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Russia

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1 Collateral

What types of collateral are available?

Russian law provides for different types of security instruments, which the parties may use as collateral on their project finance transaction. Among them, the following types are expressly referred to in the Civil Code of the Russian Federation (the Civil Code):

- pledge or mortgage;
- suretyship;
- bank guarantee;
- possessory lien;
- security deposit; and
- penalty.

The most commonly used collateral in Russia are a pledge, mortgage, suretyship and bank guarantee.

The Civil Code also provides for the opportunity to establish collateral not expressly mentioned therein. However, they are rarely used (eg, state guarantees, repo transactions, etc) since the legal status of 'non-named' collaterals is not clear in every case from a Russian law perspective. Along with conventional collateral, as mentioned above, legal practice has established quasi-collaterals, such as direct debit agreement that enables a creditor to have control over the funds on the account of a borrower.

Pledge and mortgage

A pledge and mortgage over assets are the most common ways of taking security in Russian business practice. Both legal entities and individuals are entitled to provide a pledge or mortgage under Russian law. A pledge can be created over movable property (including goods in turnover) and property rights (or claims), for example, contractual rights, a participation interest, shares, future rights, etc. A mortgage is a type of pledge creating security over immovable property, such as buildings, land plots, lease rights over land plots, ships and aircraft, etc. Only this type of security (ie, a pledge or mortgage) affords a security holder the status of a secured creditor in the event of insolvency of a security provider.

Both pledge and mortgage have accessory character (ie, their validity as secondary obligations depend on validity of a primary obligation – a contract under which the secured obligations arose). Upon termination of the main secured contractual obligation, its accessory obligation (ie, a pledge or mortgage) may, however, continue to secure any outstanding obligations of a debtor that may remain following that termination.

Under Russian law, a pledge or mortgage can be granted by a debtor itself or by a third party to secure the obligations of the debtor. Security holders under a third party pledge or mortgage agreement have the same rights as the secured creditors of that pledgor.

Suretyship

Russian law sets out that both legal entities and individuals may grant a suretyship to secure in full or in part the obligations of a third party as debtor. Along with a pledge and mortgage a suretyship is also an accessory contractual obligation that depends on validity of a primary secured obligation (ie, an underlying contract between a debtor and its creditor(s)). The surety is liable to the creditor in the same amount as the debtor unless otherwise provided by the underlying contract or suretyship. The Civil Code provides that a suretyship shall be terminated in the following cases:

- a termination of the secured primary obligations;
- a change of the secured primary obligations resulting in an increase in the surety's liability or other unfavourable consequences for the surety without its consent;
- a transfer of a debt under the secured primary obligation to another person (without the consent of the surety);
- refusal of the creditor to accept a proper performance of the secured obligation offered by the debtor or the surety; or
- expiration of the indicated term of the suretyship.

The Civil Code also provides for the following special provisions on the termination of the suretyship whose term was not established. The suretyship shall be terminated if:

- the creditor does not bring a suit against the surety within one year from the day on which the secured obligation was to be performed; and
- no time for performance of the primary secured obligation was indicated and cannot be determined or is determined by the time of demand unless the creditor brings a suit against the surety within two years from the date of the suretyship.

Bank guarantee

The Civil Code provides that by a bank guarantee a bank, other credit institution, or insurance organisation (the guarantor) grants at the request of the other person (the principal) a written obligation to pay a monetary sum to the creditor of the principal (the beneficiary) in accordance with the terms and conditions of the written obligation given by the guarantor upon the presentation by the beneficiary of a written demand concerning the payment thereof. From a Russian law perspective a bank guarantee is a unilateral transaction since it is a declaration of will of the guarantor to pay, regardless of the obligations of the debtor.

Unlike the suretyship the bank guarantee does not depend on the primary obligation secured by this bank guarantee (ie, it has a non-accessory character). Generally, a bank guarantee is an irrevocable and non-transferrable obligation unless otherwise provided therein.

Pledge of bank account and direct debit agreement

The Civil Code provides that property rights may be the subject of a pledge. Formally speaking, it contemplates that the rights to a bank account or rights to funds on a bank account, or both may be pledged as property rights. However, from the perspective of Russian business and court practice, such a pledge would be questionable and would not be considered as effective and enforceable collateral. Due to uncertainties with validity and enforceability of such collateral, creditors under domestic and international financing transactions prefer to use a direct debit agreement (an agreement between a borrower as holder of a bank account, its account bank and a creditor) as collateral. A direct debit agreement provides the creditor with rights to directly debit the borrower's bank account for the amounts outstanding under their loan agreement and apply them for repayment of a debt. From a Russian law perspective, a direct debit agreement is not a 'security' in the strict sense of the word and it does not give the creditor any priority in satisfaction of its claims in the event of the borrower's insolvency as would be the case with a pledge or a mortgage. It is also worth noting that a holder of a bank account is entitled to close it at any time and any limitation of this right is not legally valid under Russian law. However, due to the relatively effective repayment mechanism established by a direct debit agreement, which allows the creditor to withhold funds independently from the debtor, this quasi-security instrument is quite popular among creditors of Russian companies.

2 Perfection and priority

How is a security interest in each type of collateral perfected and how is its priority established? Are any fees, taxes or other charges payable to perfect a security interest and, if so, are there lawful techniques to minimise them? May a corporate entity, in the capacity of agent or trustee, hold collateral on behalf of the project lenders as the secured party?

There is a general requirement of Russian law that security agreements should be in written form. There are no further special requirements in relation to such agreements or suretyships and bank guarantees. However, as a matter of practice, an exception from this rule is that bank guarantees made using SWIFT are also valid.

At the same time, Russian law sets out several special perfection requirements for a mortgage and certain types of a pledge (registration in the relevant register and notarisation). For example, a mortgage must be registered in the state register of immovable property (in the case of mortgage of aircraft or sea vessels, in the relevant aircraft or sea vessels registers accordingly). Generally a notarisation of a mortgage is not required, however, in certain cases a mortgage will be subject to notarisation (in particular, if the mortgage provides for out-of-court enforcement procedure). The absence of such notarisation would not render the whole mortgage agreement ineffective, but it would invalidate the provision on out-of-court enforcement (ie, only court enforcement would then be possible).

Most pledges are not subject to any registration and filing. However some pledges may require registration depending on the subject of each particular pledge. For example, a pledge of a participation interest must be notarised and recorded in the Russian Unified State Register of Legal Entities. A pledge of shares must be filed in the share or custodian account of the pledgor with the share registrar or custodian. A pledge of intellectual property rights is also subject to registration in the relevant state register. A pledge or mortgage agreement without due perfection is not effective and would cede priority to any subsequent pledge or mortgage agreement that is perfected ahead of it.

It is worth noting that a single asset may be pledged or mortgaged to secure more than one debt. However, it is not possible under Russian law to establish an equal-rank pledge in favour of several creditors unless they are co-creditors. Therefore the pledges or mortgages would rank in priority in the order of creation (or registration if applicable).

There is also a general requirement that a Russian security provider maintains an internal record of all pledges and mortgages granted by it, called a 'pledge book' (a pledge ledger). Although the security provider is liable for any losses arising from its failure to maintain a pledge book, recording in the pledge book is not considered a perfection requirement. However, as a matter of practice, creditors usually require security providers to provide evidence that the pledge is recorded in their pledge books.

In addition, in cases contemplated by Russian law and the charter of a security provider, granting collateral may require prior approval of a respective corporate body of the security provider (general shareholders' meeting or board of directors). By virtue of Russian law a suretyship issued by an individual requires a spousal consent. State approvals are generally not required.

The cost for registration of security interest includes a registration fee and a notarisation fee (where applicable). Both fees are set out by Russian law and are reasonable. No other taxes are required to be paid to perfect a security.

A security structure with one of the lenders acting as security administrative agent of all creditors under a loan facility transaction is used in Russian practice. This agent is usually appointed by the creditors to deal with administrative issues connected with establishment, preservation and enforcement of security. A collateral structure with a security trustee is not used as it is not enforceable from a Russian law perspective in respect of Russian law mortgages and pledges. The same relates to the concept of parallel debt, which has not been tested by Russian courts and is unlikely to be enforceable in Russia.

3 Existing liens

How can a creditor assure itself as to the absence of liens with priority to the creditor's lien?

One of the main problems of taking security in Russia is the absence of the unified public register of encumbrances. As a matter of practice, a potential security holder would usually want to verify whether the asset is already encumbered. It is easy to make a check in relation to the agreements, which require state registration (eg, mortgages, pledges of participatory interests, intellectual property, etc). In this case, a security holder would usually require from a security provider a recent extract from the relevant register, showing that there are no registered encumbrances over relevant assets.

In respect of certain assets (in practice, any movable property other than participatory interest and shares) it is nearly impossible to verify the history of encumbrances.

Records made by a security provider in its pledge book may not be considered as evidence of the history of encumbrances over assets due to the reasons mentioned above.

4 Enforcement of collateral

Outside the context of a bankruptcy proceeding, what steps should a project lender take to enforce its rights as a secured party over the collateral?

A pledge or mortgage may only be enforced if a borrower whose obligations are secured by this collateral fails to perform the secured monetary obligations. Enforcement of a pledge or mortgage because of any other type of an event of default (eg, breach by a borrower of representations or certain financial covenants) is invalid from a Russian law perspective. A way to overcome this restriction is to accelerate a repayment of a loan after the occurrence of an event of default and then to enforce the security in the event of non-payment by a borrower following a lender's debt payment demand (ie, a pledge or mortgage).

A pledge and mortgage can be enforced through the court by obtaining a relevant court decision (ie, an enforcement of security through a court enforcement procedure). Following a court enforcement

procedure, the pledged or mortgaged property is sold at a public auction arranged by a specialised organisation engaged by court bailiffs.

The court may refuse to enforce a pledge or mortgage if the security provider can prove that the failure to perform an obligation on which the enforcement is based is immaterial and disproportionate to the enforcement. The circumstances in which a breach will be deemed immaterial (and the claim disproportionate) are that the amount of the payment in default is less than 5 per cent of the value of the secured property and that such default has been outstanding for less than 3 months. If a pledge or mortgage agreement secures an obligation that has to be performed by periodical payments (eg, a scheduled repayment under a loan agreement), such a pledge or mortgage agreement may be enforced in the case of regular non-payment events (ie, more than three times within the 12 months immediately preceding the enforcement). This restriction may be included in the relevant pledge or mortgage agreement upon agreement of the parties.

Parties to a pledge or mortgage agreement may also agree (to the extent permitted by Russian law) that a pledge or mortgage can be enforced without recourse to a court and obtaining a relevant court decision (ie, an enforcement of security in out-of-court enforcement procedure). Russian law is not entirely clear whether a notarisation is necessary for pledge and mortgage agreement providing for an out-of-court enforcement procedure. However, we are of the view that notarisation is necessary.

In the case of out-of-court enforcement procedure, the pledged assets may be realised:

- by way of sale through a public auction;
- by way of private sale;
- by way of sale under a commission agency arrangement; or
- by way of retention of ownership rights by the security holder.

In the case of the out-of-court enforcement procedure, the mortgaged assets may be realised:

- by way of sale through a public auction (or closed auction when such required by Russian law); or
- by way of retention of ownership rights by the security holder.

According to recent Russian court practice, parties to mortgage agreements may choose only one method of enforcement. If the parties have not referred to an out-of-court enforcement procedure in their mortgage agreement, only court enforcement procedures will be available. It is not necessary to choose only one method of enforcement and realisation of pledged assets under a pledge agreement.

Realisation of pledged or mortgaged assets in an out-of-court enforcement procedure requires the cooperation of a security provider or else, in practice, realisation may be problematic.

Project lenders may participate as buyers in a sale of pledged assets. All payments for the purchased pledged assets shall be made in roubles.

5 Bankruptcy proceeding

How does a bankruptcy proceeding in respect of the project company affect the ability of a project lender to enforce its rights as a secured party over the collateral? Are there any preference periods, clawback rights or other preferential creditors' rights (eg, tax debts, employees' claims) with respect to the collateral? What entities are excluded from bankruptcy proceedings and what legislation applies to them? What processes other than court proceedings are available to seize the assets of the project company in an enforcement?

Not every Russian legal entity may be declared bankrupt. State budget companies, non-profit organisations and individuals (other than registered individual entrepreneurs) are exempt from Russian bankruptcy proceedings. Exceptions to this rule may be established by Russian law only. According to recent information, the draft law on insolvency of individuals is now being considered by the Russian parliament. Bankruptcy of enterprises forming a company town, agricultural companies, financial institutions, strategic companies and natural monopolies are subject to special procedure provided by Russian law.

Bankruptcy hearings take place before a local arbitrazh court at the place of registration of the company or individual entrepreneur. Foreign creditors may participate in bankruptcy proceedings to the same extent as Russian creditors.

Upon the commencement of bankruptcy proceedings, the satisfaction of monetary claims against the insolvent company is generally subject to the following statutory order of priorities:

- claims related to so-called 'current payments' (essentially, payments that have arisen after the commencement of insolvency proceedings including court and bankruptcy costs, taxes, and utilities and operational costs) together with the costs of any measures to prevent industrial or environmental harm;
- claims for harm inflicted to health or life and claims for moral damages;
- employment claims (wages and severance payments) and royalty claims under copyright agreements; and
- all other claims.

Creditors secured by a pledge or a mortgage enjoy the right to have their claims satisfied out of the proceeds of sale of such pledged or mortgaged assets ahead of the claims of all other unsecured creditors. Russian insolvency law provides for the following allocation of the proceeds of sale of pledged or mortgaged assets:

- 80 per cent (under a facility agreement) and 70 per cent (under all other contracts) of the proceeds, but in the amount not exceeding the aggregate amount of principal and accrued interests; and
- the remaining 20 per cent (under a facility agreement) and 30 per cent (under all other contracts accordantly) is credited to a special bank account for further allocation for satisfaction of unsecured claims and court costs as provided by Russian insolvency law.

There are certain circumstances set out by Russian law when the transactions of a company that is the subject of insolvency proceedings may be considered by the court as void. In particular, a transaction may be void if it was made after or within one month prior to the filing of the petition for bankruptcy and would result in the preferential satisfaction of the claims of specific creditors. In addition, this term may be extended to six months prior to the bankruptcy petition if the person in whose favour the transaction was made was aware of the potential insolvency of the debtor.

Moreover, a transaction may be considered as void if it was made within one year prior to the bankruptcy petition (or three years if the related person was aware of the potential insolvency of the debtor) where the unequal discharge of obligations by the other party to the transaction has occurred. This is particularly the case where a transaction has not been concluded on an arm's-length basis.

6 Foreign exchange

What are the restrictions, controls, fees, taxes or other charges on foreign currency exchange?

Current Russian currency control legislation is less restrictive than previously and generally provides just a few limitations on foreign currency exchange transactions. Russian law requires that all foreign currency exchange transactions should be made through Russian banks (so called 'Russian account banks'). Also, when conducting most currency operations under cross-border transactions, Russian residents have to open a so-called 'transaction passport' with the Russian bank.

A transaction passport is a document to be completed in the form set out by Russian legislation and filed by a Russian debtor with the Russian bank and serves the purpose of currency control under foreign contracts (ie, the contracts between Russian residents and non-Russian residents) in Russia. It contains information on the parties to a foreign contract and main terms of such contract (such as date, currency, the amount of the contract, etc). Once the transaction passport has been issued, all transfers of the funds of the Russian resident under the relevant contract shall be made though its accounts with the relevant Russian account bank.

A transaction passport is required for either a foreign trade contract between a Russian resident and non-resident for the supply of goods, services, works, information and IP or a rouble or foreign currency-denominated loan provided between a Russian resident and a non-resident (ie, Russian residents lending to non-residents and vice versa). Russian law also sets out certain exceptions when the issuance of a transaction passport is not required (for example, when the amount of the contract is less than US$50,000, etc).

7 Remittances

What are the restrictions, controls, fees and taxes on remittances of investment returns or payments of principal, interest or premiums on loans or bonds to parties in other jurisdictions?

Generally, all dividends distributed by a Russian company to a foreign shareholder being a legal entity are subject to 15 per cent withholding tax. It may be reduced to 5 to 10 per cent depending on the provisions of the relevant treaty on avoidance of double taxation (DTT). If the distribution of profits is structured as interest payments on debt obligations or royalties, withholding tax amounts to 20 per cent. However, it can be fully eliminated in certain cases (eg, by operation of a relevant DTT).

Interest on loans is generally deductible for profit tax purposes provided that the loan was used for business purposes and the interest on the loan does not deviate from the interest on comparable loans by more than 20 per cent. If no information on comparable loans is available to the Russian borrower, the deductible interest on loans denominated in a foreign currency may not exceed 15 per cent and in roubles – the Bank of Russia refinance rate multiplied by 1.1.

8 Repatriation

Must project companies repatriate foreign earnings? If so, must they be converted to local currency and what further restrictions exist over their use?

Foreign currency proceeds accruing to a Russian resident under foreign trade contracts (including sales of goods, works, services and intellectual property) must be repatriated in full to a bank account held by that Russian resident with a Russian bank within the terms set out by the relevant contract. Furthermore, a Russian resident must ensure that any advance payments it makes to non-residents are returned to the Russian Federation in the case that the goods are not delivered, works are not performed or services are not rendered under such foreign trade contracts.

Russian law provides for exemptions from the repatriation rule stating that a Russian resident is entitled to transfer export proceeds into its own or a third party bank account opened with a non-Russian bank. Such transfers are permitted for the purpose of performing the obligations of the Russian resident as borrower under a loan agreement provided that the term of the loan agreement exceeds two years and the lender is a resident of the Organisation for Economic Co-operation and Development (OECD) or Financial Action Task Force (FATF) member states, or is the agent of a foreign government. Certain other exemptions are provided by the Russian currency control law.

9 Offshore and foreign currency accounts

May project companies establish and maintain foreign currency accounts in other jurisdictions and locally?

According to the Russian currency control law, Russian legal entities and individuals may open accounts (deposits) in foreign and local currency both with Russian and foreign banks in countries that are members of OECD and FATF.

If Russian legal entities and individuals open (or close) such foreign accounts (make deposits) or change details of accounts (deposits) then they have to notify the Russian tax authorities at the place of their registration within one month of taking such action by filing a special form.

The reports on flows of funds through the accounts (deposits) with banks outside the territory of the Russian Federation, which are opened by branches, representative offices and other subdivisions of legal entities set up in accordance with the legislation of the Russian Federation and that function outside the Russian Federation, shall be submitted to the tax bodies by these legal entities.

There are generally no restrictions on money transfers from Russian accounts of an account holder to its foreign account(s) and vice versa. However, payments to and settlements between the parties may be received and conducted via foreign bank accounts in a number of cases set out by relevant Russian legislation. Settlements under long-term loan agreements with international banks in countries that are members of the OECD or FAFT may be conducted via foreign bank accounts of a Russian borrower.

10 Foreign investment and ownership restrictions

What restrictions, fees and taxes exist on foreign investment in or ownership of a project and related companies? Do the restrictions also apply to foreign investors or creditors in the event of foreclosure on the project and related companies? Are there any bilateral investment treaties with key nation states or other international treaties that may afford relief from such restrictions? Would such activities require registration with any government authority?

Russian law on foreign investment constitutes the principle legal framework for foreign investments in Russia. According to this law a 'foreign investor' includes legal entities, unincorporated entities and individuals, as well as international organisations acting under international agreements and foreign governments. The provisions of the said law also apply to branches of foreign investors and commercial entities in which foreign investors participate, but not to subsidiaries or affiliated companies of the latter.

Russian law establishes the principle of national treatment of foreign investors as regards the conditions of their activity and the use of profits obtained from such activity. As a general rule (with certain exceptions), foreign investors may contract, acquire and own assets and otherwise participate in civil relations in Russia to the same extent as Russian investors. This means that foreign investors may participate in Russian companies as partners, shareholders or other equity or debt holders; lease and purchase real estate and other property; contract to buy or sell products and services; purchase and sell shares and other securities of Russian companies; participate in the privatisation process, etc. Foreign investors are entitled to make investments in any manner that is not expressly prohibited by Russian law and to reinvest or repatriate profits freely after payment of applicable taxes.

'Foreign investment' is defined broadly and includes cash, securities, property, property rights, intellectual property, services and information having monetary value. Investments in banks and other credit organisations, insurance companies and non-profit organisations for the purpose of socially desirable objectives are specially regulated activities.

As mentioned, Russian law subjects foreign investors to a legal regime that is not less favourable than the regime provided to

Russian investors (national treatment). The Russian Federation has effective bilateral investment protection treaties with many foreign countries. In addition, the law on foreign investment provides foreign investors with certain state guarantees, which are more like principles rather than security in the strict sense. Many of these state guarantees are declarative, however, several guarantees are very important. In particular, foreign investors are given the guarantee that:

- they will enjoy protection from expropriation or nationalisation, except pursuant to federal law or an international treaty of the Russian Federation and are entitled to demand a compensation of damages;
- they are protected against unfavourable change in the Russian legislation (the so-called 'stabilisation clause' or 'grandfather clause'); and
- they enjoy the right to use, at their own discretion, all earnings from their business, including further funding into business in the territory of the Russian Federation, or withholding such earnings abroad, etc.

Exceptions to the regime of national treatment can be established by Russian federal law only and solely if justified on the grounds of the protection of constitutional or public order, health, rights and legally protected interests of other persons or national security.

The Russian Federation has effective bilateral investment treaties on national treatment with more than 60 foreign countries and has also entered into a partnership and cooperation treaty with the European Union and its member states.

11 Documentation formalities

Must any of the financing or project documents be registered or filed with any government authority or otherwise comply with legal formalities to be valid or enforceable?

As a general rule, there are no restrictions on the choice of language of the agreement. However, if the agreement is subject to mandatory notarisation or state registration, such an agreement has to be concluded in Russian language or in a bilingual form with the Russian language prevailing.

Mandatory notarisation is required in the following main cases:

- agreement of investment partnership;
- agreement on disposal or pledge of participation interest in the limited liability company registered in the Russian Federation;
- pledge agreements – in the case of securing obligations under the agreements that required a notarisation (mandatory or contractual);
- assignment and transfer of rights and claims – if such rights and claims arose out of the agreements that required a notarisation (mandatory or contractual); and
- mortgage agreements providing out-of-court enforcement (according to recent amendments to Russian law and clarifications obtained from the Russian Ministry of Finance).

Generally a state registration is required for all transactions with immovable or intellectual property (such as trade marks, licence agreements etc) and franchising agreements.

Project documents regarding engineering survey, planning, construction and putting into operation of facilities must be filed with the appropriate state agencies. Distribution agreements are normally executed only in writing and generally do not need to be registered, but must be presented in Russian to tax and other authorities upon request.

In the case that any document issued outside Russia has to be submitted to the Russian state authorities, such a document is required to be notarised by the foreign notary, apostiled and attached with the notarised translation into Russian.

12 Government approvals

What government approvals are required for typical project finance transactions? What fees and other charges apply?

Government approvals are often required with respect to project finance transactions in areas having strategic importance to the country (eg, natural monopolies), licensing activities (including, inter alia, transportation, subsoil use, working with hazardous or nuclear materials, spirits, etc) or that involve state subsidies, foreign investments in the Russian insurance companies, import of certain equipment (eg, dual-use goods), engineering survey, planning and construction activities, public procurement and environmental permits.

The official fees to obtain these approvals are usually rather low. However, the relevant procedures are often cumbersome and time-consuming.

13 Foreign insurance

What restrictions, fees and taxes exist on insurance policies over project assets provided or guaranteed by foreign insurance companies? May such policies be payable to foreign secured creditors?

There is no special legislation on foreign insurance in Russia. However, some regulations related to foreign insurance are provided by the Russian law on foreign investment. In particular, the principle of subrogation is guaranteed. According to this principle, the Russian Federation will recognise the payment demands from foreign investors or their successors. In practice, foreign investments are often insured by foreign insurers (insurance companies and export credit agencies). In the case of damage or loss of the investment on the territory of the Russian Federation, the insured foreign investor usually claims compensation from the relevant foreign insurer and the latter enjoys a recourse right against the Russian Federation. It should be noted that the said law does not establish a mechanism of subrogation, but guarantees such a right. In the absence of the relevant legislation the general principles of Russian civil law together with international practice shall apply.

To avoid any risks related to recognition of foreign insurance, in practice, parties to cross-border transactions prefer to insure their investments through both foreign and Russian insurers.

14 Foreign employee restrictions

What restrictions exist on bringing in foreign workers, technicians or executives to work on a project?

Russian Law stipulates two sets of requirements for foreign employees in Russia: (i) entry rules (visa requirements); and (ii) employment rules (work permit requirements). Foreign employees who enjoy a visa-free regime shall obtain work permits pursuant to a simplified procedure.

Russian law establishes a two-stage procedure for securing a right to work in the Russian Federation. As a first step, the employer must obtain an authorisation to hire foreign employees (an annual quota) and, further, the employer must apply for the individual work permits with respect to each of the foreign employees it is going to employ.

As a general rule, a work permit is valid for one year and has to be re-issued upon expiration. For highly qualified specialists who receive an annual salary of at least 2 million roubles, a work permit can be obtained for three years. No work permit or quota is required if the foreign individual is doing installation work, supervision of installation, guarantee and repair services with regard to equipment shipped by a foreign company to Russia.

The process of obtaining a work permit normally takes around three months, but may take longer in the case of any complications.

15 Equipment import restrictions

What restrictions exist on the importation of project equipment?

Depending on the type of equipment to be imported into Russia there are tariff and non non-tariff restrictions stipulated by the federal laws, international treaties and other regulations.

Tariff regulations are mainly import customs duties and levies, import VAT (for most goods) and excise tax (mainly for luxury goods). Certain types of project equipment may be imported to Russia free of duty or with tariff preferential or privilege.

Non-tariff restrictions include quotas, licences, currency control restrictions, provision of exclusive rights, controls of various types (phytosanitary, health, etc), certification and protection measures (such as embargoes).

16 Nationalisation and expropriation

What laws exist regarding the nationalisation or expropriation of project companies and assets? Are any forms of investment specially protected?

The main legal documents that contain provisions on nationalisation or expropriation are the following:

- the Constitution;
- Protocol No. 1 to the European Convention on Protection of Human Rights and Fundamental Freedoms;
- bilateral foreign investment protection treaties between Russia and 62 foreign countries;
- the Civil Code of the Russian Federation; and
- the Federal Law, dated 9 July 1999, No. 160-FZ on International Investments in the Russian Federation.

The ownership rights may be taken from the owner in favour of the state in the process of nationalisation, requisition and expropriation. Russian law regulates the basis for requisition and expropriation but does not regulate the basis for nationalisation. International investments have additional protection from international treaties, which provide that nationalisation, requisition and expropriation may take place only on the following basis:

- that it is for public purposes;
- that it is in accordance with the established legal procedure;
- that it is on a non-discriminatory basis; and
- that there is a prompt, adequate and effective compensation.

Compensation can be made in a monetary or natural form (by way of providing adequate replacement of property). The value of the monetary compensation can be challenged in court. However Russian law contains a discrepancy in regulating provisions of such compensation; in accordance with the Civil Code it has to be provided after change of ownership in favour of the state while in accordance with the Constitution the compensation has to be provided prior to such change.

It should be noted that the rights of the pledgees are protected in the following way:

- in the case of nationalisation, the pledge will be transferred to the new property (in the case of the provision of replacing the property) or the pledgees will have the right to satisfy their demands in priority to other lenders from the amount of monetary compensation; and
- in the case of expropriation, the pledge will cease to exist and the pledgees will only have the right to accelerate the loan. However, in the case of a mortgage the mortgage will be preserved and the new owner of the nationalised immovable property would become the new mortgagor.

17 Fiscal treatment of foreign investment

What tax incentives or other incentives are provided preferentially to foreign investors or creditors? What taxes apply to foreign investments, loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Generally, tax law prohibits differentiation in tax rates, levies or tax incentives on the basis of the form of ownership, citizenship or origin of the capital investment. Therefore, foreign investors are treated in the same way as Russian companies and can be provided with grants, tax incentives, customs benefits, state guarantees and subsidies by federal, regional and local authorities, depending on the sector of the economy, location and the volume of investments. Usually, tax incentives may be granted with regard to the regional part of the capital gains tax, property tax, land tax and transport tax.

Tax incentives are provided, inter alia, for:

- the leasing investments;
- investors participating in the major state projects;
- foreign capital investments provided for financing of production, subject to utilisation of such investments within one year from the date of its receipt;
- for producers in special economic zones; and
- import of foreign technological equipment having no domestic analogues in Russia.

Withholding tax of 20 per cent (15 per cent for dividends) is payable for income from sources in Russia. Such tax is not paid in Russia in the case that the relevant treaty on avoidance of double taxation provides for a reduced or zero rate.

Russian law also stipulates thin capitalisation rules depending on a standard debt-equity ratio of three to one and a debt-equity ratio for banks and leasing companies of 12.5 to one.

The cost for registration of security interest includes a registration fee and a notarisation fee (where applicable). Both fees are provided by Russian law and are reasonable. No other taxes are required to perfect a security.

18 Government authorities

What are the relevant government agencies or departments with authority over projects in the typical project sectors? What is the nature and extent of their authority? What is the history of state ownership in these sectors?

There are three types of federal executive bodies; ministries, agencies and services. Ministries are the main executive bodies responsible for establishment of public policy and statutory regulation. Agencies and services are subordinated either to a certain ministry or directly to the president or the government of the Russian Federation. Services are responsible for monitoring and supervision each in its sphere and agencies are rendering state services each in its sphere.

Some of the federal executive bodies that have authority in the indicated project sectors are the following.

Oil, gas, minerals extraction, chemical refining and water treatment

The Ministry of Natural Resources and Ecology with the subordinated bodies:

- the Federal Supervisory Natural Resources Management Service;
- the Federal Subsoil Resources Management Agency (which, inter alia, grants licences for extraction of subsurface resources);
- the Federal Water Resources Agency; and
- the Federal Service of Ecological, Technological and Nuclear Supervision subordinated to the government.

Power generation and transmission

- the Ministry of Energy; and
- the Federal Tariff Service.

Transportation and ports:
- the Ministry of Transport;
- the Federal Agency for Rail Transport; and
- the Federal Agency for Sea and River Transportation, etc.

Telecommunications
- the Ministry of Communications and Mass Media; and
- the Federal Agency for Information Technologies.

In addition to the above, the following federal ministries have authority over certain aspects of project financing:

- the Ministry of Finance coordinates and organises state financing of projects;
- the Ministry of Economic Development deals with all federal PPPs, special economic zones and concession projects, supervises the implementation of federal and other special purpose state programmes and coordinates the work of other authorities on the implementation of such programmes;
- the Ministry of Industry and Trade is in charge of the management of state property; and
- the Ministry of Regional Development is in charge of construction, housing and utilities, project financing from the Investment Fund of the Russian Federation, Sochi-2014 projects and public procurement.

It should be noted separately that certain activities may be recognised as 'strategic' activities (ie, activities that have strategic importance for the defence of the country and the security of the state), which also includes activities in the field of natural monopoly. Such activities are very regulated and are subject to strict governmental supervision and control mainly conducted by the Federal Antimonopoly Service and Federal Tariff Service (both subordinated directly to the Russian government). The activities in the above mentioned project sectors are mostly likely to be strategic activities.

19 International arbitration

How are international arbitration contractual provisions and awards recognised by local courts? Is the jurisdiction a member of the ICSID Convention or other prominent dispute resolution conventions? Are any types of disputes not arbitrable? Are any types of disputes subject to automatic domestic arbitration?

International arbitration awards are recognised and enforced in Russia in accordance with the following international treaties and Russian law:
- the 1958 New York Convention;
- the 1961 European Convention on International Commercial Arbitration;
- the Russian Arbitrazh Procedural Code;
- the Russian Civil Procedural Code; and
- the Russian Law on International Commercial Arbitration adopted on the basis of UNCITRAL Model Law on International Commercial Arbitration.

Accordingly, the Russian court should, subject to compliance with the rules of the international treaties, Russian law, public order and public security applying to the recognition and enforcement of foreign arbitral awards, recognise and enforce such arbitral awards, without re-examination of the underlying issues on the merits, as a final and conclusive award against the Russian companies.

The submission to international arbitration is not subject to revocation.

The Russian Federation is a party to the ICSID Convention, however this convention has not been ratified and entered into force in Russia as yet.

The following disputes are generally regarded as not arbitrable (ie, should be resolved only via state court):
- insolvency disputes;
- certain corporate disputes;
- disputes governed by Russian administrative law (eg, with state authorities) including competition, tax and privatisation disputes; and
- disputes related to Russian real estate that may affect registration entries in a real estate register.

Russian law does not set any mandatory requirements as to exclusive jurisdiction of domestic arbitration in relation to dispute resolution.

20 Applicable law

Which jurisdiction's law typically governs project agreements? Which jurisdiction's law typically governs financing agreements? Which matters are governed by domestic law?

In accordance with Russian law, the parties to the transactions that include a foreign element may specify a law other than that of the Russian Federation to govern their contractual relations insofar as the application of a specific foreign law provision is not considered to be contrary to public order of the Russian Federation.

There are certain cases where the contractual choice of foreign law is not permitted and the transactional agreements must be mandatorily governed by Russian law. If the agreement is not subject to such a mandatory requirement, however, it has to be notarised by Russian notaries; no Russian notaries will notarise an agreement governed by foreign law. Therefore, such agreements should be governed by Russian law. The transactional documents have to be governed by Russian law in the following cases:
- the transaction relates to immovable or intellectual property registered in the Russian Federation;
- pledge agreements – in the case of securing obligations under agreements that required notarisation (mandatory or contractual);
- assignment and transfer of rights and claims – if such rights and claims arise out the agreements that required notarisation (mandatory or contractual); and
- the transaction relates to the disposal or pledge of participation interest in the limited liability company registered in the Russian Federation.

Usually the loan facility documentation between a foreign lender and a Russian borrower is governed by English law. However, the security agreements (pledge, suretyship, etc) that are to be performed in Russia are usually governed by Russian law.

21 Jurisdiction and waiver of immunity

Is a submission to a foreign jurisdiction and a waiver of immunity effective and enforceable?

The Russian Federation is not a party to multilateral or bilateral treaties with most foreign countries for the mutual recognition and enforcement of court judgments. Consequently, should a judgment be obtained from a court in such countries, it is highly unlikely to be given direct effect in the Russian court. Moreover, should a judgment be obtained from a Russian court it will not be recognised and enforceable abroad.

The judgment of foreign courts may be recognised and enforced in a Russian court and the judgments of Russian courts may be recognised and enforced abroad based on the 'principle of reciprocity'. However, the grounds for application of this principle are uncertain.

Therefore, in accordance with international commercial practice in the transactions made between foreign and Russian parties or in

relation to assets located in the Russia, the parties usually choose international arbitration or Russian courts for dispute resolution.

The concept of immunity is poorly developed in Russian Law and it is, therefore, unclear what would be the precise effect of the purported waiver of immunity.

22 Title to natural resources

Who has title to natural resources? What rights may private parties acquire to these resources and what obligations does the holder have? May foreign parties acquire such rights?

Ownership right to subsoil

Under Russian legislation, the state (ie, Russian Federation) is the sole owner of the subsoil and non-extracted mineral resources. Such ownership right to the subsoil is inalienable. The subsoil plots may not be sold or otherwise disposed of.

Subsoil-use enterprises may only obtain the rights to 'use' the subsoil (but not the ownership rights) and such rights can only be granted by the state under a subsoil use licence. The title to the subsoil, nevertheless, remains with the state. The title to extracted products (eg, minerals) generally passes to the licensee from the moment it reaches the surface. The exercise of rights to use the subsoil is regulated and controlled by various Russian state authorities through an intricate system of federal and regional licensing laws and regulations.

Foreign investments

Foreign investors obtain access to the Russian subsoil-use system either by acquiring a stake in a Russian company or by establishing a Russian subsidiary engaged in developing subsoil plots. However, current Russian investment legislation sets out specific restrictions for foreign investments into the Russian subsoil-use system. In particular, foreign investors may acquire 25 per cent or more in the charter capital of a Russian company developing subsoil plots of federal importance only with prior consent of a special government committee headed by the prime minister of the Russian Federation.

Russian legislation provides for a number of other restrictions towards ownership of Russian resources by foreign investors. In particular, foreign legal entities (including legal entities in which more than 50 per cent of the shares are held by foreign persons) are not entitled to own agricultural land or border areas. Nevertheless, foreign legal entities still enjoy the right to own other types of land, for example, commercial land.

The privatisation of state-owned land by a foreign investor may be pursued with certain exceptions set by Russian legislation (in particular, the Federal Law on Privatisation of State and Municipal Property) and a specific plan (programme) on privatisation adopted by the Russian authorities. For example, Russian legislation prohibits privatising of coastal land that is adjacent to water objects (eg, lakes) that are in the ownership of the Russian Federation. In the event that the privatisation cannot be pursued, state-owned land may be leased under a long-term lease agreement of up to 49 years. The commercial land may also be leased by a foreign investor under a short-term lease (up to one year) that does not require state registration or a long-term lease (in practice, up to 10 years) that is subject to state registration.

Legal protection of minority groups

Russian law contains specific legislation aimed at protecting the rights and interests of aboriginal, indigenous and other recognised groups of people in the territory of the Russian Federation. Such groups have specific rights towards the use of mineral resources (eg, water, lands of different types, commonly used minerals, etc). Generally, Russian oil-producing companies enter into so-called 'social agreements' with the regional and local authorities (ie, the authorities of the region where oil companies carry out their activities) for support of such groups, for example, for construction of facilities, development of transport infrastructure etc. Failure to fulfil the requirements of social agreements by the subsoil users might constitute a ground for revocation of subsoil-use licences by the relevant Russian authorities.

23 Royalties on the extraction of natural resources

What royalties and taxes are payable on the extraction of natural resources, and are they revenue- or profit-based?

The list of payments related to subsoil use and mineral extractions paid by subsoil users are indicated, in particular, in the Federal Law of the Russian Federation No. 2395-1 on Subsoil, dated 21 February 1992 (as amended) (the Subsoil Law).

Under the Subsoil Law, the subsoil use-related payments include, in particular:

- fees for participation in auction and tenders;
- lump sum payments (eg, at the beginning of extraction); and
- regular payments for the use of subsoil.

Subsoil users are also subject to taxes in accordance with Russian tax legislation (eg, the Federal Tax for Mineral Extractions (NDPI)). NDPI is calculated on the basis of the value of extracted minerals (excluding NDPI on oil, natural gas and coal, which are calculated on the basis of the quantity produced). NDPI tax rates vary depending on the type of minerals produced. The zero NDPI rate is applicable in particular cases (eg, in relation to associated petroleum gas (APG), etc).

The participants of production sharing agreements (PSAs) pay taxes and fees in accordance with a specific tax regime set by Russian production sharing legislation. The principal law governing PSAs in Russia was adopted in 1995. However, since that time, no PSAs have been granted.

24 Export of natural resources

What restrictions, fees or taxes exist on the export of natural resources?

All companies exporting produced minerals (eg, oil, natural gas, precious metals and stones, etc) must comply with the state's export rules and regulations. The exporters are subject to payment of export duties in accordance with Russian customs legislation.

25 Environmental, health and safety laws

What laws or regulations apply to typical project sectors? What regulatory bodies administer those laws?

Regulatory overview

The primary source of Russian environmental legislation is the Federal Law on Environmental Protection (the Environmental Law) that designates environmentally sensitive land resources, mineral resources, soil, surface and underground water, forests and other vegetation, animals and similar organisms and ambient air as state-protected. Also, certain specific environmental protection requirements may be found in a wide range of laws, which include the Subsoil Law, the Land Code, the Water Code, the Forestry Code, the Law on Industrial Safety on Production Sites, the Law on Wastes of Production and Consumption, etc. These laws, together with the Environmental Law, are the principal laws constituting Russian Environmental Protection legislation.

Concepts of Russian Environmental Protection legislation

The Russian Environmental legislation is based on the following fundamental principals:

- 'pay-to-pollute' regime;
- pollution emissions and sewage disposal quotas;
- full compensation for damage to the environment;
- rehabilitation of polluted areas (for oil and gas companies);

- state ecological expertise of project documentation;
- licensing of operations with hazardous substances and waste; and
- creation of protection zones around hazardous production sites.

Regulating Authorities

The main government authority in charge of state environmental and health protection policy is the Ministry of Natural Resources and Ecology of the Russian Federation (Minprirody). Minprirody adopts rules and regulations for implementation of the Russian Environmental Protection legislation. The following Minprirody's agencies and services control the implementation of the Russian Environmental Protection legislation:

- the Federal Agency for Subsoil Use;
- the Federal Agency for Water Resources;
- the Federal Supervising Service;
- the Federal Service for Forestry Household;
- the Federal Service for Hydrometeorology and Environmental Monitoring; and
- the local offices of the above mentioned federal agencies and services.

The Ministry of Health Care and Social Development and its local agencies are the state bodies controlling enforcement and implementation of heath protection and safety legislation.

26 Project companies

What are the principal business structures of project companies? What are the principal sources of financing available to project companies?

Legal forms of project companies

Russian corporate legislation provides a number of legal company forms (eg, limited liability company, joint stock company, partnership, etc).

The most commonly used forms for project companies are a limited liability company (LLC) and a joint stock company (JSC). A JSC may be incorporated in the form of a closed joint stock company (CJSC) or an open joint stock company (OJSC).

The charter capital of an LLC is divided into participation interests, which are not securities. A participation interest represents rights to part of the company's net assets, proportionate to the participants shareholding. An LLC cannot proceed with any public offering of shares or be listed on stock exchanges.

The charter capital of a JSC (both CJSC and OJSC) is divided into shares, which are securities. The CJSC is essentially intended as a vehicle for a relatively small number of shareholders (up to 50), whereas the OJSC is intended as a public company.

According to contemplated changes of Russian civil legislation, companies shall be divided into public and private legal entities.

Sources of financing

Once established, the project company may be financed by means of an increase of the charter capital of the project company (either in kind or in cash), intercompany or third party loans, IPOs (for OJSCs), issuance of corporate bonds, etc. In certain cases, donations from the state can be used for financing the project.

27 Public-private partnership legislation

Has PPP-enabling legislation been enacted and, if so, at what level of government and is the legislation industry-specific?

The current federal Russian legislation does not contain a special law devoted to PPP. However, on 22 June 2012 the Federal Ministry of Economic Development published on its official website a draft Federal Law on PPP for discussion (the Draft Law). The Draft Law, particularly introduces the concepts of public (ie, the state) and private (ie, the investor) partners, determines the peculiarities of relations between public and private partners, defines the subject matters of the PPP agreements, etc.

Currently, the principal federal law related to PPP is the Federal Law on Concession Agreements (the Concession Law). The Russian federal government has also enacted model concession agreements for transport sectors, such as roads, railway, pipelines, sea, river ports, etc.

As for regional laws on PPP, a number of Russian regions and municipalities passed laws related to PPP projects, in particular, St Petersburg, Moscow, Tomsk oblast, Altay region, etc.

28 PPP – limitations

What, if any, are the practical and legal limitations on PPP transactions?

Pursuant to the Concession Law, the model forms of concession agreements are approved by the government. The Concession Law does not provide much discretion to the parties to change or amend the provision of model concession agreements.

The Concession Law does not set out many incentives for the investor. For example, the investors may enjoy only lease and sublease rights over the land where the concession project is being implemented. The investor may not transfer its lease or sublease rights to third parties unless otherwise is provided by the land lease or sublease agreement.

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However, the Concession Law provides for guarantees of rights and lawful interests of the investors (eg, protection of rights and lawful interests of investors, right to claim damages, etc). All investors (either Russian or foreign) enjoy equal rights. In addition, discriminatory measures cannot be applied to Russian or foreign investors with respect to their investments and proceeds received from such investments.

The Concession Law sets out that all disputes arising out of the concession agreement will be resolved solely in the state courts or in the arbitration courts in the Russian Federation (eg, in the International Commercial Arbitration Court under the Chamber of Commerce and Industry of the Russian Federation).

It appears that the Draft Law provides more comfort for the PPP investors and is focused on minimising the risks of the investors. In particular, under the Draft Law, the investor is entitled to request changes to the conditions of the concession agreement in the event of changes to state regulated tariffs and to claim compensation for illegal actions carried out by the state authorities.

29 PPP – transactions

What have been the most significant PPP transactions completed to date in your jurisdiction?

Russian PPP projects are not completely up to date. The majority of PPP transactions are either pending or frozen. Generally, the PPP projects relate to transport sector. Such examples of PPP projects include, in particular, Pulkovo airport reconstruction, construction of Moscow – St. Petersburg highway, the Sochi 2014 Winter Olympic Games projects, etc.

Update and trends

At the present time, we are experiencing the most wholesale revision of Russian civil legislation that has occurred in the past two decades. The first draft of amendments to the Civil Code was passed by the Russian state duma in April 2012. Numerous amendments to this draft are now being prepared and discussed. However, it appears that the cornerstones and main concepts introduced by the draft amendments shall remain and be approved by Russian legislators. The proposed amendments have quite a radical character since they contemplate conceptual changes of current Russian civil law and introduction of completely new legal concepts adopted from foreign legal systems. Such amendments, for example, include the division of the companies into public and private entities, the recognition of representations, warranties and indemnities, the introduction of inter-creditors agreements regulating priority of demands and framework and escrow agreements. These changes shall undoubtedly have impact on the regulations described in this chapter (including Russian law security). It is not clear when such amendments will be finally approved and enter into force, however, when reading this chapter, such forthcoming changes should be considered.

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