effect, the motion should be granted. If there is a potential limitation on competition, the motion may be denied. If an applicant can demonstrate that the transaction's positive social effect outweighs its negative consequences, or that the applicant is able to take measures to preserve competition, a motion may be granted even in the presence of a finding that competition will be limited as a result of the proposed transaction.[39]

Subsequent notification of a transaction to the Ministry must furnish information that enables the Ministry to assess the effect of the transaction on competition. A finding that the transaction has negatively impacted competition may result in its rescission by the Ministry.

Typical Transactions Subject to Antimonopoly Control

Subject to the triggering of economic thresholds, which vary for each type of transaction and are set forth in the table below, the Antimonopoly Law governs the following types of transactions:

- The formation of a commercial organization such as a limited liability company, joint stock company, full partnership or limited partnership.[40]

- Mergers and acquisitions involving Russian commercial organizations.[41]

[37] Law of the RSFSR No. 948-1, dated March 22, 1991 (as amended).
[38] Antimonopoly Law, Article 2(1).
[39] Antimonopoly Law, Article 17(4).
[40] Antimonopoly Law, Article 17(5).
[41] Antimonopoly Law, Article 17(1).

- A transfer of fixed assets exceeding 10% of the total book value of the fixed and intangible assets of the transferring entity, through sale, donation, lease, temporary uncompensated use, or other instances of temporary transfer.[42]

- The acquisition of 20% or more of the shares or participatory interests in a Russian company.[43] This rule is not applied to the founders of a company at the time of its formation.

- The acquisition of the right to control business activity of a Russian legal entity or to perform the functions of its executive body.[44] For example, the execution of a management contract by which one legal entity performs the functions of the executive body of another legal entity.

- The election of an individual to the Board of Directors (Supervisory Board) or to another executive body of a Russian legal entity.[45]

Threshold Amounts Invoking Antimonopoly Control

Type of transaction:	**Value of assets of person/entity involved:**	
	Exceeding 100,000 TMW[46] (approximately $345,000)	Exceeding 200,000 TMW (approximately $690,000)
Formation of a Russian legal entity	No control	Notification
Mergers and acquisitions	Notification	Approval
Transfer of fixed assets through sale, lease or otherwise	Notification	Approval
Purchase of shares or participatory interest in a Russian legal entity	Notification	Approval
Acquisition of rights to determine business activity of a Russian legal entity or to perform functions of its executive body	Notification	Approval
Election of an individual to the Board of Directors (Supervisory Board) or executive bodies of Russian legal entities	Notification	Notification

Timing and Venue of Filing

[42] Antimonopoly Law, Article 18(1).
[43] Antimonopoly Law, Article 18(1).
[44] Antimonopoly Law, Article 18(1).
[45] Antimonopoly Law, Article 18(6).
[46] TMW is an abbreviation for "times the minimum (monthly) wage," established by the Government of the Russian Federation. As of today the minimum wage for the purposes of administrative law is 100 rubles. Given the current exchange rate of approximately US$1to RuR 29, the minimum wage is approximately US$3.45.

The antimonopoly bodies generally must consider motions for approval within 30 days from the date of filing,[47] however, under certain circumstances, they may extend this period for an additional 20 days. In practice, the antimonopoly bodies may also request additional documents and thus renew the period of consideration.

Subsequent notifications must be filed within 45 days after the reported event took place.[48] The Antimonopoly Law does not specify the time period within which the Ministry must issue a decision regarding notifications. In practice, a reply is usually received within two months after filing.

Motions for approval and notifications of mergers and acquisitions, and notifications of the formation of legal entities are filed with the federal Ministry of Antimonopoly Policy, if the assets in question exceed 10 million TMW.[49] In other cases, these motions and notifications are filed on the regional level with the relevant subdivisions of the Ministry.

The acquisition of rights to control business activity, transfers of fixed assets, purchases of shares and elections to the boards, as set forth above, are controlled on the federal level when the assets of the entities involved exceed 20 million TMW.[50] Otherwise, these events are subject to antimonopoly control on the regional level.

Basic Information and Documents Required for Filing

Document requirements are extensive and vary for each type of controlled transaction. However, all filings include the registration documents of parties to the transaction (charter, certificate of incorporation), a statement of the purpose of the transaction, the value of total assets involved, and a list of the members of the executive body and the board of directors. All foreign documents filed must bear an apostille or consular legalization and be supplemented by a certified Russian translation. If information provided at filing constitutes a commercial secret, applicants must alert the antimonopoly bodies to this fact.

After the initial filing, the Ministry may require additional information and documents before making a decision on the application and may set a deadline for the provision of such information and documents at its own discretion.[51] Therefore, preparatory work to collect the anticipated information and documents should be undertaken in advance. Additional information may be requested relating not only to the parties to the transaction, but also related to other interested persons. The list of additional information is extensive.[52] The most noteworthy requests include the following:

a) Information contained in quarterly accounting and statistical reports or in their supporting documents, as well as other documents related to the calculation and payment of taxes and other obligatory payments for three preceding years.

[47] Antimonopoly Law, Article 17(2).
[48] Antimonopoly Law, Article 17(5).
[49] Regulations on the procedure of filing of motions and notifications with the antimonopoly bodies under Articles 17 and 18 of the Law of the RSFSR "On Competition and Limitation of Monopolistic Activities on Commodity Markets," approved by Ministry of Antimonopoly Policy Order #276, August 13, 1999 (MAP Order), Item 6.1.2.
[50] MAP Order, Item 6.2.1.
[51] MAP Order, Item 5.3.
[52] MAP Order, Appendix 1, Item 2.

b) Description of major types of goods (work, services) supplied to the market and their major substitutes in production and consumption.

c) Information on the volume and share of supply for government and military orders.

d) Description of the market environment before and after the transaction.

e) Information on production facilities and the level of their utilization for the production of the specific type of goods (work, services), including an assessment of the total production facilities of the type in the Russian Federation or region.

Liability for Violation of Antimonopoly Control Rules

Failure to file a motion for approval or a subsequent notification with the antimonopoly bodies when required by law is subject to administrative fines. The amount of such fines ranges from 20 to 50 TMW (approximately $70-170) for executives,[53] and from 500 to 5,000 TMW (approximately $1,700-17,000) for legal entities.[54]

In addition to administrative fines, antimonopoly bodies may seek court ordered liquidation of a legal entity formed in contravention of the Antimonopoly Law.[55] Furthermore, any transaction conducted in violation of the Antimonopoly Law may be challenged and invalidated in court proceedings on the basis of its illegality.[56]

VI. Labor Contracts: Dos and Don'ts

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi. Ms. Prisekina has been advising clients on various issues of International and Russian law since 1995. She specializes in admiralty, labor, and international commercial and investment matters. Together with other Russin & Vecchi attorneys, Ms. Prisekina issued a legal opinion on the oil spill prevention and liquidation responsibilities of Exxon Neftegas Limited in connection with transportation of oil through the De Kastri and Tatar straight to foreign ports. She has also provided legal advice on the issues of cabotage conducted by foreign flag vessels in the Russian Federation. Ms. Prisekina is a graduate and PhD recipient of the Law Institute of the Far Eastern National University (Vladivostok, Russia) and has an LL.M. degree in Transnational Business Practice (McGeorge School of Law, University of the Pacific, Sacramento, California, USA).

What to Include in Employment Agreements

The most recent Russian Federation Labor Code ("Labor Code") came into effect on February 1, 2002.[57] The Labor Code continues many of the pro-employee protections that were developed during the Soviet period, albeit with at least two significant changes reflective of the new market economy. First, the list of grounds for dismissal of employees at the employers' initiative has been greatly extended. Previously

[53] The Code of the Russian Federation on Administrative offences #195-FZ, dated December 30, 2001, Article 19(8).
[54] The Code of the Russian Federation on Administrative offences #195-FZ, dated December 30, 2001, Article 19(8).
[55] Antimonopoly Law, Article 17(9).
[56] Russian Civil Code, Article 168.
[57] Russian Federation Labor Code No. 197-FZ, dated December 30, 2001.

employees could be fired for only the most egregious violations of company rules.[58] Second, the company general director may now be dismissed before the expiration of his term, without cause, by the board or the shareholders.[59] Until this recent change to the Labor Code, there was a conflict of authority as to whether a general director may be dismissed without cause or only for the limited reasons set forth in the Labor Code.

The Labor Code establishes the following mandatory provisions for inclusion in employment agreements:[60]

1. Place of work (indicating the structural subdivision, if any);
2. Starting date (term and reason must be specified if it is a fixed-term agreement);
3. Title of the position, specialty, profession, indicating the qualification;
4. Rights and duties of the employee;
5. Rights and duties of the employer;
6. Description of work conditions, compensation and benefits for work in hard, harmful or dangerous conditions;
7. Labor and rest regime (if it differs for this employee from the general rules established by the organization);
8. Remuneration (including the size of tariff scale or wage rate, additional payments and bonuses);
9. Social insurance provisions (types and conditions of social insurance that are directly connected with the labor activity).

The terms and conditions contained in employment agreements may be amended only as agreed by the parties and in written form.

Discretionary provisions of employment agreements, pursuant to the Labor Code, may include: a probationary period, the non-disclosure of secrets protected by law (state, official, commercial and other), the duty of an employee to work a specific term after completing employer-paid education, and other terms at least as beneficial to the employee as provided by the Labor Code, laws, normative legal acts, collective contract, and agreements.

Workday and Workweek

The standard duration of a workweek consists of five workdays and two days off, six workdays and one day off, or a workweek with days off to be allotted on a sliding scale.[61] As a rule, working hours may not exceed 40 hours per week,[62] and eight hours per day. However, the Labor Code allows these norms to be exceeded for overtime work,[63] as a result of combining jobs,[64] and where employer and employee have agreed to a non-fixed workday.[65] For employees working under harmful or dangerous working conditions, the normal workweek is reduced by four or more hours, and therefore may not exceed 36 hours per week.[66] Employers are obligated to keep track of time actually worked by each employee.

[58] Labor Code, Article 81.
[59] Labor Code, Article 278, para.2.
[60] Labor Code, Article 57.
[61] Labor Code, Article 100.
[62] Labor Code, Article 91.
[63] Labor Code, Article 99.
[64] Labor Code, Article 98.
[65] Labor Code, Article 101.
[66] Labor Code, Article 92.

Permissible Purposes for Overtime Work

An employer may enlist an employee for overtime work with the employee's written consent, under a limited number of circumstances, related to national defense, the avoidance of industrial accidents, and other situations involving a threat to public health and safety.[67] In other cases, enlisting employees to overtime work is permitted with the employee's written consent and in view of opinion of the company's trade union. Each time an employer instructs an employee to work overtime, the Labor Code requires the employer to record its justification, which must be based on a permissible reason under the Labor Code. The use of overtime for purposes other than those indicated is a violation of Russian labor law.

The duration of overtime work is limited to a maximum of four hours in two consecutive days, and 120 hours per year. Certain employees are not eligible for overtime work due to their age, gender, family circumstances, and physical condition.

Employers must pay increased rates for overtime work; time and one half for the first two hours and not less than double time thereafter. Employees may request to substitute additional time off for overtime payment. Additional time off may not be less than the amount of overtime worked.[68]

Non-fixed Workday

The non-fixed workday is a special work regime that employers may utilize for some of their employees, on an occasional basis, when necessary to permit such employees to work beyond the limits of normal working hours. Many private firms and governmental organizations have adopted the concept of a non-fixed workday to provide the flexibility necessary to meet deadlines and work loads.

Employees working a non-fixed workday are not bound to the 8 hour/day, 40 hour/week standard maximums. They may be required to stay at work beyond the close of the standard workday, or called to start work earlier than the usual opening hour. For construction work, the use of a non-fixed workday allows the employer to set work hours in accordance with actual construction needs. Extra hours worked are not considered overtime work, as the non-fixed workday is established by the employment agreement. Employers may require employees to work based on the demand of the tasks at hand, subject to the requirement to provide the employee with reasonable rest and recuperation.

Utilization of the non-fixed workday regime is appropriate only under certain circumstances and following certain guidelines. The regime is appropriate when in the company's interests and when required by the employee's labor function. It may only

[67] Circumstances where overtime work is permissible include: 1) to perform work necessary for national defense, for the prevention of industrial accidents or the elimination of consequences of an industrial accident or natural disaster; 2) to perform publicly necessary works related to water supply, gas supply, heating, illumination, drainage, transport, or communication in order to rectify unforeseen problems that prohibit normal function; 3) when necessary to complete work, delayed by unforeseen industrial reasons, if non-completion of such work could damage or destroy the employer's or state or municipal property, or threaten human life and health; 4) where temporary work is required to repair or restore equipment or structures in order to avoid substantial interruption of other employees' work; 5) where continuity of relief work is essential and the relief worker is absent. Labor Code, Article 99.

[68] Labor Code, Article 152.

be applied on an occasional basis; employees generally work normal schedules but occasionally may be called on to work under the non-fixed workday regime. Employers must issue an express order to implement the non-fixed workday. However, employees need not agree to the order to be bound to work, assuming the non-fixed workday is provided for in the employment agreement. In order to call on a specific employee, that employee's position must be on the company's list of positions subject to the non-fixed workday regime, established by collective contract, agreement, or the internal labor schedule of the company. Work performed must be within the scope of the employee's job description.

Employees subject to the non-fixed workday regime must be provided with additional annual paid vacation[69] (duration determined by collective agreement or internal labor schedule of the organization, but not less than 3 calendar days) or, upon written consent of the employee, this additional paid vacation time may be paid out instead of taken.[70] Employers must keep track of their employees' time.

Shift work

Shift work is another option available under the Labor Code when industrial processes exceed the permissible duration of a workday, or when employers seek to make the most efficient use of equipment or to increase output or services rendered.[71] In such instances, work in two, three, or four shifts is permissible.

Employees perform their work during established working hours according to a shift schedule. Two consecutive shifts are not permissible. Shift duration is limited in the presence of harmful or dangerous conditions; eight hours is the maximum shift length for employees with a 36-hour workweek, and six hours is the maximum shift for employees with a maximum 30-hour workweek.[72] Employers must consider the opinion of the employees' representative body when drafting shift schedules, which, as a rule, supplements the collective contract. Shift schedules must be brought to the employees' notice one month prior to their implementation.

Vacations

Employees must be provided with annual vacations subject to preservation of their position and average earnings. The duration of annual basic paid vacation in Russia is 28 calendar days.[73]

Additional annual paid vacation is afforded to employees engaged in harmful or dangerous work,[74] non-fixed workdays, employment in the Extreme North regions and other hardship districts, as well as in other cases stipulated by federal laws.[75]

Companies may, depending on their industrial and financial opportunities, establish additional vacation time for their employees on an independent basis, unless otherwise

[69] Labor Code, Article 119.
[70] Labor Code, Article 152.
[71] Labor Code, Article 103.
[72] Labor Code, Article 94.
[73] Labor Code, Article 115.
[74] Such work includes: underground mining and open mining in cut- and open-cast mines, in zones of radioactive contamination, other work involving the unavoidable influence of harmful physical, chemical, biological, or other factors. Labor Code, Article 117.
[75] Labor Code, Article 116.

stipulated by federal laws. The procedure and conditions for granting such vacation must be determined by collective agreements or local normative acts.

Employees are eligible to use leave after six months of employment, unless the parties agree to earlier eligibility. Certain groups must be granted earlier leave upon request. These include women, before or directly after maternity leave, employees under eighteen years old, employees with an adopted child (or children) under three months of age, and in other cases stipulated by federal laws. After the first year, leave may be taken at any time, pursuant to the company's established schedule.[76] The leave schedule is determined annually and must be approved by the employer at least two weeks before the start of the year for which the schedule applies. The leave schedule is obligatory for both the employer and the employee. Employees must be notified of their vacation time at least two weeks prior to its beginning.[77] In calculating vacation time, non-working holidays that fall within the period of leave are not included and are not paid.[78]

Annual paid vacation must be prolonged due to the temporary disability of an employee, the performance of state duties during leave, and in other cases stipulated by laws, or the local normative acts of the organization. An employee may postpone vacation if not duly paid or if the employee is not duly notified (at least two weeks prior). An employer may postpone an employee's vacation, with the employee's consent, if the timing would negatively impact the company's operations. Postponed leave must be taken by the end of the year following year in which it was granted.

The Labor Code prohibits employers from refusing to grant employees annual paid vacation two years in succession and from refusing to grant annual paid vacation to employees under eighteen years old and those involved with harmful and/or dangerous work.[79] The parties may agree to divide annual paid vacation into parts, with at least one part that is 14 calendar days or longer. Remaining parts may be shorter in duration, however, multiple vacations of short duration should be avoided, as the length of vacations should be long enough for an employee to adequately recuperate.

Employers may call employees back to work prematurely from their vacation only with their consent. The Labor Code does not stipulate the form of such consent, however, it is advisable to obtain the employee's written consent. In such an instance, the remaining leave should be granted at the employee's time preference, within the current working year or joined to vacation to be taken during the next working year. Employees under eighteen years old, pregnant women, and employees involved with harmful and/or dangerous working conditions may not be called back to work from their vacation.[80]

By written application, employees may request that their vacation days in excess of 28 calendar days be paid out. The Labor Code does not permit this practice, however, for pregnant women, employees under eighteen years old, or those engaged in hard labor or work with harmful and/or dangerous working conditions.[81]

[76] Labor Code, Article 122.
[77] Labor Code, Article 123.
[78] Labor Code, Article 120.
[79] Labor Code, Article 124.
[80] Labor Code, Article 125.
[81] Labor Code, Article 126.

Upon dismissal, employees must be compensated for all unused vacation time. Employees may request in writing that they be provided with the unused vacation before their dismissal, except for cases of dismissal for guilty actions. In such cases, the last day of vacation is considered the day of dismissal. This is also possible when an employee is dismissed in connection with an expired employment agreement. In such cases, when the vacation completely or partially falls beyond the limits of the agreement, the last day of vacation is considered the day of dismissal.

An employee taking leave followed by dismissal upon cancellation of an employment agreement on his/her own initiative has the right to withdraw his/her application for cancellation before the first day of leave, unless another employee has been transferred to his/her place.[82]

Unpaid leave is available for family and other valid reasons, pursuant to an employee's written application. The duration for such leave is determined by agreement of the parties.[83]

Termination

There are three ways to terminate an employment agreement: 1) by agreement of the parties at any time;[84] 2) at the initiative of one of the parties to the employment agreement, i.e. employee[85] or employer;[86] or 3) due to the impossibility to continue the labor relationship as a result of various changes in circumstance, including the following: expiration of a definite term employment agreement,[87] employee's consent to move to a new employer or to an elective post,[88] an employee's refusal to continue work due to change of owner of the organization's property, or its reorganization,[89] change of essential conditions of the labor contract,[90] refusal to transfer to another position based on health conditions that are supported by a medical certificate, refusal to transfer due to relocation of the employer,[91] force majeure,[92] violation of the law in concluding the agreement, and where continued work is impossible.[93]

Termination: Employee's Initiative

An employee has the right to cancel an employment agreement by providing two weeks' written notice to the employer. The notice period may be shortened if termination is conducted by agreement of the parties.

If the employee's application to terminate at his/her own initiative is due to the impossibility to continue work for various reasons such as entering an educational institution, retirement, or in the event of proved infringement by the employer of laws

[82] Labor Code, Article 127.
[83] Labor Code, Article 128.
[84] Labor Code, Article 78.
[85] Labor Code, Article 80.
[86] Labor Code, Article 81.
[87] Labor Code, Article 79.
[88] Labor Code, Article 72.
[89] Labor Code, Article 75.
[90] Labor Code, Article 73.
[91] Labor Code, Article 72.
[92] Labor Code, Article 83.
[93] Labor Code, Article 84.

and other normative legal acts, the employer must terminate the employment agreement within the period specified in the employee's application.

Until the notice period expires, the employee has the right to recall his/her application for termination. If this occurs, the employee will not be dismissed, unless another employee has received a written offer to take the position, and such new employee can not be refused employment pursuant to the Labor Code and other federal laws (i.e. transfer of the employee from another company).

Upon expiration of the notice period, the employee has the right to stop working. On the employee's last working day, the employer must return the employee's labor book, other documents related to work, if requested in writing by the employee, and conclude final settlements with him/her. If the employee does not insist upon termination and the agreement is not terminated upon expiration of the notice period, it is considered still valid.

Termination: Employer's Initiative

Termination at the employer's initiative is generally prohibited during an employee's temporary disability or leave. The Labor Code establishes the following grounds for termination at other times at the employer's initiative:

1) Liquidation of the organization or termination of the activity of a physical person/employer;[94]
2) Reduction in number or staff;
3) Unfitness of the employee due to:
    a. Health conditions, supported by a medical certificate,
    b. Inadequate qualification, proven by test results;
4) Change of the owner of the organization's property (with respect to the head of the organization, his deputies and chief accountant);
5) Employee's repeated non-performance of labor duties despite disciplinary sanctions (warning and reprimand);
6) Employee's single gross violation involving:
    a. Absence from work (unexcused for more than 4 consecutive hours during a work day),
    b. Alcoholic, narcotic or other intoxication at work (including coming to work in such state),
    c. Divulgence of a legally protected secret (state, commercial, official or other), which became known to the employee through his/her labor duties,
    d. Workplace theft, misappropriation, intentional destruction or damage to property subject to an enforced court judgment, or
    e. Breach of safety requirements with severe, or threat of severe, consequences (industrial accident, emergency or catastrophe);
7) Employee's illegal actions affecting material or commodity values, provided that such actions lead to losing employer's trust
8) Immoral acts of an employee working as a tutor;
9) When the company director (branch, representation), deputies or chief accountant adopts a decision threatening the safety of the company's property, requiring its illegal use, or resulting in other damage to company property;

[94] Employees may be terminated on this basis even during disability or leave.

10) For a single gross violation of the official duties of the head of an organization (branch, representative office) or his deputies;
11) Employee's submission of false documents or false information in concluding employment agreement;
12) Termination of employee's access to state secrets, if work performed demands such access;
13) Reasons stipulated by the labor contract signed by the head of the organization, members of its collegial executive body;
14) In other cases, stipulated by the Labor Code and other federal laws.

Fixed Term Employment Agreements

Employment agreements may be concluded for an indefinite period or for a fixed term not exceeding five years, unless another term is established by the Labor Code or other federal laws.

Fixed term employment agreements are permissible only under specific circumstances, some of which follow below. When such circumstances are not present, the result is an indefinite term agreement.

1. When an indefinite term employment agreement is impossible due to the type of work or performance conditions, unless otherwise provided by the Labor Code or other federal laws;
2. To replace an employee who is absent for specific period of time in order to retain his/her place of work in accordance with the law;
3. For temporary (up to two months) or seasonal employment;
4. For transfer to Extreme North regions and similar hardship regions;
5. For seasonal work to prevent and rectify accidents, catastrophes, epidemics, epizootics*;*
6. In small businesses of up to 40 employees (up to 25 for retail trade and service organizations) as well as where employer is a physical person;
7. For employees sent to work abroad;
8. For extraordinary activity of the organization (reconstruction, erection, start-up and adjustment and other operations), and temporary (up to one year) increased production or volume of services;
9. In organizations created for a specific period of time or for performance of a specific task, which is known in advance;
10. For employees hired for performance of a specific task, when completion is not determinable in advance;
11. For work directly connected with the employee's practice and professional training;
12. For managers, deputy managers and chief accountants of organizations regardless of their legal form of organization or form of ownership;
13. For employees directed to temporary work by employment services, as well as for the performance of public works;
14. In other cases provided by federal laws.[95]

Indefinite Term Employment Agreements

[95] Labor Code, Article 59.

Employment agreements are indefinite: 1) where their term is not stipulated, 2) where a fixed term agreement is not terminated by the parties due to expiration of its term and work continues, and 3) as stated above, where an agreement is concluded for a fixed term without appropriate justification. Russian labor legislation prohibits the conclusion of fixed term agreements for the purpose of avoiding the provision of benefits afforded to indefinite term employees.

VII. Secondment Contracts, Direct Employment and Body Shops

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

Companies with expatriate workforces in Russia must consider the most appropriate manner for structuring such employment. Expatriates may be seconded, which entails continued employment by an offshore entity with the subsequent provision of the expat under a secondment agreement to the entity with operations in Russia. In the alternative, expats may be directly employed by a Russian legal entity or a foreign legal entity with a representative office in Russia. Which approach to take depends on an evaluation of the taxation and human resource issues involved.

A seconding company's only responsibility is to provide staff to the receiving company. The seconding company is not involved in a secondee's work and is not responsible for its quality. The secondment fee paid by the receiving company may cover a secondee's salary and certain additional expenses, such as accommodation and business trips. Not all expenses may be covered by the fee. The receiving company does not pay for services provided, but rather for the time of the seconded staff. Secondment fee payments and other amounts paid in accordance with secondment agreements should be accompanied by an act issued by the receiving company stating that the staff was provided by the seconding company, not that the payment is for the provision of services.

Russian tax laws contain specific rules for secondment, in accordance with which secondment is not deemed to form a permanent taxable presence for the sending entity and the costs of secondment are deductible for the receiving company. Income received by the seconding company pursuant to a secondment agreement is treated as passive income and is subject to tax exemption. The seconding company is not required to pay payroll taxes on amounts received by the expat as pay, in accordance with an agreement with the Russian entity. The receiving company must pay value added tax on the secondment fee.

These benefits, however, apply only to corporate profit taxes. There is no tax relief with respect to the payment of personal income tax and social taxes, however, in a secondment arrangement, taxes may be collected through tax returns and self-assessment. There are no personal income tax withholding obligations. Beginning in 2004, expatriate employees seconded to Russian companies who spend more than 183 days in Russia and are therefore Russian tax residents, must not only file returns with the Russian tax authorities, but also pay their own personal income tax to the Russian Government from their own Russian bank account.

There are also human resource benefits with regard to secondment of foreign personnel. For instance, secondment is beneficial when contemplating confidentiality of labor relations, retaining home country benefits, continuity of service and maintaining an

employee's seniority with the seconding company. In addition, local human resource documentation is not required. Noteworthy, however, is that Russian labor law is applicable in substance to secondment arrangements. According to Russian labor law, a Russian receiving company utilizing the seconded employee will be treated as the employer and a full employment relationship under Russian laws will follow. Payments to seconded employees may be continued in hard currency. The entity with operations in Russia using seconded personnel is responsible for obtaining visas and work permits for its foreign seconded employees.

Direct employment of expatriates by the company with operations in Russia allows for salary to be fully deductible from profits tax, if the employment agreement is properly structured. An added expense to the employer is the requirement to pay the unified social tax and other payroll taxes, however, in direct employment, VAT is not applied. A direct employer is obligated to withhold personal income tax.

From a human resource perspective, confidentiality issues are greater with direct employment, and the employee may sacrifice certain home country benefits, continuity of service and seniority. Direct employers must maintain local human resource documentation and Russian labor law applies to direct employment in both form and substance. Payments in rubles may be required, with potential practical difficulty in repatriating earnings.

Body Shops

Russian job-contracting firms, known as "body shops" are companies that lease personnel, and may be used to recruit local professionals and contract them out to foreign companies. Foreign companies may use body shops in order to meet Russian content requirements for man-hours under the Production Sharing Agreement regimes. As a general rule, the foreign company makes payments to a local Russian company employing local professionals. An employment agreement is concluded between the employee and the local Russian company; therefore, the Russian company withholds all taxes. Russian employees perform work at the instruction of the foreign companies.

VIII. Extreme North Considerations

Presented by Denis Marchenko, senior associate attorney in the Yuzhno-Sakhalinsk branch office of Russin & Vecchi. Mr. Marchenko has been advising clients on various issues of Russian law since 2001, specializing in corporate formation and labor matters. Mr. Marchenko has worked on the preparation of legal opinions related to the prevention and liquidation of emergency situations for Exxon Neftegas Limited and various issues related to construction of pipelines by Sakhalin Energy Investment Company. He has also provided legal advice on issues pertaining to real estate leases on Sakhalin. Mr. Marchenko graduated from the International Institute of Economics and Law (Moscow, Russia) in 1997.

In addition to the numerous guarantees and benefits provided by the Labor Code, some of which are set forth above, employees working in certain regions of Russia are entitled to special "Extreme North" benefits as a result of working under hardship conditions. Benefits exist for regions that are approaching the Extreme North and for actual Extreme North areas.

Extreme North Benefits Related to Employee Salaries

The Labor Code requires salaries of employees working in Extreme North areas and areas approaching the Extreme North to include amounts determined by area coefficients and step increases.[96] For example, for areas in the north of Sakhalin Island, the maximum amount of area coefficients and step increases amount to 160% above an employee's basic salary. The Labor Code defers to separate federal laws to provide the specific amount of such coefficients and increases and the procedure for their payment, however, such federal laws have not been adopted to date.[97] In the absence of such laws, various, often contradictory, regulations of the former USSR and subjects of the Russian Federation continue to regulate these issues.

Area Coefficients

An area coefficient is the amount by which the base salary of an employee working in a location approaching the Extreme North or in the actual Extreme North is multiplied in order to obtain the increased salary rate for that particular region. Coefficients differ depending on their region. One subject region of the Russian Federation may have several coefficient rates applied in its various geographical areas.

For example, there are two rates of coefficients on Sakhalin Island. A coefficient of 1.8 is applied in the Nogliki and Okha districts, which are actual Extreme North areas, and a coefficient of 1.6 is applied in the remaining districts of the Island including the city of Yuzhno-Sakhalinsk, which are areas approaching the Extreme North.[98] As a result, in Nogliki and Okha districts, as a result of application of the area coefficient, an employee is entitled to his base salary plus 80% of his base salary, and in the remaining districts of the Island, an employee is entitled to his base salary plus 60% of the base salary. Clearly, these increases are significant and should be considered when determining employee base salaries.

Step Increases

In addition to area coefficients, employees working in Extreme North areas and areas approaching the Extreme North are entitled to step increases, or increases over time, to their basic salary. The amount of step increases also differs depending on the region of application.

By way of example, in Nogliki and Okha districts, which are actual Extreme North areas, step increases reach their maximum at 80% of the basic salary.[99] In the remaining districts of the Island, which are areas approaching the Extreme North, step increases reach their maximum at 50% of the basic salary.[100] These increases are separate from and in addition to the area coefficients described above.

Step increases are granted over time, and in the Extreme North reach their maximum after five years of employment. The schedule for granting increases is different in Extreme North areas and in areas approaching the Extreme North. For the first three

[96] Labor Code, Article 315.
[97] Labor Code, Articles 316 and 317.
[98] Decision of the Executive Committee of the Sakhalin Regional Council of People's Deputies "On Area Coefficients to Salary of Workers and Office Employees" No.130 dated April 24, 1991, Section 1.
[99] Instruction "On Procedure for Providing Social Guarantees and Compensations to Persons Working and Residing in Extreme North and Areas Approaching Extreme North According to Effective Normative Acts," Section 16, Subsection (b), introduced by the Order of the Russian Federation Ministry of Labor No. 2 dated November 22, 1990 ("Ministry of Labor Instruction")
[100] Ministry of Labor Instruction, Section 16, Subsection (v),

years of work in Nogliki and Okha districts, the employer must increase the employee's salary by 10% every six months. After both the fourth and fifth years of work in these areas, the employer must increase the employee's salary by an additional 10% each.[101] In all the remaining districts of Sakhalin an employee's right to the step increase arises in one-year increments, 10% for each year of work in areas approaching the Extreme North until the full benefit of 50% is achieved.[102]

Employees under thirty years of age, who were residing in either Extreme North areas or areas approaching the Extreme North for at least five years before their employment and who are employed for the first time are entitled to the full step increase from the first day of their employment.[103]

Additional Vacation

Employees working in Extreme North areas and areas approaching the Extreme North are entitled to additional paid vacation beyond the standard 28-calendar day vacation afforded to all employees in Russia under the Labor Code. Such additional vacation is 24 calendar days in Extreme North areas and 16 calendar days in areas approaching the Extreme North,[104] resulting in 52 and 44 calendar days, respectively.

Travel Expenses

An employee working in Extreme North areas or in areas approaching the Extreme North is entitled, every two years, to round-trip company funded vacation travel within the territory of Russia and to 30 kilograms of luggage transportation. Employers must also pay the travel expenses of those members of the employee's family who do not work. An employee's right for company funded vacation travel arises after 12 months of work and lapses if not exercised within 2 years, from the time which vacation was due.[105]

Employees from other parts of Russia and foreign employees, as well as members of their families, are also entitled to company funded travel to the location of their new employment within Extreme North areas and areas approaching the Extreme North and to luggage transportation of up to 5 tons per family. Luggage transportation for these purposes is limited to the railroad tariffs. Furthermore, employees traveling to these regions for new employment are also entitled to compensation in the amount of a one time double monthly salary payment, and a one time half monthly salary payment for each family member traveling with such employee. Additionally, such employees are entitled to a 7-day paid vacation for settling.[106]

Upon termination of a labor agreement for any reason (including the employee's death), with the exception of dismissal for misconduct, the employee and family members are entitled to company funded travel to their new place of residence located in another part

[101] Ministry of Labor Instruction, Section 16, Subsection (b),
[102] Ministry of Labor Instruction, Section 16, Subsection (b),
[103] Russian Federation Law "On Guarantees and Compensations for Persons Working and Residing in Extreme North Areas and Areas Approaching Extreme North." No. 4520-1, dated February 19, 1993 ("Law No. 4520-1"), Article 11, part 2.
[104] Labor Code, Article 321.
[105] Labor Code, Article 325.
[106] Labor Code, Article 326.

of Russia and to transportation of up to 5 tons of luggage per family. Luggage transportation for these purposes must also be paid within railroad tariffs.[107]

Accommodation

An employee, working in areas approaching the Extreme North and Extreme North areas is entitled to company funded accommodation. If a company cannot provide such accommodation, it must reimburse the employee's expenses related to lease or purchase of accommodation.[108]

Other Extreme North Benefits

There are other Extreme North benefits including, but not limited to, the following:

Women working in Extreme North areas and areas approaching the Extreme North are entitled to a 36-hour workweek. This is four hours less than the 40-hour standard workweek required for all employees under the Labor Code. Salaries for these women may not be less than salaries paid for a full 40-hour workweek.[109]

Employees working in Extreme North areas and areas approaching the Extreme North are entitled to one non-paid day off per month if they have children under the age of 16. Such day off must be provided only for one of the parents.[110]

Employees in these regions are entitled to use unscheduled annual vacation to accompany a child under 18 years old entering an educational establishment located in another area.[111]

Employees in these regions who are terminated due to liquidation of the employing company or reduction in staff, are entitled to receipt of their monthly salary while they are looking for a new job, for a time period not to exceed six months from the date of their firing.[112] This is three months more than the standard three-month period provided for all employees under the Labor Code.

IX. Obtaining Visas

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi, and Denis Marchenko, senior associate attorney in the Yuzhno-Sakhalinsk branch office of Russin & Vecchi.

In order to enter and subsequently exit the Russian Federation, whether for a short business trip or for an extended period of employment, a foreign citizen must obtain a visa. Federal law regulates the procedure for entering and exiting the Russian

[107] Labor Code, Article 326.
[108] Law No. 4520-1, Article 18.
[109] Labor Code, Article 320.
[110] Labor Code, Article 319.
[111] Law No. 4520-1, Article 18.
[112] Labor Code, Article 320.

Federation.[113] The procedure for issuing visas, and their extension, renewal and annulment is set forth by governmental regulation.[114]

Visas are obtained on the basis of an invitation, formalized in accordance with Russian legislation, in a procedure established by the Russian government. A territorial body of the Ministry of Internal Affairs (usually the local office of the Passport-Visa Service of Internal Affairs Department) issues such invitations, upon application of a legal entity registered with it for this purposes. At the present time, Russian legislation and the internal acts of the RF Ministry of Internal Affairs do not provide a detailed procedure for the registration of legal entities for this purpose.

Depending on a foreign citizen's purpose for traveling to Russia, the following types of visas may be issued: diplomatic, official, ordinary, transit, and temporary residence. Most foreigners coming to Russia for business purposes will obtain an ordinary visa, which are further subdivided into private, business, tourist, student, work, humanitarian and refugee visas.

Visas are also categorized by their term of validity and the frequency with which they permit one to enter and leave the country. There are single, double, and multiple entry/exit visas. Visas for up to three months may be issued as single or double entry visas. Visas for a period of over three months may also be issued as multiple entry visas.

Ordinary business visas are issued to foreign citizens coming to the Russian Federation for business purposes. They may be single or double entry for up to three months, and in some cases, they may be multiple entry for up to one year. In this case, continuous stay of the foreign citizen on the territory of the Russian Federation cannot be for more than 180 days.[115].

In order to obtain an ordinary business visa on behalf of a foreigner, a company must first register with the Passport-Visa Service of the Ministry of Internal Affairs, and then apply to Passport-Visa Service with its request for an official invitation for a particular foreigner.[116] Only those companies that have undergone prior registration with these authorities can apply for the issuance of a visa invitation. The first stage is generally accomplished within five business days from filing all of the necessary documents with

[113] Federal Law No. 114-FZ, "On the Procedure for Entering the Russian Federation and Exiting the Russian Federation," August 15, 1996.

[114] Governmental Regulation No. 335, June 9, 2003. State bodies authorized to issue, extend, renew or annul visas include:

- Embassies or consular offices of the Russian Federation, which issue all types of visas, annul and renew visas, except transit visas with code TP1.
- RF Ministry of Foreign Affairs, its representative offices on the territory of the Russian Federation, which issue and extend visas, annul and renew diplomatic and official visas.
- Representative offices of the RF Ministry of Foreign Affairs located at entry points on the border of the Russian Federation, which issue in exceptional cases with permission from the RF Ministry of Foreign Affairs, visas of all types, and extend, annul and renew visas.
- RF Ministry of Internal Affairs and its territorial bodies, which issue transit visas with code TP1, extend, renew and annul visas, except diplomatic and official visas.
- Border control subdivisions at entry points on the border of the Russian Federation, which annul visas, and, in the absence of a representative office of the RF Ministry of Foreign Affairs, in exceptional cases extend visas for a term necessary for exit from the Russian Federation.

[115] Governmental Regulation No. 335, Article II, para. 29, June 9, 2003.

[116] Sub-section "b" of Section 1 of Article 25 of the Federal Law of the Russian Federation "On Procedure for Leaving the Russian Federation and Entering the Russian Federation" No. 114-FZ dated August 15, 1996.

the Passport-Visa Service. These documents include: the respective application, the applicant's foundation and registration documents (Certificates on State and Tax Registration), documents certifying the appointment of the head of the entity, the work permit for the head of the entity (assuming this person is a foreign citizen), and if the invitation will be issued for performing labor activity, the company's consent to recruit and employ foreign employees (not necessary for an ordinary business visa).

The Passport-Visa Service considers these documents, and if it approves the application, issues a corresponding certificate and enters information on the applicant into a computer database.

The entity may then apply to the Passport-Visa Service for issuance of an invitation for a particular foreigner. At this stage, the head or authorized representative of the entity should present the following documents to the Passport-Visa Service: passport, power of attorney (if person submitting application materials is an authorized person and not the head of the entity), the respective application, a guarantee letter assuring assumption of financial, medical, and residential obligations on behalf of invitees, the company's consent to recruit and employ foreign employees and work permits for foreign employees (if invitees will perform labor activity), and receipts evidencing payment of relevant state fees.

Within 30 days of filing these documents, the Passport-Visa Service must consider the application and verify whether grounds exist pursuant to Russian legislation for prohibiting the foreign citizen's entry into Russia. If there is no basis for prohibiting entry, the Passport-Visa Service issues the respective invitation and conveys it to the entity's authorized representative.

Ordinary work visas are issued for up to three months to foreigners who intend to work in Russia. Their duration may be extended by the territorial body of the RF Ministry of Internal Affairs at the place of the foreigner's registration, by issuance of a multiple entry visa for the term of the employment (or service) agreement, not exceeding one year.[117]
A work permit must be obtained before the work visa.
As a general rule, in exceptional cases the duration of a visa may be extended for up to ten days. In order to obtain an extension, the foreigner must file an application with the authorized state body at the place of his/her registration (or factual stay), supported by documents that justify the need for an extension. The authorized state body makes a decision regarding visa extension on the basis of the documents submitted, including a petition from the organization, Russian citizen, or foreign citizen permanently residing in Russia that obtained the invitation for the foreigner's visa.

Registering Foreign Personnel on Sakhalin

Within three business days after arrival in Russia, foreigners must register with the local body of the Passport-Visa Service of the Ministry of Internal Affairs.[118] The Passport-Visa Service registers foreigners on the basis of a written application submitted by the foreign citizen or the inviting entity.[119] In addition to the application, the foreign citizen or inviting entity must present the foreign citizen's passport and migration card.[120]

[117] Governmental Regulation No. 335, Article II, para. 35, June 9, 2003.
[118] Federal Law of the Russian Federation "On the Legal Status of Foreign Citizens in the Russian Federation," No. 115-FZ, July 25, 2002, Article 20, Section 1 ("Law on Legal Status").
[119] Law on Legal Status, Article 21, Section 2.
[120] Law on Legal Status, Article 23.

Foreigners must register in the region where they reside. Should the foreigner move to another part of Russia, he/she is obligated to register with the Passport-Visa Service at the new place of residence within three business days.[121]

Violation of registration rules is an administrative offense and foreigners may be fined in the amount of five to ten times the minimum monthly wage ($15-$30) and may be subject to deportation from Russia.[122] If a foreign citizen commits two administrative offenses within three years, the Russian authorities may prohibit his/her entry into Russia.[123]

X. Annual Quotas for Foreign Employees and the Sakhalin Administration

Presented by Denis Marchenko, senior associate attorney in the Yuzhno-Sakhalinsk branch office of Russin & Vecchi LLP.

The employment of foreign citizens in Russia is limited each year by an annual quota system. The Russian Government determines quotas for each calendar year, based on proposals from the executive bodies of subjects of the Russian Federation. These proposals must be based on a preference for the use of national labor resources, and must take into consideration the condition of the labor market, the demographic situation within the subject federation, and the subject's capabilities with respect to accommodating foreign citizens.[124]

The annual quota for 2003 was established in the amount of 530,000 foreign employees.[125] President Putin expressed his dissatisfaction with this amount due to the fact that the actual amount of foreign employees working in Russia currently exceeds 10 million, and establishing such a nominal quota would likely lead to further illegal use of foreign labor forces in Russia. Nonetheless, the annual quota established for 2004 is 213,000 foreign employees,[126] approximately half that of the previous year.

Regional authorities play a significant role in the process of establishing the quota, as most stages of this process fall within the competence of subjects of the Russian Federation. The executive bodies of each subject are charged with creating inter-departmental commissions ("Commission"), which coordinate the activities of all regional bodies involved in the process.[127] In the Sakhalin Region, such a Commission was formed on October 8, 2003 and is called the Commission on Recruitment and Employment of Foreign Employees of the Sakhalin Region Administration.

Employers also play a significant role in this process, as the decision regarding quota amounts begins with a review of employer input pertaining to their need for foreign

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[121] Law on Legal Status, Article 21, Section 3.
[122] Russian Federation Code on Administrative Offences No. 195-FZ, December 30, 2001, Article 18.8.
[123] Law on Legal Status, Article 7, Section 7.
[124] Law on Legal Status, Article 18, Section 1.
[125] Enactment No. 782 of the Russian Federation Government "On Approval of the Quota for Issuing Invitations for Entering the Russian Federation by Foreign Citizens for Employment Purposes," October 30, 2002, Section 1.
[126] Enactment No. 658 of the Russian Federation Government "On Approval for 2004 of the Quota for Issuing Invitations for Entering the Russian Federation by Foreign Citizens for Employment Purposes," November 3, 2003.
[127] Enactment No. 23 of the Russian Federation Ministry for Labor and Social Development "On Approval of the Procedure for Preparation and Consideration of Proposals on Determining the Quota for Issuing Invitations for Entering the Russian Federation for Performing Labor Activity to Foreign Citizens," April 29, 2003, Section 1 ("Quota Enactment").

employees. Employers planning to recruit foreign citizens should file applications regarding the necessity of hiring foreign employees for vacant and newly created positions with the Commission before June 1 of the year preceding the year, for which the quota is being established.[128]

Upon receipt of all employers' applications, the Commission forwards them for consideration to the respective territorial executive bodies, the Russian Federation Ministry of Internal Affairs, and the territorial employment bodies of the Russian Federation Ministry of Labor.[129] With regard to territorial executive bodies, for example, if an applicant is involved in construction, its application will be forwarded to an executive body regulating construction.

These bodies analyze the applications within their competence and return them to the Commission with their comments regarding the reasonability of the number of foreign workers requested by employers and their own proposals for quota amounts.[130]

The Commission decides on a final quota amount for the respective subject of the Russian Federation. This decision must be reached based on information received from the respective executive bodies, and must take into account the opinion of employer associations, professional unions, and the principle of priority of use of national labor resources.[131] The Commission then forwards its final decision to the Governor of the subject or to the Governor's deputy for signature and forwarding to the Russian Federation Ministry of Labor for consideration.[132]

The decisions received from all Russian subjects are then considered at the federal level and the Russian Government reaches a final decision regarding the amount of the annual quota for foreign employees.

XI. Procedures for Obtaining Work Permits

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

Russian legislation strictly regulates the manner in which foreign employees are engaged to work in the Russian Federation. Pursuant to federal law, an employer seeking to employ foreigners must first obtain: 1) consent from the Ministry of Internal Affairs or its territorial body[133] to recruit and employ foreign workers, and 2) an individual work permit on behalf of each foreign employee before the employee engages in labor activity in Russia.[134] Both are valid for a maximum of one year.

The Law on Legal Status defines "labor activity" in this context as a foreign citizen's work in Russia pursuant to a labor contract or a civil contract for rendering services or performing work. The same procedures described in this article also apply to Russian entities utilizing foreign employees pursuant to secondment agreements, even though

[128] Quota Enactment, Section 3.
[129] Quota Enactment, Section 4.
[130] Quota Enactment, Section 5.
[131] Quota Enactment, Section 8.
[132] Quota Enactment, Section 9.
[133] On Sakhalin, this is the Migration Department of Internal Affairs Department of Sakhalin Region.
[134] Federal Law On the Legal Status of Foreign Citizens in the Russian Federation of July 25, 2002 No. 115-FZ ("Law on Legal Status").

the direct labor contract in such cases is generally between the foreign entity and the foreign employee.

The law does not contemplate an easier procedure for obtaining work permits for foreign citizens employed as directors of companies with foreign investments, as was the case under prior legislation, nor does it contain any provisions on the employment of foreign employees by representative offices of foreign companies. At a recent forum held by the American Chamber of Commerce in Moscow, Russian government officials stated that any foreign employee listed in the employment roster of a Russian legal entity, including the general director, even if not located in Russia full time, must obtain a work permit.

Thus, the general procedure established by the Law on Legal Status for obtaining work permits applies to all categories of foreign citizens, with the following, limited exceptions: 1) foreigners with permanent or temporary resident status in Russia who plan to reside in Russia for six months out of each of three consecutive years. For employers, such status may be beneficial as it replaces the need for consents to employ such employees and application for individual work permits each year; 2) foreign employees performing assembly works, service and guarantee maintenance, or post-guarantee repair of technical equipment previously imported into Russia by their company; 3) employees of diplomatic representations, journalists, teachers, and foreign students studying in Russia who work part time.[135]

The first step in obtaining a work permit is to obtain consent to recruit and employ foreigners. In this procedure, first the territorial body of the Ministry of Labor verifies the expediency and necessity of a Russian legal entity's recruitment and employment of foreigners, considering the preference to employ Russian citizens. The Ministry of Labor also considers the Employment Center's proposal on the expediency of recruitment and employment of foreigners, which takes into account the availability of registered Russian candidates for the positions. Subsequently, the regional and federal offices of the Migration Department consider the Ministry of Labor decision and the application materials. Finally, the Department of External Labor Migration of the RF Federal Migration Service issues consent to recruit and employ foreigners.

The Sakhalin Region Migration Department currently requires submission of the following documents in order to obtain consent to recruit and employ foreigners: 1) Application; 2) Decision of Employment Department; 3) Model Labor Agreement; 4) Employer's certificate on state registration; 5) Application to obtain a petition to the Department of External Labor Migration, Federal Migration Service, Ministry of Internal Affairs to issue consent; and 6) Receipt for payment of state fee.

The same documents and a separate application must be filed with the Federal Migration Service.

Once consent to recruit and employ foreigners has been received, an application for work permits may be filed. The Ministry of Internal Affairs issues work permits to the employer, based on the employer's application on behalf of the employee. Although issuance of a work permit is intended to be subject to the employer's deposit of funds sufficient to arrange for the departure of the foreign worker from Russia, to date the implementing legislation for this procedure has yet to be passed.

[135] Law on Legal Status, Article 13, para. 4,

The work permit application should include the following documents:

1. A copy of valid identification of the employee with a remaining term of validity of at least six months;
2. The original consent to recruit and employ foreign employees;
3. A color photograph of the employee (30x40 mm);
4. Copies of documents confirming his/her qualifications in cases required by law;
5. For an individual entrepreneur, a copy of the registration certificate;
6. Copies of documents allowing access to territories, organizations and objects with special status, if the foreigner is planning to work at such locations, and
7. Receipt showing payment of state fee in the amount of 1000 Rubles (approximately 30 USD) for each employee.

The territorial department of internal affairs must consider an application within 30 business days from the date of its filing with all of the necessary documents. It may refuse to issue a work permit if it determines that information in the application is false or that the employee poses a threat based on activities, as set forth by law, such as advocating for violent constitutional change in Russia, financing terrorist acts, testing positive for HIV, etc.[136] If the application is rejected, the territorial department of internal affairs must indicate the reason for rejection.

Upon receipt of a work permit, the employer must transfer it to the respective employee. Regulations have recently been introduced, which allow an employer to apply for the revocation of an employee's work permit if the foreign employee violates the terms and conditions of employment.[137]

XII. Personal Income Tax Considerations

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

Taxation of expatriate employees in Russia is regulated by Russian legislation. However, if the expatriate's country of residence has a double taxation treaty with Russia, the provisions of the double taxation treaty should prevail.

The following physical persons (Russian citizens, foreign citizens and persons without citizenship) are considered taxpayers of personal income tax pursuant to Russian tax legislation:[138]

- residents of the RF for tax purposes: defined as physical persons who spend more than 183 days within the territory of the RF within a calendar year,[139] and
- non-residents of the RF for tax purposes: defined as physical persons who spend less than 183 days in the territory of the RF within a calendar year, who receive income from sources in the RF

[136] Law on Legal Status, Article 7.
[137] Law on Legal Status, Article 32, para. 2,
[138] RF Tax Code, Article 207. In accordance with Article 2, Item 1 of the Law on the Legal Status of Foreign Citizens in the Russian Federation, a foreign citizen is defined as a physical person, who is not a citizen of the RF and has proof of citizenship of a foreign country.
[139] Methodical Recommendations, approved by Order No. BG-3-08/415 of the Ministry of Taxes and Levies of the Russian Federation, November 29, 2000, last amended on March 5, 2001, Article 3.

The tax rate for residents is 13% on income received both from sources in and outside the RF. The tax rate for non-residents is 30% on income received from sources in the RF. The object of taxation for non-residents is only income received from sources in the RF.

Income received from sources within the RF includes remuneration for the performance of labor or other obligations, work performed, service rendered and the performance of activity in the RF, as well as dividends and interest received from a Russian legal entity by both residents and non-residents.[140] Remuneration of directors of an organization, which is a Russian tax resident located in RF, is considered income received from sources in RF, irrespective of the place where management functions were performed and payment was made.[141]

Income received in the form of dividends is taxed at the rate of 6% for both Russian tax residents and non-residents.

Taxes are calculated in rubles; hard currency payments are converted at the RF Central Bank rate on the day received. The tax period for personal income tax is one calendar year.

If, in accordance with the labor contract concluded between an expatriate and his/her employer abroad, the employer is obligated to make personal income tax payments for the expatriate, these amounts should be included in the expatriate's taxable income.

A branch office of a foreign legal entity accredited in Russia is considered a tax withholding agent for the purpose of payment of personal income tax on behalf of expatriate employee taxpayers of this tax, and, as a result, is obligated to calculate, withhold and pay personal income tax from remuneration and dividends (if any) received by expatriates from a branch office, or as a result of their relations with a branch office.[142] A branch office must withhold expatriates' Russian personal income tax from their income at the moment of its actual payment to expatriates. A Russian branch office, as a tax-withholding agent, must provide expatriates' income data to the tax body at the place of its registration in Russia.[143]

Taxpayers who must file personal income tax declarations are listed in Articles 227 - 229 of the RF Tax Code, and include private entrepreneurs, notaries, as well as tax resident individuals who receive income from sources outside of the Russian Federation or other individuals who receive other income from which tax was not withheld by tax agents. Expatriates who are Russian tax residents and who receive salary and other compensation for work and/or services performed in the Russian Federation are considered as having income from sources in the Russian Federation[144] and the branch or representative office through which they are employed must withhold personal income tax from their salaries.[145]

[140] Article 208, Item 1 (Sub-Items 1 and 6) of the RF Tax Code.
[141] RF Tax Code, Article 208, Item 1.6.
[142] RF Tax Code, Articles 214 and 226.
[143] The specific accounting forms for tax withholding agents are attached to Order No. BG-3-08/379 of the RF Tax Ministry.
[144] RF Tax Code, Article 208, Item 1.6.
[145] RF Tax Code, Article 226.

Individuals, who are not required by law to file personal income tax declarations, have the right to file them with the tax authority at the place of the individual's residence (for foreigners at the place of their registration in the RF).[146]

Foreign citizens with a right to tax benefits in accordance with a treaty on avoidance of double taxation should file confirming documents with the Russian tax bodies including: proof of residence in the foreign country, a document confirming income received and tax paid in the foreign country, verified by the foreign tax body.[147] A Russian branch office may file the necessary documents on behalf of expatriates, as it will act as a tax-withholding agent.

XIII. Maritime Considerations: Oil Spill Prevention

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

The Russian Federation is a party to several multilateral international conventions related to oil pollution issues. These include: 1) The International Convention *Relating to Intervention on the High Seas in Cases of Oil Pollution Casualties* (Brussels, November 29, 1969)(recognizing the right of states to intervene in the open sea in the event of accidents or threatened accidents that could result in oil contamination of their coastlines, and incorporating a test for the adequacy of measures taken); 2) The International Convention *For the Prevention of Pollution from Ships* (November 2, 1973, as modified by the Protocol of 1978 relating thereto (except for Protocol of 1997)) (introducing strict rules for the prevention of oil contamination of the sea in Appendix I to the Convention); 3) The International Convention *On Civil Liability for Oil Pollution Damage* (Brussels, September 29, 1969, as amended by the protocol of 1992)(dealing with civil liability for oil pollution, establishing, *inter alia*, instances where liability is excluded and limited); and 4) The International Convention *On the Establishment of an International Fund for Compensation for Oil Pollution Damage* (Brussels, December 18, 1971, as amended by the protocol of 1992)(supplementing the International Convention *On Civil Liability for Oil Pollution Damage* (Brussels, September 29, 1969) and discussing the procedure and organization of the International Fund for compensating oil pollution damage within certain limits).

U.S. Secretary of Energy Spencer Abraham and Russian Energy Minister Igor Yusufov met in September 2003 to discuss energy issues of interest to both countries and to implement the oil spill prevention and response agreement the two countries developed over the past year. They signed the oil spill response protocol at the second U.S.-Russia Commercial Energy Summit.

The original proposal, signed in March 2003, recommended extensive mutual assistance from both countries in the areas of technology, logistics, training, regulatory

[146] RF Tax Code, Article 229, Item 2; Order of RF Ministry on Taxes and Levies No. BG-3-08/415. Specific procedures for filing personal income tax declarations by physical persons are detailed in the Instruction On Filling In Physical Persons' Tax Declaration (attached to Order No. BG-3-04/592 of the RF Ministry on Taxes and Levies); RF Tax Code, Article 229; and Methodical Recommendation on Application of Chapter 23 of the RF Tax Code (attached to Order No. BG-3-08/415 of the RF Ministry on Taxes and Levies). The forms of declarations are attached to Order No. BG-3-04/592 above (for physical person/non-residents the form of declaration is: 4-NDFL, and expatriate/residents of the RF, the form of declaration is: 3-NDFL).

[147] RF Tax Code, Article 232, Item 2.

issues and exchange programs. It also recognized their common commitment to environmentally sustainable development and transportation of oil.

The Russian Federation has already developed oil spill contingency plans for each of its regions, and has worked closely with local government officials on plans applicable to marine bodies from the Black and Caspian Seas to the Barents and Pacific coast. The U.S. has meanwhile developed similar response plans, employing cutting-edge technologies to clean up oil spills, and constantly updated and improved technologies to prevent oil spills. Under the auspices of the protocol, the U.S. and Russia will share ideas, information, technologies and methods in order to assist both countries in increasing the effectiveness of their oil spill regulation, prevention and response.

Russian legislation[148] requires organizations that have production facilities that are considered to be hazardous to have a plan with respect to the prevention and elimination of oil and petroleum products spills.[149] As part of such a plan, the organization must estimate the amount of resources necessary to clean up spills that may occur.[150]

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[148] Russian Federation Government Decree No. 613 "Concerning Urgent Measures on Prevention and Liquidation of Oil and Petroleum Products Emergency Spills," August 21, 2000 (modified by RF Government Decree No. 240, "On the Procedure for Organizing Measures for Oil and Petroleum Products Spills Prevention and Elimination within the Territory of the Russian Federation," April 15, 2002); and "Rules for Organizing Measures for Oil and Petroleum Products Spills Prevention and Elimination within the Territory of the Russian Federation."

[149] Such plan must include the following:

a) forecast of potential oil and petroleum products spills;
b) estimate of resources required for liquidation of emergency situations connected with an oil and petroleum products spills and an assessment of the site capabilities in liquidation tasks and the need to employ professional emergency rescue units;
c) resource organization scheme;
d) description and location of resources;
e) organization of control, communications and notification;
f) procedure for resource preparedness with indication of the organizations responsible for keeping them at an established level of readiness;
g) communication system linking spill liquidation participants;
h) priority actions for emergency situation alert;
i) technical aspects (geographic, navigation-hydrographic, hydrometeorology and other) of spill area that must be taken into account in organizing and conducting liquidation operations;
j) assurances of safety of the population and the provision of medical aid;
k) timetable for oil and petroleum products spills liquidation operations;
l) organization of logistic, engineering and financial support of oil and petroleum products spills liquidation operations.

[150] The following factors must be considered in arriving at such an estimate:

a) maximum potential spill volume;
b) area covered by the spill;
c) year the object (source) was placed in service and the year of its most recent major repairs;
d) maximum spill volume at the object;
e) physical-chemical properties of the spill;
f) effect of the location of the object on the rate of spread of oil and petroleum products to determine the possibility of their ingress into seas, rivers and inland ponds;
g) technical conditions (hydro meteorological, hydro geological and other) at the object's location;
h) capabilities of the object's available resources and also professional emergency rescue units stationed in the region (with an agreement in writing to participate in liquidation of oil and petroleum products spills);
i) availability of oil waste trans-shipment, storage and processing ranges;
j) transportation infrastructure in the area of a potential oil and petroleum products spill;
k) time of delivery of resources to the scene of the emergency situation;
l) time of localization of oil and petroleum products spill, which must not be more than 4 hours in the event of a water spill and 6 hours in the event of a land spill.

Various ministries of the Government must develop and approve lists of organizations responsible for the preparation of Oil Spill Response Plans ("OSRP").[151] Such lists, according to their sectoral affiliation, are approved by a federal executive body in agreement with the Ministry of the Russian Federation for Civil Defense Affairs, Emergency Situations and the Elimination of the Aftermath of Natural Disasters, the Ministry of Natural Resources of the Russian Federation, and with the Federal Mining and Industrial Inspectorate of Russia.

Organizations responsible for preparing OSRPs must form their own units for oil and petroleum products spills elimination, perform attestation procedures for these units in compliance with the legislation of the Russian Federation, equip them with special technical facilities and conclude contracts with professional emergency rescue services companies performing oil and petroleum products spills elimination works, and which hold relevant licenses and/or which have been attested in the established manner. They must immediately notify relevant governmental bodies and local governments regarding the facts of oil and petroleum products spills, organize their localization and elimination, and maintain financial and logistical resource reserves for the purpose of oil and petroleum products spills localization and elimination. They must train employees in protective techniques and operations in emergency situations relating to oil and petroleum products spills, maintain technological equipment in operable condition, conduct engineering/technical measures in advance aimed at prevention of potential oil and petroleum products spills and/or reduction of the scope of danger from their aftermath. They must also take measures to protect the life and health of employees in the case of an oil and petroleum products spill, declare the industrial safety of hazardous production objects, monitor production and observe industrial safety requirements at hazardous production objects, adjust plans in the event of changes in initial data, allow only qualified operators at hazardous production objects, without medical contra-indications for such work. In addition, they must hold a hazardous industrial object operation license as required by Russian legislation, and form and maintain in operable condition oil and petroleum products spills detection systems as well as communications and warning systems.[152]

OSRP measures are deemed complete after compulsory performance of the following: 1) stopping the dumping of oil and petroleum products; 2) collecting spilled oil and petroleum products to the maximum possible level corresponding to the technical characteristics of the special technical facilities used; and 3) storage of collected oil and petroleum products for their later utilization excluding secondary pollution of production objects and the environment.[153]

In the event of an oil and petroleum products spill, the term of spill localization may not exceed four hours for spills in the area of water, and six hours for spills on the ground, timed from spill detection or receipt of information.[154]

[151] RF Government Decree No. 240 "On the Procedure for Organizing Measures for Oil and Petroleum Products Spills Prevention and Elimination within the Territory of the Russian Federation," April 15, 2002, ("Decree 240"), Item 3.
[152] Decree No. 240, Item 4.
[153] Decree No. 240, Item 8.
[154] Decree No. 240, Item 7.

Oil spill response plans must be capable of implementation on a 24-hour basis in all weather conditions (in the sea – when navigation and hydro meteorological conditions are admissible).[155]

Where oil and petroleum products spills take on regional and federal significance, the Minister of the Russian Federation for Civil Defense Affairs, Emergency Situations and the Elimination of the Aftermath of Natural Disasters, has the right to convene an Inter-Departmental Commission for Emergency Situation Prevention and Elimination.[156]

XIV. Cabotage

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

Russian maritime law requires that Russian flag carriers be used for domestic cabotage, which is all marine transportation between Russian ports. There are two exceptions to the requirement of Russian flag carriers: (1) when a specialized vessel is needed, and no such vessel is available in the stock of Russian flag vessels; and (2) when use of a foreign flag vessel is needed for urgent carriage and towage, and there is no possibility for vessels flying the Russian flag to render the required service.[157] Cabotage by foreign flag vessels is permitted only between Russian ports that are open to foreign vessels.[158] A list of such ports is published and periodically updated in the official publication "Notifications to Navigators."

The Russian Ministry of Transport issues permits for cabotage by foreign flag vessels. Applications should be submitted directly to the Ministry, not to local offices. Ministry of Transport Regulations set forth detailed requirements for applications for permission to use foreign flag vessels for cabotage in Russian waters.[159] Separate permission is required for each foreign flag vessel.

Despite the exceptions set forth above to the Russian flag carrier requirement, a cabotage permit applicant need not prove that Russian vessels are unavailable, as the Ministry makes this determination on the basis of its own roster of available Russian vessels. The applicant also is not required to state *when* the vessel is needed.

A person using a vessel in his own name, irrespective of whether he is the owner of the vessel or has a different legal title, should file the cabotage permit application.[160] The applicant should submit the application in Russian with the RF Ministry of Transport, addressed to the Head of the State Sea Fleet Service of the RF Ministry of Transport, specifying the following:

- name and address (location) of applicant;
- vessel name;
- vessel flag;
- name of the port (place) where the vessel is registered;
- identification number of the vessel, assigned by International Maritime Organization;

[155] Decree No. 240, Item 7.
[156] Decree No. 240, Item 7.
[157] Russian Government Resolution No. 404 of May 24, 2000, Item 1.
[158] Russian Government Resolution No. 404 of May 24, 2000, Item 2.
[159] RF Ministry of Transport Regulation, August 23, 2001.
[160] RF Ministry of Transport Regulation, Item 5, August 23, 2001.

- call signal of the vessel;
- place and the year of vessel construction;
- type and purpose of the vessel, area of her sailing;
- main technical specifications of the vessel including tonnage (gross and net), full carrying capacity and main dimensions of the vessel;
- vessel class and term of validity of classification certificate;
- name and quantity of the cargo declared for carriage (data sufficient to allow identification of vessels subject to towage or other floating objects);
- port of loading (departure) and port of discharge (destination).

Copies of the certificate of ownership to the vessel, the certificate of the right of use of the foreign flag vessel, and the classification certificate should accompany the application.

The State Fleet Service of the RF Ministry of Transport considers the necessity of involving foreign tonnage in the carriage (towage) within five days from receipt of the application and notifies the applicant of its decision. Permission may be denied if the application is filed by an improper person (not the ship owner or the person using the ship in his name), or if the documents filed do not meet the established requirements. A denial must be issued in written form with details explaining the reasons for such denial. Documents filed as part of the application are returned to the applicant.

If permission is granted, the Navigation Security Department of the RF Ministry of Transport notifies the captains of ports within which foreign flag vessels have been permitted to carry (tow) cargo.

XV. Water Use Licensing

Presented by Natalia Prisekina, senior associate attorney and Director of the Vladivostok branch office of Russin & Vecchi.

The Water Code of the Russian Federation and its implementing regulation,[161] establish the main parameters for the regulation of water use in Russia. Although the Water Use Regulation establishes that the RF Ministry of Natural Resources (MNR) *or its territorial bodies*[162]license water use, a subsequent MNR Order clarifies that construction, exploitation, exploration, amenities, and operation of undersea deposits including hydrocarbon resources, are licensed by the MNR *in Moscow*.[163]

As a general rule, rights to use water areas are acquired on the basis of a water use license issued by a state authorized body, and under an agreement for the use of the water area concluded in conformity therewith.[164] In the event the agreement for use and the provisions of the water use license are contradictory, the agreement shall be deemed invalid.[165]

[161] Decision No. 383 "On Approval of Regulations on Granting Use to Water Areas which are State Property, Setting and Revising Water Use Limits, and Issuing Water Use Licenses and Managerial Licenses" dated April 3, 1997 ("Water Code Regulation").
[162] Water Code Regulation, Point 20.
[163] MNR Order No. 226 "On Distribution of Authority in Accordance with Objects of Licensing," October 14, 1998, Addendum 1, Points 2.4 and 2.6.
[164] RF Water Code, Article 46.
[165] RF Water Code, Article 56.

Short-term use of a body of water may be established for a period of up to three years, and long-term use for a period from three to 25 years, with the opportunity to prolong at the initiative of the water user.[166] The MNR has taken the position that advances in drilling technology are so frequent that long-term licenses are inappropriate.

The licensing body considers water use license applications within 30 days of their receipt along with the necessary accompanying documentation. Depending on the complexity and volume of materials, the licensing body may extend the term of its consideration by an additional 30 days. Moreover, if deemed necessary, the licensing body may order additional study of the application and its accompanying documentation, but must then issue its decision on licensing within 15 days of receipt of the results of the additional study, and in no case later than 60 days from the initial date of filing.[167] Rejection of a water use license application must be accompanied by a decision of the licensing body explaining the rejection.[168] Decisions and other actions of RF licensing bodies may be judicially contested.[169]

Although a positive ecological examination is a mandatory prerequisite for the MNR to grant a water use license,[170] it alone is not a guarantee of license issuance, as the application may be rejected, for example, due to the inadequacy of the license application or the necessary accompanying documentation.

The MNR must form a commission of independent experts to conduct the ecological examination within 30 days of receipt of an application accompanied by all of the necessary documentation and payment of the required fee.[171] The commission must reach its conclusions within four months from the date of issuance of a receipt confirming the applicant's payment of the fee. Where the MNR determines that an ecological examination is complex, the term for consideration may be extended for two additional months.

Ecological examination conclusions must be either positive or negative and must be approved by a majority of the independent experts on the commission. Special consideration (which is undefined in the Law on Ecological Examination) must be given to the opinions of independent experts who disagree with the conclusions of the majority. The MNR must approve conclusions, and the head, the responsible secretary, and each independent expert of the commission must sign them in order for them to have legal force. Such conclusions cannot be altered without the consent of these individuals. This statutory framework appears to provide the MNR with the ability to delay the implementation of positive conclusions and the granting of a water use license by acting deliberately in approving or rejecting positive conclusions. Ecological examination conclusions may be judicially contested.

Once issued, a water use license, depending on the manner and objectives of use of a water area, must contain the following:

- information on the water area;

[166] RF Water Code, Article 42.
[167] Water Code Regulation, point 32.
[168] Water Code Regulation, point 33.
[169] Water Code Regulation, point 47.
[170] Federal Law No. 174-FZ "On Ecological Expertise." November 25, 1995, Article 11, Point 7.
[171] Section II of the Regulation promulgated to implement the Law on Ecological Expertize (RF Government Decision No. 698 "On Approval of the Regulation on the Procedure for Conducting State Ecological Expertize" of June 11, 1996).

- information on the water user;
- information on the water consumers;
- a statement of the manner and objectives of use of a water area;
- an indication of the spatial limits (coordinates) of the water area or part thereof made available for use, and whenever necessary, the places of intake (drainage) of water;
- information on the limits of water use;
- information on the obligations of the water user with respect to the water consumers;
- the period of license validity;
- requirements for the rational use and protection of water areas and the environment.[172]

XVI. An Overview of the Major Aspects of Licensing Procedures

Presented by Sergei L. Lazarev, Partner of the firm's Russian Practice Group and Executive Director of the firm's Moscow office.

Basic Principles of Licensing

The Federal Law "On Licensing Certain Types of Activities,"[173] ("Law On Licensing") sets forth the general requirements of licensing procedures in Russia.[174] The Law on Licensing defines relevant terms associated with licensing, provides a list of activities, which are subject to licensing, and regulates relations arising between State authorities and legal entities (or entrepreneurs) that apply for licenses.

Pursuant to the Law on Licensing, the basic principles of licensing include: 1) uniformity with respect to the economic environment throughout the territory of the Russian Federation, the types of activities subject to licensing and licensing procedures; 2) statutes establishing the specific types of activities subject to licensing containing licensing requirements and conditions; 3) public awareness and access to information regarding licensing; and 4) the observance of licensing laws.[175]

Criteria for Determining Activities Subject to Licensing

In determining whether an activity should be subject to licensing, legislators should consider the following: threat of damage to the rights, lawful interests and health of citizens, to the defense and security of the state, to the cultural heritage of nations of the Russian Federation, and whether such activity may be regulated by methods other than licensing.[176]. When an activity is determined to meet these criteria, it should be included in the list of activities subject to licensing established by the Law on Licensing, if necessary, by amendment.

Licensing Authority

[172] RF Water Code, Article 49.
[173] Federal Law No. 128-FL "On Licensing Certain Types of Activities," August 8, 2001, last amended March 11, 2003.
[174] A revised version of the law will enter into force in January 2004. The only substantial change is that as of 2004, the sale of electrical power to the population is a licensed activity.
[175] Law on Licensing, Article 3.
[176] Law on Licensing, Article 4.

The Law on Licensing authorizes the Russian Government to approve statutes on licensing specific activities, determine which federal executive bodies should be responsible for licensing specific activities, and establish the types of activities which should be licensed by Regional executive bodies.[177] The list of activities subject to licensing by federal executive bodies as well as by Regional executive bodies is established in Government Enactment No. 135, dated November 02, 2002.

The licensing agencies are authorized to perform the following: issue licenses, re-execute documents confirming the availability of licenses, suspend the validity of licenses, renew licenses, annul licenses, maintain the license registry, and enforce licensee observance of licensing requirements and conditions while performing licensed activities subsequent to license issuance.[178]

Validity of a License

There are territorial and other limitations to the validity of licenses. According to the Law on Licensing, licenses issued by federal licensing agencies are valid throughout the Russian Federation, while licenses issued by regional agencies require prior notification of the licensing agencies of a different region if a licensee intends to perform licensed activity in that region.[179] In addition, each type of activity listed in Article 17 of the Law on Licensing requires the receipt of a separate license, and only the legal entity or entrepreneur to whom the license has been issued may perform the particular licensed activity. In other words, a license cannot be assigned or otherwise transferred by one legal entity to another.

Licenses are issued for a term of validity of at least five years, unless the applicant requests a shorter term in the license application.[180]

Documents Accompanying a License Application

Article 9 of the Law on Licensing provides that an applicant for a license (a legal entity) must submit the following documents, common to all license types, to the licensing agency in order to obtain a license:

a. an application indicating:
    i. the name, the legal form and location of the legal entity;
    ii. licensed activity an applicant intends to perform;
b. a copy of foundation documents and certificate on state registration of an applicant in its capacity as a legal entity;
c. a copy of the applicant's certificate of registration with the tax body;
d. a document confirming payment of fees for application review (approximately $10);
e. copies of documents confirming the corresponding qualifications of the legal entity's employees for licensing requirements.

Copies of documents indicated in sub-points "b" and "c" above, not certified by a notary, should be presented with an original.

[177] Law on Licensing, Article 5.
[178] Law on Licensing, Article 6.
[179] Law on Licensing, Article 7, Point 2.
[180] Law on Licensing, Article 8.

Term of Review

The licensing body must render a decision issuing or refusing to issue a license within 60 days from the date that the application, with all necessary attachments, is received.

In addition to the documents listed above, statutes on licensing specific types of activities may require submission of other documents, as mandated by regulations governing the performance of such activities.

Upon receipt and acceptance of documents by the licensing agency, the agency should provide the applicant with a list of documents accepted, indicating the date of their receipt.[181] An applicant for a license bears responsibility under Russian law for the submission of unreliable or distorted data.[182]

Grounds for Refusal

The licensing authority may deny a license application if the documents submitted by the applicant contain unreliable or distorted information, or if an applicant does not meet the licensing requirements and conditions.[183]

License Annulment and Suspension

Licenses may be annulled in the following events:[184]

- liquidation of the legal entity or termination of its activity as a result of its reorganization, except for transformation (change of its legal form).

- non-payment by the licensee of the license issuance fee within three months from receipt of the licensing agency decision granting the license.

- Licensee's infringement of license requirements and conditions, which entail infliction of damage to the rights, lawful interests, health of citizens, defense and security of the state, cultural heritage of nations of the Russian Federation, and (or) in the event a licensee has not eliminated the infringements within the period of time established by the license agency.

Licensing agencies have the right to suspend the effect of a license if they become aware of a licensee's repeated or gross infringements of the license requirements and conditions. In such event, the licensing agency establishes a period of time for the elimination of such infringements and the license is suspended for this period of time.[185] This period cannot exceed six months.[186] After this period of time, if the licensee has not eliminated these infringements, the licensing agency should apply to a court for annulment of the license. If the licensee has eliminated the infringements, it should notify the licensing agency in written form. Within three days of receipt of such notice, the licensing agency should verify that the infringement has been eliminated in fact and make a decision on renewal of the license and inform the licensee. No payment is

[181] Law on Licensing, Article 9, Point 1.
[182] Law on Licensing, Article 9, Point 1.
[183] Law on Licensing, Article 9, Point 3.
[184] Law on Licensing, Article 13, Points 2, 3, and 4.
[185] Law on Licensing, Article 13, Point 1.
[186] Law on Licensing, Article 13, Point 1.

levied for the renewal of the license. The period of validity of the license is not extended as a result of the period of suspension.[187]

The licensing agency must inform the licensee if it suspends, annuls, or files an application with the court to annul, a license, in written form, with justification of its decision within three days of its adoption. Such decision may be appealed by the licensee in accordance with the procedure established by Russian law.

Content of a License

The Law on Licensing provides that the license should indicate the following:
- Name of the licensing agency;
- Name, legal form and address of the licensee;
- Licensed type of activity;
- Term of validity of the license;
- Taxpayer Identification number;
- License number;
- Date of issuance of the license.

Construction Contractors and GOSSTROI Registration

Russian law establishes specific standards for construction, referred to as the State Standard (GOST).[188] These standards are used to categorize buildings and other construction projects into three separate levels based on the degree of responsibility required for their construction. This is determined by the economic, social and ecological impact of the construction.

For instance, the first level of responsibility applies to buildings and structures, the failure of which is highly likely to lead to significant economic, social and ecological damage. These include oil tanks with a capacity of 10,000 cubic meters or more, pipelines, industrial buildings with heights equal or greater than 100 meters, telecommunication towers of 100 meters or more, and buildings and structures that are considered unique in some way.

The second level of responsibility applies to buildings and construction projects of a massive, or complex nature such as residential complexes, and public, industrial, and agricultural buildings. The third and lowest level of responsibility applies to constructions that have seasonal and auxiliary functions, such as hotbeds, hothouses, summer pavilions, small warehouses and similar constructions.

Only the design and construction of hotbeds, hothouses, summer pavilions and similar constructions, the failure of which would not create economic, social or ecological hardships, do not require licensing.

Design, construction and engineering works for the construction of buildings and installations of the first and second levels of responsibility in accordance with the State Standard are subject to licensing.[189] A Government Decree provides the list of federal

[187] Law on Licensing, Article 13, Point 1.
[188] State Standard (GOST) No. 27751-88 "Reliability of Constructions and Foundations. Principal Rules of Calculations," July 1, 1988.
[189] Law on Licensing, Article 17.

executive bodies that perform licensing procedures.[190] Regulations establish the procedure for application and issuance of licenses for each type of activity (design, construction, engineering).[191] In addition, further guidance for construction license applicants is provided by methodical recommendations issued by Gosstroi, which include a list of documents that must be submitted with the application, model forms of the application, and some supporting documentation.[192]

Types of Construction Subject to Licensing

A regulation referred to as the Model Classifier provides a comprehensive list of activities in the construction area, which are subject to licensing.[193] A license application must contain the specific types of activities that an applicant intends to undertake, as they are indicated in the Model Classifier.

For example, the Model Classifier lists the following activities, among others, as requiring a license under the heading “General Construction Works”:

1 Geodesic work carried out on construction sites

- Geodesic marking basis for construction;
- Marking work in the process of construction;
- Geodesic control of the accuracy of the geometric parameters of buildings (structures);
- Executive geodesic survey;
- Geodesic measurements of deformations of grounds, construction of buildings (structures) in whole or part.

2 Site preparation

- Clearing of territories and preparing them for construction;
- Stripping and dismantling buildings and structures;
- Construction of temporary roads, engineering utilities and structures;
- Laying tracks.

3 Land work

- Excavating, vertical planning;
- Earth compaction and laying out ground cushions;
- Land work in collapsible and heaving soils;
- Land work in special conditions (in bogs, poor soil, salt soil, active sand, landslide slopes).

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[190] Russian Federation Government Decree No. 135, February 11, 2002.

[191] Regulation on “Licensing of Design Activity of Buildings and Installations of the First and Second Levels of the Responsibility in Accordance with State Standard," approved by Government Decree No. 174 of the Russian Federation, March 21, 2002 ("Regulation on Licensing").

[192] Methodical Recommendations on Preparing Documents Necessary for Obtaining a License by an Applicant, approved by Gosstroi Order No. 93, June 3, 2002 (“Methodical Recommendations”).

[193] Composition of the Types of Activity for Design, Construction and Engineering Survey Licensing Referred to the Authority of Gosstroi (the Russian Federation Ministry for Construction), approved by the Chairman of Gosstroi of Russia Mr. A.Zh. Shamuzafarov, October 7, 2002, enacted by Gosstroi Order No. 720, October 8, 2002.

4 Stone works

5 Precasting of concrete and ferroconcrete units

- Construction of formwork and rebar placement;
- Precasting of solid concrete and ferroconcrete units.

6 Assembling of concrete and ferroconcrete units

- Assembling of foundations and walls of underground portions of buildings;
- Assembling elements of structures of above-ground portions of buildings (columns, frames, girth rails, girders, beams, slabs, wall panels);
- Assembling of ventilation blocks, module lift shafts and trash chutes, utility blocks.

7 Assembling of wood structures

- Site assembly of structures;
- Assembling of factory-made wood (block) buildings and structures.

8 Assembling of light weight enclosed structures

- Metal structures;
- Enclosed structures made from extrusion panels and slabs;
- Framed partitions;
- Walls made from “sandwich” type panels;
- Walls and structures made from glass blocks and shaped glass;
- Window and door blocks, modules made of aluminum, PVX, fiberglass, other polymers and combined materials.

9 Insulation work

- Arrangement of insulation from rolled bituminous materials, hot asphalt mixtures, bituminous pearlite and bituminous ceramzit;
- Arrangement of insulation from polymers of rolled and sheet materials;
- Arrangement of insulation from cement mortar;
- Arrangement of insulation from polymers and emulsified mastic compounds;
- Arrangement of insulation from metal sheets;
- Arrangement of heat insulation using soft, hard and semi-hard fibrous wares and arrangement of insulation coverings made of hard materials;
- Arrangement of heat insulation from slabs and fill materials.

10 Roofing work

- Arrangement of roofs from rolled materials;
- Roofs made from polymers and emulsified bituminous make up;
- Arrangement of roofs made from pieced units;
- Arrangement of details of roofs made from metal sheets.

11 Territory Improvement

- Arrangement of access, walkways and grounds;
- Arrangement of open sports structures;
- Planting.

The Model Classifier also requires the licensing of what it refers to as “Specialized Works” which include, among others, the following types of activity:

- Erecting special structures for intersectoral economy.
- Arrangement of external engineering networks and communications.
- Arrangement of internal engineering systems and equipment.

Many other aspects of construction require licensing pursuant to the Model Classifier. To cover all activities in the confines of this article is impossible. Contractors are encouraged to refer to the Model Classifier with regard to each activity they intend to perform.

Licensing Requirements

Contractors seeking to perform licensed activities should keep in mind the following requirements, which must be satisfied:[194]

- Qualification of Workers;
  a) The legal entity must have managers and specialists with higher or mid-professional education for the profile of work. No less than 50% of managers and specialists on the staff of the legal entity must have higher professional education and work experience of no less than three years for specialists with higher professional education, and no less than five years for specialists with mid professional education;
  b) No less than once every five years, a legal entity’s workers who construct buildings and structures must attend continuing professional education courses to improve and refresh their skills;

- Sufficient Technical Means for performing the licensed type of works;
  c) The legal entity must have under right of ownership or on some other legal basis buildings, structures, construction vehicles, transport means, mechanical and hand instruments, technological rigging, mobile energy devices, means for guaranteeing safety, means of control and survey;

- Observance of the Law;
  d) Performance of licensed activity in accordance with the requirements of the laws of the Russian Federation, corresponding state standards and norms of technical documents for construction;

- Secure Quality Control;
  e) System of quality control for completed work and finished products.

Special List of Documents for Applications of Branch or Representative Offices

[194] Regulation on Licensing, Item 4.

Gosstroi has developed the following special list of documents that must accompany license applications of non-Russian entities, which have established a branch or representative offices in Russia:

1. Application indicating the name, the legal form and location of the legal entity and licensed activity, its substance and time frame during which it shall be carried out.
2. Copy of foundation documents, translated into Russian, notarized and legalized by Russian Federation consulate authorities abroad or apostilled (for signatory countries of the Hague Convention of 1961):
   - charter;
   - certificate by the tax body of the foreign country on the registration of the foreign organization as a taxpayer in the country of incorporation, indicating the taxpayer identification number;
   - an excerpt from the trade register or certificate of incorporation or other analogous document, which contains information on the body which registered the foreign organization, the registration number, date and location of registration;
   - excerpt from the bank register or a bank reference;
   - a decision by an authorized body of the foreign organization on the founding of a department in the Russian Federation (branch or Representative office);
   - powers of attorney issued by the foreign organization to the head (manager) of the Russian department.
3. Permission to open a Representative office on the territory of the Russian Federation, issued by the State registration chamber under the Russian Federation Ministry of Justice.
4. A certification on the entry into the State register of representative offices of foreign companies, which have been accredited on the territory of the Russian Federation, issued by the State registration chamber under the Russian Federation Ministry of Justice.
5. A certificate on registration in the tax body of the Russian Federation, indicating INN [tax-payer identification number].
6. Charter of the branch (Representative office) of the foreign legal entity, indicating:
   - name of the branch and its founding organization;
   - legal form of the founding organization; location of the branch (Representative office) on the territory of the Russian Federation and registered address of its founding organization;
   - purpose of founding and types of activity of the branch (Representative office);
   - composition, volume and terms of investments of capital in the fixed assets of the branch (Representative office) of the foreign legal entity on the territory of the Russian Federation.
7 Copies of documents confirming the corresponding qualifications of the legal entity's workers for licensing requirements.
8 Information evidencing applicant's right of ownership or other legal right to the buildings and structures necessary to carry out the licensed activity, indicating the title and other requisites of the documents.
9 Documents confirming payment of licensing fees.

An extremely important issue for foreign entities to consider is that foreign legal entities, which have not established a branch or a representative office in Russia, are not entitled to apply for a Russian license and as a result, cannot perform licensed activities in Russia.

XVII. Leasing Real Estate in Russia: Considerations for Lessees

Presented by Rita Hoffmann, senior associate attorney and Director of the Yuzhno-Sakhalinsk branch office of Russin & Vecchi. Ms. Hoffmann's expertise in real estate leasing on Sakhalin Island is the result of her involvement as counsel in multiple leasing transactions over the past year. These include the restructuring of a commercial lease transaction involving an investment component, as well as the negotiation and drafting of preliminary agreements with respect to multiple residential properties. Ms. Hoffmann has also overseen due diligence reviews conducted by Yuzhno-Sakhalinsk attorneys for Russin & Vecchi with respect to land and real property ownership rights. Before joining Russin & Vecchi, Ms. Hoffmann practiced regulatory law in Alaska. She graduated in 1999 with honors from the Washington College of Law at American University.

There are several issues that individuals and legal entities planning to lease real estate in Russia should consider prior to entering lease transactions in order to ensure that the terms of the transaction are as beneficial to them as possible. Lessees should:

- be aware of obligatory and discretionary lease provisions under Russian law,
- understand the specific steps that must be taken with respect to leasing complete and incomplete construction,
- know whether a preliminary lease agreement is necessary,
- be aware of the scope of due diligence required to protect a lessee's interests,
- understand how the status of the parties to a lease agreement as Russian, foreign, entity or individual can impact the transaction,
- be aware of the potential pitfalls of financing construction with advanced lease payments,
- know the limitations of mortgages as security and mortgage foreclosure procedures under Russian law,
- and consider the best venue for dispute resolution.

Although the scope of all general provisions of lease agreements is too broad to cover in the context of this article, parties entering into a lease should be aware of the following, at a minimum. Lease agreements must be in writing and contained in a single document.[195] They must also contain an adequate description of the property to be leased. If the term of the lease is not indicated in the agreement, it will be assumed to be a lease for an indefinite term, which is subject to three months notice of either party to terminate.[196] A lease with a term of less than one year is not subject to state registration.[197] Property must be used in accordance with both the particular use permitted by agreement and with its designated use under zoning provisions.

Lessees should also be aware of the different preparatory actions necessary with respect to leasing complete and incomplete construction. Ownership rights in complete construction and any transactions involving the registered property must be registered

[195] Russian Civil Code, Article 651(1).
[196] Russian Civil Code, Article 610(2).
[197] Russian Civil Code, Article 651(2).

with the Institution of Justice.[198] As a result, ownership and/or any existing lease rights to complete construction may be verified through a search of the state registry. When ownership rights in complete construction are properly registered, the parties may execute a lease agreement, as the right to lease right is immediately available.

In the alternative, when preparing to lease incomplete construction, lessees should be aware that registration of ownership in the construction is a prerequisite to execution of an actual lease.[199] Although registration of ownership rights in incomplete construction is possible, generally lessees are not interested in receiving the property for use until construction is complete. Once complete, the property must be accepted by the state before it may be registered.[200] Due to these various contingencies, a commitment between lessor and lessee with regard to future lease of incomplete construction may only be secured through the execution of a preliminary lease agreement.

A preliminary lease agreement obligates the parties to execute a lease at some point in the future.[201] Such an agreement is used when the parties cannot legally execute a lease at the time when a commitment is needed. This could be in the case of incomplete construction or where construction is complete, but ownership rights are not yet registered.

A preliminary lease should include, at a minimum: a determinable subject (an adequate property description), the essential terms of the principal lease, which include the property description and lease amount.[202] Generally, the safest way to ensure the specific obligations of the parties is by attaching a draft lease to the preliminary lease agreement, which must be executed in identical form, once execution is permissible. Preliminary leases are enforceable by court order.[203] Obligations under preliminary leases cease if the principal lease is not concluded within the time period established in the preliminary lease.[204]

Lessees should conduct an adequate due diligence review before committing to lease property. Such a review, with regard to a lease for incomplete construction, should include an investigation into the land parcel upon which the building will be located, the corporate foundation documents (or other identifying documents) of the landowner, and any contractual relations between the landowner, developer, and future lessor.

With regard to the land parcel, lessees should ensure that title and lease rights to the land are in order and have been properly registered. In addition, lessees should verify that all required legal norms were followed in land alienation procedures undertaken prior to the lease. Lessee should verify whether there are any recorded liens or encumbrances on the property, and if such encumbrances exist, determine whether it is willing to accept the property despite them.

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[198] Russian Civil Code, Article 131; Federal Law No. 122-FZ "On State Registration of Real Estate Rights and Related Transactions," July 21, 1997 ("Law on State Registration"), Article 26.
[199] Law on State Registration, Article 13(2), para. 3.
[200] Russian Civil Code, Article 753(2), para. 2; Enactment of USSR Ministry Board on Acceptance for Exploitation of Completed Construction Objects, No. 105, January 23, 1981.
[201] Russian Civil Code, Article 429.
[202] Russian Civil Code, Articles 429(3), 607(3), 654(1).
[203] Russian Civil Code, Articles 429(5), 445(4).
[204] Russian Civil Code, Article 429(6).

The land owner's and future building owner's foundation documents should be reviewed to ensure that there are no defects in corporate formation that would jeopardize the owners' legal status, thereby jeopardizing the transaction.

A review of contractual relations between the land owner, developer, and future lessor should include the general terms of any investment agreement between these parties, and assurances that all work to be performed on the property is properly authorized, and all intended uses of the property are consistent with its permitted use. Lessee should also confirm that all licenses and permits held by the developer are in order and valid for the duration of the construction, and that the developer has properly registered its design, construction, and building plans.

The legal status of parties to a lease agreement as either Russian or foreign, as legal entities or individuals, will affect certain provisions of the lease agreement. The parties should be aware of how these distinctions affect currency control issues with regard to lease payments, profit tax withholding, the value added tax exemption for foreign accredited lessees, and the preferred venue for dispute resolution (jurisdiction of courts over individuals and entities).

Where lessees are in a position to finance a lessor-developer's construction costs through advance lease payments, these lessee-creditors should determine an appropriate legal mechanism to transfer funds in light of the fact that lease payments in advance of a duly registered lease are inappropriate. One alternative is to enter into an interest-free loan agreement with the lessor-developer, through which the lessor-developer's obligation repay the loan is offset by the lessee's obligation to pay lease payments as such obligations arise. Such loans may be secured through the use of a mortgage or other pledge. Ideally, a mortgage of already existing and registered property is available for security.

Mortgage as a pledge of security is available for both incomplete and complete construction; however, the procedures for obtaining a mortgage and registering it are cumbersome and time consuming. Registration of ownership rights in the property to be mortgaged is a prerequisite.[205] Notarization and state registration of the mortgage agreement is required.[206] There is a notary fee of 1.5% of the value of the property to consider,[207] which can be a considerable expense. The parties should consider the 30-day term for the Institution of Justice to register both ownership rights in the property and a subsequent mortgage pledge of such property. As pledge rights arise from the moment of state registration of the mortgage,[208] until this 60-day time period has lapsed,[209] any loan agreement to be secured through the mortgage remains unsecured.

Lessee-creditors who have obtained a mortgage pledge and who seek to foreclose on the property securing the pledge should also be aware of the particularities of mortgage foreclosure procedures under Russian law. Such procedures exist in both judicial and non-judicial variants. Non-judicial foreclosure allows the parties to avoid obtaining a court decision on foreclosure by mutual agreement.[210] However, as the Civil Code

[205] Law on State Registration, Article 13(2), para. 3.
[206] Federal Law No. 102-FZ "On Mortgage (Pledge of Real Estate)," July 16, 1998 ("Law on Mortgage"), Article 10.
[207] Law of the Russian Federation No. 2005-1, "On State Fees," December 9, 1991, Article 4(4), para. 3.
[208] Russian Civil Code, Article 131(1); Law on Mortgage, Article 10.
[209] The two 30-day terms referenced are the maximum time periods afforded for registration. State registration authorities may complete the process in less time.
[210] Russian Civil Code, Article 349/1, para. 2.

prohibits entering such agreements in advance with respect to real estate,[211] the parties may agree to this approach and conclude such an agreement before a notary only after the creditor's right to foreclose has arisen. Jurisdiction over mortgage foreclosure proceedings otherwise is with the Russian Federation Arbitrazh Courts. Upon filing for foreclosure, a mortgagee does not become the owner of the mortgaged property by default. Sale of the property is mandatory, through either an open tender or auction procedure, depending on the circumstances.[212] The mortgagee is then compensated through the sale proceeds.[213]

Although neither party to a real estate transaction likes to anticipate potential disputes, dispute resolution options must be considered at the outset of the transaction so that they are provided for in the preliminary and principal lease agreements. By default, Russian Arbitrazh courts have jurisdiction over disputes involving real property in Russia.[214] Despite this requirement, some parties still opt, to resolve disputes through arbitration instead of immediately submitting to Arbitrazh Court jurisdiction. As Russia is a signatory to the New York Convention on Enforcement of Arbitral Awards, an arbitral award reached in another convention country should be enforceable by the court in Russia. If opting for arbitration, the parties should consider the efficiency and costs of foreign arbitration proceedings. Often Russian Arbitrazh courts may adjudicate issues faster and more cost effectively. Russian Arbitrazh courts also allow for injunctive relief, which may be a factor in determining the appropriate forum for dispute resolution.

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[211] Russian Civil Code, Article 349/1.
[212] Russian Civil Code, Article 350(1); Law on Mortgage, Articles 57, 59.
[213] Russian Civil Code, Articles 334(1), 349, 350; Law on Mortgage, Article 1(1).
[214] Russian Federation Arbitrazh Procedural Code No. 95-FZ, July 24, 2002, Article 38(1).

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