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Realizing Russia's Potential
THE LEGAL ENVIRONMENT AND ITS IMPACT ON BUSINESS
Round Table

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St. Petersburg, Russia
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Moderator:

Dmitry Afanasiev, Chairman, Co-Founding Partner, Egorov Puginsky Afanasiev & Partners

Panelists:

Kirill Androsov, Managing Partner, Altera Capital

Ruslan Ibragimov, Vice-President for Corporate and Legal Matters, MTS

Leonid Melamed, Member of the Board of Directors, Rusnanomedinvest; Chairman of the Board of Directors, Team Drive

Andrei Nikitin, General Director, Agency for Strategic Initiatives

Ivan Oskolkov, Head of the Department for Innovation Development and Corporate Governance of the Ministry of Economic Development of the Russian Federation

Anatoly Tikhonov, Member of the Management Board, First Deputy Chairman, State Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank

Boris Titov, Chairman, All-Russian Public Organization Business Russia

Andrei Tsarikovsky, State-Secretary, Deputy Head, Federal Antimonopoly Service

Front row participants:

Christian Herbst, Partner, Schoenherr

Sergei Kuznetsov, Head of Law Department, State Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank

Oleg de Lousanoff, Partner, Hengeler Mueller

Andrei Popov, Director, Department for Legal Issues and Corporate Governance, Rosatom State Nuclear Energy Corporation

Tomasz Wardyński, Advocate and Founding Partner, Wardyński & Partners

Alexei Zagorovsky, Chief Executive Officer, Shtokman Development AG

D. Afanasiev:

Good morning, ladies and gentlemen. First of all, as you have come here this morning to work, I would like to congratulate you on having successfully survived yesterday's 'white night'. And allow me to thank you very much for coming to support us despite today being Saturday and the last day of the Forum.

This morning, a colleague told me the following story. During a conference, the presenter comes out on stage to find that his audience consists of just one person. The presenter says, "Why should I present if only one person has come? I think I will go." The lone audience member objects, "Absolutely not: I paid the conference registration fee and want to hear what you have to say." So the presenter gives his speech and is getting ready to leave when the audience member says, "No, you cannot go, I am the next presenter."

Fortunately, today's situation is different; for this, I am truly grateful to you. We have a discussion of a very pressing topic ahead of us, and, a bit later, I will say a few boring words on what this topic is about and why we have gathered these particular people here. But, since one of our guests must leave us early due to important business in Moscow, I would like to speak very briefly and pass him the microphone for a short presentation.

In brief, what is a legal environment? It is an organism's circulatory system. We can treat a patient's sore arm, leg, or head, but if the circulatory system is not working, everything will be to naught. This is the general topic of today's session. Each of those present, presenters and commentators, has his or her own view on it. But first I would like to cede the floor to Andrei Nikitin, General Director of the Agency for Strategic Initiatives. I believe that the overwhelming majority of those present know what this agency is. For those who do not yet know, I will say that this is an extremely important new organization which has become the nerve centre for not only the concepts but also the practical implementation of the civil society and business community initiatives that the government has undertaken in order to improve the investment climate in our country. I beg Mr. Nikitin to say a few words,

and once again thank him for finding the time to come even though in the next few hours he needs to be in Moscow.

A. Nikitin:

Good morning, colleagues. A big thank you for the invitation.

I will be brief and will simply try to explain what we do and how we do it. Under the chairmanship of Boris Titov, many proposals were voiced at the Delovaya Rossiya conference in December. Business proposed various ideas and initiatives of various scales; that is, some were more comprehensive and others were of a more industry-specific character. Vladimir Putin, who was attending the conference back then as Prime Minister, proposed the format for the so-called National Entrepreneurial Initiative.

What is this? It is an invitation to business to independently set out for the Government and the Presidential Administration what needs to be done to improve the investment climate in the country, and create the investment climate that entrepreneurs require. Changing the attitude of entrepreneurs themselves to the conduct of business in the country is a key issue, while change in Russia's position in the ratings – the '100 steps forward' challenge – is secondary.

We were tasked with implementing the National Entrepreneurial Initiative. In point of fact, we do not actually do this, but we do function as a forum, a kind of moderator. When government agencies act like they do not understand the language of the entrepreneur, we act as a translator. We do not occupy the position of an expert. We are exclusively a conductor of the ideas provided by businessmen. We have no expert perspective as a matter of principle; we do that which business requires.

What should we discuss and what would we like to ask you, colleagues? We began with customs, with construction, with one thing or another, but later on, invariably we will arrive at the legal environment because the art of making decisions in business, the art of moderating conflicts or of moderating changes comes down to consensus, agreements, in some cases court rulings, and so on and so forth. At the moment, there are several road maps on our agenda. From Monday, we will be looking at

how to implement three of them. They are, perhaps, not the most comprehensive ones. The first is company registration: we want to simplify this procedure significantly. The second road map is related to property registration. As the World Bank inquiry showed, despite the fact that, here in Russia, property is registered by a federal agency, it is done differently in different regions. We would like this to happen within minimal timeframes and at minimal cost. Thanks to the initiative of the Minister of Economic Affairs, we will have a working group on simplifying regulatory practice. As you know, the Government has approached this idea more than once, and yet to this day it is still necessary to have a notarized copy of the charter, meaningless seals, and so on. We intend to finally remove these barriers.

In the autumn, we will begin to create a road map for protecting investors' rights. It promises to be one of the most complex because we must first determine what constitutes the protection of investor rights: financial guarantees, protection in the courts, a degree of liberalization of the criminal code? There are very many approaches and I, as the General Director of the Agency, am most afraid that we will take on a range of issues that is too wide and as a result solve each one in only general, not concrete terms. I want my road map to be full of concrete things which can be implemented, which we can ask for, and which will bring concrete results. We do not need declarations. No-one needs them, neither the Government, nor the President, nor business.

I would particularly ask you to focus your discussion today on the following question: what do we mean by the protection of investors' rights? Because you, the entrepreneurs, must answer this question and tell our agency which direction to move in and what the priorities should be.

I have already heard several opinions. There is the opinion of the financiers that greater guarantees are needed to protect investments from fluctuations in the economy. There is the opinion of those who worked on the liberalization of the criminal code that, before anything else, there must be a guarantee against groundless criminal prosecution. As a former entrepreneur, my perspective on the protection of investors' rights focuses most on an effective and fair system of legal

adjudication because we in business operate by means of agreements and contracts, and in the event of conflicts, someone who will solve these issues is always needed.

Just a few more words. The Agency, as they said in Soviet times, warmly welcomes the creation of an ombudsman for the protection of entrepreneurs' rights. We wanted this; we moved towards this together. Boris Titov has a huge amount of experience, including his work with Delovaya Rossiya. We will be creating the road map for the protection of investors' rights together. We will try to do it in a manner that leaves the ombudsman with as little work as possible.

I will pay very close attention to the results of this discussion, and I promise you that you will see your solutions implemented in practice in the very near future. Thank you very much.

D. Afanasiev:

Thank you very much. Colleagues, at one point in time, our legal firm became concerned with the following phenomenon: very few transactions in our country are carried out under Russian law. Is not this partially the reason for the inadequacy of the investment climate? We conducted a survey of our clients. The firm is large, and the survey turned out to be quite large. I cannot claim that this was a scientific survey, nor that it qualified as a sociological investigation, but it was what it was. Take a look at what came to light. About 10% of significant business transactions in the country are carried out in accordance with Russian law. The shocking situation is that 33% of companies subject 10–50% of their transactions to Russian law, and only 10% of companies subject more than 50% of their transactions to Russian law. In our survey we asked, what is the reason for this? The responses were no less shocking. Sixty-seven percent of legal department managers from Russian companies replied that this was due to the inconvenience of Russian law for conducting business. Sixty-two percent said that they preferred foreign courts and therefore draw up agreements on the basis of foreign law so that they will include the arbitration provisions of that jurisdiction. Forty-eight percent mentioned the tax

regime. Fourteen percent responded that they had foreign counterparts. Fourteen percent referred to a desire to conceal the beneficiaries of the transaction, and 10% cited a lack of reliable mechanisms for protecting investors' rights through the civil code.

What is the significance of these figures? Our businesses create offshore entities not to evade taxes but so that the transaction may have a cushion that allows it to be subject to foreign law; so that, in the event of a dispute, it may be examined in a foreign court. Why did we see this as a bad thing? First of all, I am convinced that this is a threat to national security: in five to ten years, English courts will be deciding the direction in which Siberian rivers flow, and English lawyers will be explaining the issue to them.

Secondly, this leads to stagnation in Russian law. If we talk about the need to develop the rule of law, but do not provide opportunities for the development of legal scholarship or practice in our country, then we are unlikely to solve this problem. The consequence of this will be the collapse of the Russian legal sector. Perhaps this worries the audience least, but the fact remains: our national legal sector is falling behind because it is uncompetitive under conditions in which transactions are entered into under non-Russian law.

Further, this creates additional expenses for Russian business because foreign litigation is not cheap. Finally, this constitutes lost income for the Russian state because these transactions are undertaken beyond Russia's borders. All of these together influence the country's rating by the World Bank, which assesses the investment climate based on the protecting investors indicator.

The question is, what is to be done? In Russia, this question is not a new one. It was answered, again, by business representatives, the heads of legal departments of the largest Russian companies that we surveyed: 67% percent replied that legal regulation needs to be made more flexible and that contractual freedom must be guaranteed in practice, so that businessmen can enter into transactions in a manner convenient to them. Secondly, the legal instruments which are called upon and used every day in foreign legal systems need to be introduced into Russian law –

indemnities, conditional transactions, and so on. Then, 48% said that the feedback loop between the legal community and government needs to be improved, so that government could heed what needs to be done to increase the attractiveness of the Russian legal environment.

There are three things that can be done as soon as today. The first is to widen the principle of optionality in corporate law, especially in the sphere of relations between entrepreneurs. What does this mean in layman's terms? This is when you and I enter into a transaction and the government gives us the option of drawing up an agreement in any way we like, as long as this agreement does not infringe on legitimate public interests – that is, the interests of the state and society. If our transaction does not impact on society's interests, then who cares how we come to an agreement about a put option, a call option, or whatever else? These basic, simple things will help make the Russian legal system more attractive.

Second. Although entrepreneurs continue to prefer foreign courts, over the past few years huge progress has been made in the reform and positive development of the Russian *arbitrazh* court system. A lot of work has been accomplished. All investors note that when they find themselves in an *arbitrazh* court, they feel more protected than ten years ago. Another interesting piece of evidence is that foreign legal firms have begun to develop legal practices in their Moscow offices, whereas before they would not even come near Russian courts. Nevertheless, because it deals with one of the more conservative parts of the state (as is the case in every nation), reform of the court system will take an enormous amount of time.

What can be done today so that entrepreneurs can comfortably resolve their disputes here in Russia? We can develop a legitimate, powerful, and modern system of commercial justice. Unfortunately, this system discredited itself in the 1990s when 'pocket' arbitral tribunals were being established practically in people's apartments. But this is a parody. There are examples in Europe: we have the London centre for arbitration, the one in Paris, the continental one, as well as, nearer to us, the ones in Zürich and Stockholm. We need to identify an example along these lines, and in accordance with its principles, either develop our existing

system or create something new. The most important thing is that it should be a modern European model.

Third: the time has come to regulate the field of legal services. But I think we will talk more about this later.

For now, I would ask Boris Titov to express his opinion. As you know, the President of the Russian Federation, Vladimir Putin, literally two days ago appointed Mr. Titov Commissioner of Entrepreneurs' Rights.

Mr. Titov, I thank you for finding the time to come. As I understand it, this is your first public appearance since your appointment.

B. Titov:

Many thanks. The first thing was a comment about private initiative, which Stolypin unleashed, and which rescued Russia at that moment.

The topic we are discussing today is, at the moment, the main topic of my life. The creation of a favourable legal environment for business development, the protection of entrepreneurial rights and the protection of corporate and private property are the areas which are set to dominate my work in the near future. Therefore, the topic proposed today by the legal community and the legal firm Egorov, Puginsky, Afanasiev and Partners is very relevant as a starting point for an entire approach. By the way, I wanted to first thank you, Dmitry, because, from the beginning, your firm assisted Delovaya Rossiya and the Business Against Corruption Centre for Public Procedures in their work in this area. When we fought for the rights of entrepreneurs in relation to specific complaints and problems arising for specific people – we had small businesses such as bakeries or flower growers – your firm provided pro bono legal assistance, conducted legal audits free of charge, and played an active role in our work. Thank you very much.

Returning to the immediate problems and proposals which have been raised, today it is very important to conclude that priority process which we have so lengthily but with legal precision named the 'humanization of criminal law in the economic sector'. Much has been done, but the first steps have already given us an idea of

how the authorities, the individual civil servants, react to changes in the law – the kinds of workarounds they find. Today we are preparing a new package of legislative initiatives, which will encompass several sections of the Criminal Procedure Code, especially article 159 on fraud. I will not be focusing on this at the moment because this is a very serious challenge. Entrepreneurs are being imprisoned at the preliminary investigation stage precisely because of article 159, and this is very hard to avoid. We must change it but not in the manner that the Supreme Court suggested today: it proposes to itemize the types of fraud covered by the law, but preserves the main article, and that will not work at all. Furthermore, our raider class is so creative that it will be necessary to create an enormous amount of statutes to cover all possible initiatives on their part. It is impossible to describe all the possible schemes for fraud, and therefore we are proposing a somewhat different route. But I can explain this a bit later when we have fully formulated our proposal.

In connection with this, it is important to solve the following problem: today, neither corporate nor civil law plays the leading role in our entrepreneurial life. This role is fulfilled by the threat of criminal prosecution. The prosecutor basically decides who is in their right and who is guilty, whether the debt needs to be repaid or whether we have agreed that it need not be – and whether there ever even was a debt to begin with. It often happens (just recently there was a case in Volgograd) that both parties have no complaints against one another, but since it is necessary to take a swipe at this or that entrepreneur, a statute is found on the basis of which an indictment can be made. A law enforcement official initiates an investigation on behalf of one party, who is allegedly the victim, even though this party does not consider itself as such. Therefore it is extremely important to develop the initiative proposed by the President in his pre-electoral and, later, post-electoral speeches and executive orders: commercial disputes should first be examined via the civil process, while criminal proceedings should only be initiated in the event that the civil court's ruling remains unheeded. Pursuant to this, we are proposing an amendment to article 140 of the Criminal Procedure Code in relation to entrepreneurial activity – the definition

of which does exist in civil law. Our variant proposes the possibility of commencing criminal proceedings only after the non-execution of the commercial or civil court's ruling.

We are pushing a lot of things forward in legislation, but we are currently most actively discussing the possibility of creating a new judicial platform. We are not talking about courts of general jurisdiction, but specifically about courts of arbitration that resolve problems and disputes occurring in the course of entrepreneurial activity in a straightforward manner. As Dmitry correctly pointed out, the state *arbitrazh* system has taken significant steps forward. Today we harbour fewer suspicions that a particular process is not objective, that bribes are accepted, that rulings are simply put out to tender, and given in favour of whoever pays more. We have moved forward from a standstill, and the courts have become more objective, transparent, and independent. The problem with our *arbitrazh* system is that it is not professional. Courts that issue rulings on our professional disputes are not specialists in those forms of law, or in any of those forms of entrepreneurial activity that we are engaging in. They must resolve issues in the area of space law if there is an issue during the launch of an aircraft, and simultaneously be specialists in the medical field when ruling in a dispute over a contract for medical or pharmaceutical products. Our state arbitrators must be specialists in everything; however, the level of their education and preparation does not of course give us grounds to treat them as such. For these reasons we must take the same path as most nations' corporate systems: we must create independent arbitral tribunals that are based on a lengthy list of independent, private arbitrators who are not specialists in law per se, but are specialists in a particular specific business field or in the legislation pertaining to a particular industry.

And another thing: the parties in the process must retain the right to choose arbitrators whom they trust, at least one out of the three participating in the arbitral tribunal's proceedings.

In Russia, there is legislation on arbitral tribunals, and of course there are problems with it. For example, arbitral tribunals and their rulings must be ratified by a federal

court ruling, affirming that the procedure was followed correctly. Unfortunately, this is not always the case because federal courts attempt to involve themselves in the issue at stake and make their own ruling. But even this is not the main issue. Those institutions that currently exist are not broad public institutions, enjoying great support. There is the court at the Chamber of Commerce and Industry that has great historical experience, but, unfortunately, there are no professional judges there, and their procedures are outdated. It must either be modernized or, perhaps, merged with the Agency for Strategic Initiatives as a primary organization for this process, thereby creating a powerful and independent arbitration process that is supported by the majority of the corporate class. I see this process as one of the main areas that an ombudsman should engage in, as someone who must protect the rights of entrepreneurs.

That is probably all that I wanted to say today. We must work out this road map today. A very positive process that brings us nearer to the specifics is underway at the Agency for Strategic Initiatives. From general theoretical positions, meandering between various offices, and agreement at three different levels, we are setting out on a new path and coordinating directly with the country's leadership. We could also have used such a system in solving this particular challenge. Thank you.

D. Afanasiev:

Many thanks, Mr. Titov. It seems the government heard the cry in the wilderness: I am referring to our professional legal community. In connection with this, I would like to pass the microphone to Ivan Oskolkov, Head of the Department for Innovation Development and Corporate Governance of the Ministry of Economic Development.

I. Oskolkov:

Colleagues, I will be brief. I think that there are more opinions to be expressed here, and for that we will need some time. I would not like to impose in the name of a government body. On the topics of imperative law and optionality, I will point out that

our legislation has been formulated and that cannot be ignored. The civil code is formulated, it has been accepted for some time; everyone is accustomed to it. Businessmen work in accordance with it, judges judge by it, investors rely on it when deciding whether to participate in this or that project. We need to highlight the right questions. The question of how to protect investors' rights is extremely important. But when formulating investment, corporate, or civil law, it is on the whole very important not to get carried away. Why? Dmitry had a wonderful slide from the quick survey showing that only 10% of those surveyed replied that investors' rights are poorly protected. We have a wonderful civil code and wonderful laws – precisely from the perspective of the protection of investors' rights. But for whom are they wonderful? For the investor who has already come and said, "I am an investor, and I am investing money here." It is at this point that our laws are good.

Probably, something different is needed from the legal system at any given stage. Of course, statutory provisions and the legal system should further objectively and effectively protect the rights of established investors who have entered into an agreement under Russian law in the Russian Federation, or who have entered into a transaction or legal undertaking – this is undoubtedly a priority. But, it is extremely important in the current legal environment, the legal system, that we create stimuli to attract people, so that people who will later need to be protected, come to Russia in the first place.

From what I understood from Dmitry's presentation, and from my own experience with this situation, they come to us rather unwillingly. There are two reasons for this. Those who have interests in physical assets and business in Russia try to register everything under foreign law. This is a threat to us, and constitutes a wrongful situation in which deals effected with Russian assets are made and arbitrated abroad. It is evident that a good part of the blame lies in the form of our civil law.

And, a second reason. Considering the way our legislation has taken shape, it is very hard to do some things now. Instruments that investors are accustomed to using are described practically outright in our legislation, yet there are not enough of these instruments. The principle of optionality which we would all like to have exists

neither *de facto* nor *de jure*. It is the common-place things which are lacking, from the point of view of foreign investors. It is impossible to limit the legal capacity of an organization within a project that is being implemented by the same organization. There is no possibility for a project's participants to effectively agree on how they will manage it. There is no possibility of entering into a corporate agreement under our law that can later be defended in court. This issue should become one of the key themes in the aforementioned road map for protecting investors' rights. There is a wonderful platform for resolving these problems: amendments to the civil code. Here, the Ministry is actively cooperating with the business and legal communities. We hope that in the autumn, many problems will be solved. I will not take up any further time, Dmitry.

D. Afanasiev:

Many thanks, Ivan.

The day before yesterday, in his speech to the Forum, the President of the Russian Federation voiced a few priorities for improving the investment climate. One of the more important priorities he pointed to was the continued reform of antimonopoly law and law enforcement practice. Moreover, as of late, the business community has been watching with interest how the Federal Antimonopoly Service manages various legal conflicts: for example, between a shareholders' agreement concluded under foreign law and Russian public policy, including the part of antimonopoly legislation that conflicts with provisions of foreign shareholders' agreements.

I would like to ask you, Mr. Tsarikovsky to comment on these points and on the overall activities of the Federal Antimonopoly Service with respect to improving the country's investment climate. Andrei Tsarikovsky is Deputy Head of the Russian Federal Antimonopoly Service.

A. Tsarikovsky:

Good day. Why are there constant conflicts of interest in the area of law? The heart of the matter is that transactions which have a bearing on antimonopoly legislation

cannot be completed either in England or in the Bahamas. They can only be completed in Russia. The starting assets involved are located in Russia and – regardless of how an agreement was reached, who the business entity is, or what the national or territorial affiliation is – the Antimonopoly Service will only give its authorization within Russia.

Therefore, we have already become specialists in different types of law, from Anglo-Saxon law to the most exotic forms that really create conflicts. Many transactions are completed under laws that have no analogues in Russia.

However, there are some pluses. Sometimes it is much easier to build something from nothing than to redesign something. The specifics of Russian antimonopoly legislation are pretty interesting. I will attempt to quickly set out several principles of where the law should help business instead of harming it.

First of all, complementarity with international law. The new law of 2006 is fairly complimentary, and we are extending this approach in terms of Russia's accession to the WTO and later the OECD. I am not saying that our legislation is identical to that of the European Commission: it is complimentary. That is, the regulations that it prescribes are perfectly clear to legal experts who work in Europe and America.

The second principle is legal transparency and interaction between state bodies and the business community. There are several mechanisms in which many colleagues participate successfully. I would bring to your attention three such mechanisms that have been functioning for a while now, even though in some departments they are only now being created or planned. Firstly, there are expert councils that are usually dedicated to some industry-specific problem. Secondly, there is the Public Supervisory Board, created six to seven years ago. Many of its members are familiar with our work and would not accuse us of opacity. The third mechanism is newer. It has been in the process of being created for the last few years, but is of most interest to those present here as an example of active work with our service. I am talking about the Russian Jurists Association's non-profit partnership, the Competition Support Association, which works on antimonopoly legislation and competition law. Similar mechanisms are common among many bar associations. It

is a very lively mechanism. It helps clarify the law as early as the development stage. It also helps to clarify law enforcement and to amend the law in case a dispute situation arises.

But there remains a question that was already brought up in earlier presentations. We are trying to overcome it through a series of joint seminars with colleagues: the question concerns the divergence of our rulings and those of the *arbitrazh* courts. Though for many government departments the word 'court' is scary, personally, I conclude practically every session of my commission with the words, "see you in court." Our work involves significant interests and multibillion rouble fines, so being in court is a way of life for us.

Unfortunately, we do not have the kinds of specialized courts that exist in many countries. Obviously, many judges are not specialists in, say, antimonopoly law, which is one of the most complicated kinds of law, and so it is very difficult for them to decide a case. Precisely because of this, the percentage of cases that go to the Higher Arbitrazh Court is very high. The judges' qualifications as judges are uncontested, but in practice, one needs to be not only a jurist but also an economist to make a ruling concerning this specific area of law.

People are always expecting news and questions from us. Lately, I am often asked whether there will be a third antimonopoly package, and there is much surprise when I ask in response why so many packages are necessary. The answer is simple. It is not that we overlooked something, but that antimonopoly legislation reflects the general economic structure and the general business situation in the country. We are changing fairly quickly and, naturally, legislation must change too. To the question of whether there will be a fourth antimonopoly package, I like to reply that a third one already exists but a fourth one is never to be. Nevertheless, presently we will be discussing a series of interesting ideas. I will set out a few of them. I would like to hear your responses and engage with you through the mechanisms I mentioned.

The first question is fairly complicated; it is about parallel importing. Personally, it seems to me that the current arrangement in the civil code gives rise to a situation that is very detrimental to competition.

The second topic is the publication by business entities of their internal and commercial policies. Transparency in these policies could remove many of the questions that arise in antimonopoly organizations.

Third. The time has come to do away with notified transaction monitoring. It would be sufficient to monitor only the largest transactions, where our permission is required. Notified transactions should become a thing of the past. They represent extra paper and extra work for both the businesses and for us. Truthfully speaking, our hallways are not limitless. We already have no space to put cases.

These are the subjects that I would like to submit for discussion. We would be very happy to get feedback through the platforms I have mentioned today. Thank you.

D. Afanasiev:

Thank you, Mr. Tsarikovsky.

We have in our country a very important development institution, which last year got actively involved in the work to improve the Russian legal environment and, therefore, the investment climate. I would like to pass the microphone to Anatoly Tikhonov, First Deputy Chairman of Vnesheconombank.

A. Tikhonov:

Thank you, Dmitry. We really did get actively involved in this work with you last year, and thereby supported the creation of a commercial partnership for the development of corporate law. We did this completely consciously. There was an appeal from Delovaya Rossiya to the Prime Minister and to our Supervisory Board, and we accepted this assignment. Truthfully speaking, we are consulted on many issues, and we do not always have the opportunity to respond. We are specifically a development institution; even our status is special: we are a governmental corporation as well as a bank. In fact, at the moment we are not just a bank but an

entire group that includes a full-service commercial bank, a specialized bank, a specialized company, and banks in CIS countries. Legal work constitutes an inalienable part of our activities, and we are aware of all the problems with our legislation.

I can provide the example of when, due to anti-crisis legislation, we had to quite rapidly issue credit as part of the so-called refinancing scheme. We were forced to use English law to do this. Our legal system is built in such a way that sometimes it is easier even for us, a government corporation, to meet our client's wishes and complete a transaction under English law. As a result, all proposals of a non-commercial partnership are not empty words for us, and even on those issues that are being resolved thanks to our cooperation with you, we see opportunities for further improvement.

As you know, we are actively developing a concession mechanism. This is one of the priorities for economic development today. For example, yesterday we signed one of the largest agreements the modern Russian economy has seen: a construction agreement for the Western Rapid Diameter. There are gaps in respect to securitization. Objects of concession cannot function as securities, but we, as a bank, naturally have to obtain securities, and we have to develop innovative new mechanisms. The result is that we are coming up with alternative methods ourselves and creating additional burdens for our borrowers. Here is an interesting situation: we exercise the principle of noncompetition with commercial banks and therefore, naturally, we can dictate our terms to the borrower. But this is not very good when, due to legislative gaps, we end up overloading them with requirements. This is already an issue in terms of the investment climate.

To give my colleagues and other participants a chance to speak, I will come to a conclusion. It is very important for the state to listen to business today. It is important that the state understands, thanks to the contributions from the legal community, what amendments need to be introduced to the law to improve the investment climate and simplify the workings of our business – to make it accessible. Dmitry spoke also of the losses incurred by the legal business. I can say

quite cynically that this worries me much less. Of course the legal business is also a business. It is a large business environment, but the most important thing is that the legislation works for our business in our circumstances: then, naturally, our legal firms will be making money too. For our part, as a development bank, we will carry on our work in any environment. We are actively cooperating on various issues with the Agency for Strategic Initiatives and with the Ministry for Economic Development, which maintains such an active position on this issue. I would like to thank Mr. Oskolkov. We managed to accomplish many things as a result of his active engagement. And so we will continue to participate actively in this joint area of work. Thank you.

D. Afanasiev:

Thank you, Mr. Tikhonov.

Today, we have with us a person who possesses unique life experience. Initially, he looked at the problems we are discussing today from one side of the barricade; now, he is looking at them from the other. I would like to pass the microphone to Kirill Androsov. Mr. Androsov worked as Deputy Minister of Economic Development and Trade of the Russian Federation. Later, he became Deputy Head of the Office of Prime Minister Putin. Last year, to the surprise of many, he left the civil service for private business and founded the Altera Capital fund. But, of course, he could not leave entirely: Mr. Androsov is still Chairman of the Board of Aeroflot, and Chairman of the Board of Russian Railways. Mr. Androsov, you have both business and civil service experience. It would be very interesting to know whether your perspective has changed, and what you think about the relevance of the questions raised today.

K. Androsov:

Thank you, Mr. Afanasiev.

It has already been two years since I left the civil service. I cannot say that I made any fundamental discoveries after beginning, with my partners, to actively develop private equity in the Russian Federation. All the things mentioned in your

presentation were often discussed in the Ministry of Economic Development and the Ministry of Justice.

In consideration of our audience's time, I would like to draw attention to just one thing that really became an interesting revelation for me and that deserves the attention of many of my colleagues. Most of our civil servants harbour the illusion that there are still secrets in the financial or judicial world, secret fund transfers, secret deal structures, secret beneficiaries. After two years of work and the experience of closing two transactions, I am ready to assure you that, in today's world, it is impossible to evade AML or KYC procedures. It does not make sense. I assure you that the Swiss Prosecutor's Office knows much more about the turnover and nature of transactions on the accounts of our so-called politically exposed persons than even the most competent agencies of the Russian Federation.

This too is a peculiarity of Russian law. After all, one of your slides noted that 14% of Russian companies choose offshore jurisdictions in order to conceal the ultimate beneficiary. It seems to me that today we need to free ourselves of illusions. I think that this is possible and even necessary. This is probably the observation from my experience that will be of interest to the audience. Thank you.

D. Afanasiev:

Thank you very much, Mr. Androsov.

Boris Titov has to leave on important state business. I think it would be appropriate if the entire audience wishes him success in his new important endeavour. All the best, Mr. Titov.

B. Titov:

Thank you very much. For now, I have important private business in order to hand over the management of my business. I am going into civil service for the first time: the process turns out to be very complicated and difficult... Now, just to take a holiday, I need to notify the President. And I will spend the weekends extricating myself from the management of Abrau-Durso.

D. Afanasiev:

We will drink some Abrau-Durso sparkling wine today to your health and your success.

Positive shifts in the collective awareness of pressing problems occur in large part thanks to the activity of not only legal advisors, but also Russian business, specifically the heads of legal departments in the largest Russian companies. They know better than anyone else what the pressing issues are, and what business needs in order to successfully develop in our country.

I would like to ask Ruslan Ibragimov, Vice President of Corporate and Legal Matters at MTS, to comment on the issues we have been discussing today.

R. Ibragimov:

Thank you, Dmitry.

I would like to come back to the presentation, which quite explicitly shows the situation as it is today. We also took part in your survey. Our numbers differ somewhat, but our conclusions are largely the same as yours.

We support the assessment of the legal system which has been presented today. Why do we consider that it is a problem for us? Not least because going through other jurisdictions costs more. We counted once how much more money we spend on structuring transactions under foreign law. On average, maintaining and managing special companies abroad, conducting due-diligence, hiring lawyers and so on, increases our expenses by up to USD 5 million. I am not talking about our expenditures in foreign courts, if that happens. In those cases, the sum is an order of magnitude larger.

This conclusion alone forces us to consider how the situation could be improved: how we could return to Russian jurisdiction, work with our expenses, and so on.

We understand that today, in leaving Russian jurisdiction, we are thinking about how to protect the interests of our investors and shareholders, even at such an inflated cost. Nevertheless, we believe that we have matured enough to the point

where we can conduct transactions under Russian jurisdiction, and the only thing that we are by now used to and will miss under Russian jurisdiction is optionality. Business grows ever more complicated. We have to take into account many new considerations. All of this is reflected in the way deals are structured. We are entering into ever larger contracts, and encountering the need to formulate the rules of large transactions in more detailed ways. At present, our legislation is mostly imperative. Our wish is to see it become more optional.

Today we see this issue in a fairly optimistic light because the civil code, which is currently being discussed and will be adopted in the near future, is moving towards optionality. On the topic of transactions, I have already off the top of my head counted about 20 articles that develop the principle of optionality, which is a good start. The next question is how this will be applied in practice. It is still too early to discuss this at the moment.

The future civil code will also contain up to 300 articles containing valuation concepts, which also works towards the principle of optionality. When the concepts of good faith, reasonableness, and equity are widely applied in the civil code, we will be proceeding on the basis of those in all kinds of transactions. This inspires optimism and also apprehension because in practice it is hard to evaluate these principles. We do not have enough judicial experience with them.

One way or another, the new civil code, if it is adopted, will give us more optionality and will help increase the percentage of transactions completed under Russian law. But the civil code by itself is not enough to keep Russian companies within our jurisdiction. For a long time now, we have had no need to conceal the ultimate beneficiaries of our transactions. There are certain problems with taxation. Here it is too high, there it is too low, and therefore this often also plays a role in the choice of jurisdiction.

And, there are issues concerning corporate law. In the area of corporate management it is also necessary to introduce, piecemeal, norms of optionality. Many things depend on this: costs, the number of councils that need to exist in a company, the number of independent directors, and so on. This is all already

worked out in public companies, and attempts to regulate these issues now in civil law seem to us, at least in relation to public companies, unnecessary.

I agree that we need to give thought to the improvement of arbitration law. Issues concerning enforcement proceedings are also important to the choice of jurisdiction. Agreements concerning the recognition and execution of court rulings in foreign nations are also an important aspect, as are agreements on the protection of international investments. I would like to also note agreements on avoiding double taxation. It makes sense for the state to widen the circle of countries with which such agreements should be made. And, finally, an agreement about the exchange of legal information. It was just mentioned that the Swiss know more than we do. Such types of agreements will also facilitate a return to Russian jurisdiction.

Allow me to recapitulate. To increase the attractiveness of Russian jurisdiction, we need to solve a very wide range of issues. The civil code is the most important, but there will be further work ahead. After the amendments to the civil code are adopted, work will begin on amendments to the second part of the civil code. There, we will deal with specific transactions, and, in order for business to be heard, we and the legal community need to amicably offer our help in developing this document. It is possible that the input of legal experts to a deed as noble as increasing the prestige of one's own jurisdiction will be a deciding factor. The issues that lie beyond are technical in nature.

D. Afanasiev:

Mr. Tikhonov have you heard that the second part is forthcoming?

Thank you very much, Ruslan. A practical and valuable perspective. We have today the opportunity to hear the opinion of a person who possesses a very wide perspective on this range of issues because he deals with them not only in Russia but abroad as well, and has the capacity to draw comparisons.

I ask Leonid Melamed to speak. He is a member of the Board of Directors at Rusnanomedinvest and Chairman of the Board of Directors at Team Drive.

Mr. Melamed, you often work at the juncture of Russian and foreign legal systems. We would like to hear your view as a major Russian business leader, working on the international level.

L. Melamed:

Thank you for inviting me. Thank you for the fact that a person without a legal education (my education is in medicine: I am a trauma-orthopaedic surgeon) managed to nevertheless find a place of his own on such a respected panel.

D. Afanasiev:

The law should not be left to legal experts under any circumstances.

L. Melamed:

I worked with Mr. Ibragimov for many years and felt myself very comfortable and confident. And really, esteemed ladies and gentlemen, I know and respect all of you, as does the whole country. I will try to be brief because I doubt that I can add very much for a professional audience.

First off, I would like to ask the audience to consider what is at stake. After an hour of conversation, all of this seems a bit like legalese: we need to improve the civil code, and so on. But for the sake of what is this all being done?

Let us turn to the basic challenges, which the President and Prime Minister of the Russian Federation put before themselves in the area of innovative economy. After many years of work in various more or less traditional sectors – mobile communications, insurance, and so forth – in the last year, we began to work on venture capital investment in pharmaceuticals under the mandate of RUSNANO and Domain, the largest American venture capital fund in the life sciences field. Our horizon is widening dramatically by virtue of the fact that existence determines consciousness. Accordingly, now we must further advance the innovative economy. Well, why?

Do you know how many jobs were created by venture capital in the USA? Twelve percent. I was shocked. And, how much money is invested in R&D annually per capita in the United States? USD 100 per person. In Israel the figure is USD 300 per person. Did you know that 85% of all money that Europe, the European Union, the United States and Canada spend on R&D is spent inside the United States of America? Did you know that of the ten largest pharmaceutical companies in the world by capitalization, five are American and two are Swiss? There is not one that is Russian.

What does this tell you? It tells you that intelligent and wealthy people still work and pay taxes there; that large companies pay tax on profits there; that the largest patents in the world which collect royalties, and which are taxed, are not yet here. And this proves once again that the reorientation of the Russian economy towards innovation is absolutely vital. We should not underestimate the significance of that which the Government is currently doing, nor that which the specially created development institutions, such as RUSNANO, Skolkovo, and Russian Venture Capital, are doing.

In what environment do countries become innovative, that is, create jobs and generate taxes? Statistics show that annual R&D spending in countries with patent law that is considered developed is 2.5% of GDP. In countries that do not, it is 0.2%. Russia does not belong to the list of countries with developed patent law.

Further, the countries that are leaders in R&D spending are exclusively made up of those at the top on the scale of mature competition. Switzerland holds first place on this scale, the United States is fifth, and in second place is Singapore. When does competition appear? When the corresponding legislation is developed.

I could go on for a while yet, spouting figures that show how important the work that is being discussed here today is, and how wonderful it is that we have all gathered here today, and not just today – all this is the fruit of fairly significant preliminary work. If all this is not done, then the majority of intelligent people who are today creating our universities will go abroad and will continue to go abroad. There will be a large outflow of capital and so on. We know the numbers.

Concluding my presentation, I would like to mention that any process can be successful, if it combines three aspects well. This is one of those purely managerial mantras: people, process, motivation.

On the subject of people, R&D abroad is conducted by intellects that are simply amazing. Over there, there is intellect and good will. Here, among those whom you attract and those who manage these processes on a national level and in professional associations and specific courts, I am certain that the IQ is very high and the education is good.

Now, process. In the presentations before mine, the speakers mentioned road maps: what changes we want to achieve and by means of what steps.

What we are lacking, from my point of view, is motivation. For the process to take shape, we need to work out the KPF and say: here are five factors; if we achieve them all, we are there, and if we do not, we are not. In this sense, Dmitry, your presentation was very close to the goal: by means of the simple criteria that you used to survey your clients, you determined the key indicators of efficiency that you needed to take a cue from. What percentage of agreements should ideally be concluded on the basis of Russian law? One hundred percent is impossible. We will take for our examples countries that are more successful in this, and set the benchmark at 70%. How many of the arbitration proceedings regarding assets that are in the Russian Federation, should take place in Russia? That is another benchmark. Further on, these benchmarks need to be publicized – so that it is not just professionals who will click their tongues and say, “It would be great if it were 70% and not 20%” – but so that everyone would think like this: the Ministry of Justice, and the Russian Government; while the Higher Arbitrazh Court would think that it should be 80%.

The next question is, how quickly? I think that none of those present would want to come here again in four years and say that the same problems remain and that the solutions we are proposing are now new. People grow tired of solving the same problems. The KPF need to be evaluated over time to convince respondents' groups of the importance of these criteria and to further monitor progress. And each

year at the Forum, there should be a discussion of whether we have moved forward in this area or not.

Thank you very much.

D. Afanasiev:

Thank you very much. We have with us several so-called front row participants, whom we now ask to provide us with brief comments or elaborate on what has been said so far. I would like to turn to Andrei Popov, representing Rosatom. If possible, please be brief and to the point.

A. Popov:

Thank you, Dmitry. Rosatom, as a state corporation, periodically deals with a form of international cooperation, asset exchange. Effecting transactions, we must coordinate two transactions and we feel hemmed in by Russian legislation. Even if we are working with a Russian organization, we are required to structure our transactions under English law. Unfortunately, instruments like options are not protected by Russian law, and since fairly large investments are at stake, paradoxically in the interests of Russian economic security, we must turn to foreign jurisdictions. We wish that the missing instruments would appear in Russia, and we are not talking about only options, but of shareholders' agreements – already a subject which sets teeth on edge in professional communities.

As for optionality, we can only welcome a course that seeks to strengthen it in our legal system. I would very much not want to see this course get mired in bureaucracy, such as for example the appearance of a mayoral committee that examines all statutory regulations for optionality. We have in our country a tendency to bureaucratize any good beginning, and as a result, instead of something positive, we get something negative. Improving laws is important, but changing the mentality of law enforcement officials is even more important. In our country, law is viewed as a close combat weapon: depending on what the client wants, one can use it for bludgeoning or stabbing. This depends exclusively on the conscience and sense of

justice of those people who have the administrative leverage. And as long as it does not click in their heads that one must comport oneself in a manner that does not seem shameful later, change the law as we may, nothing will happen. Thank you.

D. Afanasiev:

Thank you, Mr. Popov. True words.

We need to also consider the European experience. Yes, we are orienting ourselves in many ways not only on American but also on European experience. Present here today are three leading European legal experts. They are specialists in corporate law from three countries that have very close trade and economic relations with Russia: Germany, Austria, and Poland. These are countries with a continental legal system, as is Russia's. Their experience is especially interesting to us.

I would like to invite Oleg de Lousanoff to speak. Mr. de Lousanoff is Senior Partner at Hengeler Mueller, one of the oldest, most famous, and respected German firms. As everyone knows, much of Russia's civil legislation is borrowed from Germany, and so we are especially interested in hearing what you have to say. The second reason is that you have a completely Russian name, but you are German. As I understand it, your ancestors are of ancient, aristocratic Russian descent, so that when you give us counsel, you are speaking to us not only through the high German intellect, but also the Russian soul. I would like to ask you to make some brief and to-the-point comments on that which you have heard here, from a European point of view.

O. de Lousanoff:

Thank you, Dmitry. Just a few words. I have been working on international M&A transactions for 31 years now, mainly for foreign clients. In the hundreds of deals involving a German seller, buyer, or target, German law has always been the governing law, and German courts and arbitration tribunals have always been competent to resolve disputes arising out of these transactions. In not a single case did my international client or the German party insist on stipulating a different law

than German law. What I am hearing today is really deplorable. Russia is such an important and powerful country. As Dmitry said, it is the country of my ancestors, of which I am very proud. What has been described this morning by all the speakers is not only deplorable to my Russian pride, it would also have an enormous economic impact, as has already been partly addressed. Just imagine if no single American corporation allowed American law to apply in its business dealings. I am giving you such an absurd example because it simply cannot be imagined. Consider the economic loss for the Russian economy by always having English law and English lawyers working on your deals. Dmitry, you mentioned that 10% of the parties here apply or stipulate Russian law. Based on my experience, it is 0%. I have never encountered even one of these 10%.

You may well ask me what has to be done to fix the situation. I think most of it has already been said this morning. I think there are three key requirements. The first is you need a law that responds to the needs of international business, a law allowing for freedom of contract. Ruslan Ibragimov has already mentioned this. I had the honour of advising the Russian Government on the recent reform of the Russian Civil Code. Based on my judgement, I think things are going in the right direction here, but as Ruslan said, a lot needs to be done.

The second key element is independent judges and independent courts applying the rule of law, courts rendering judgements which are predictable, reliable, and easily enforceable. That is very, very important.

The third element is you need a legal profession of highly educated lawyers who are independent and who enjoy all the benefits of the client-lawyer relationship in order to duly represent their clients. Only the combination of these three elements will provide a legal framework with sufficient trust for the parties to stipulate the law. I can add a figure: perhaps you know that the German East-West Committee has done a survey of the things that companies investing in Russia complain most about, and the figure was quite similar: 62% complained of the lack of legal certainty. The percentage is even higher for those companies who would like to do business in Russia.

Trust in the legal system is really essential. In this connection, I would like to share with you a German legend that shows what a long tradition this trust has. This is the legend of the Miller of Sanssouci. Maybe you have heard of it.

Frederick the Great built a beautiful palace near Berlin in the little town of Potsdam. When he moved into this palace, he felt disturbed during the night by a mill that was very close to the palace. It was a water mill, so the sound of the spilling water disturbed his sleep. He went to the miller and said, "Get away with your mill, you are disturbing me during the night." And the miller responded, "Your majesty, you know we and this mill have been here for generations. We were here before you came. Now you want us to go away?" And the King said, "Yes, I am the King. I want you to leave this place and to tear down this mill." When the King insisted, the miller told him, "Well, if you really want this, I will bring the case before the chamber court." The King turned to his entourage, said, "Damn it", and left the miller in his mill. He was an absolute monarch, but you could see he already knew that the court in Berlin would decide in favour of the miller, because the miller was right. Thank you very much.

D. Afanasiev:

Thank you Oleg. Tomasz Wardyński is a leading lawyer in Poland, a senior partner in a large law firm.

Say a few words Tomasz, but briefly, because we are really running out of time.

T. Wardyński:

I liked your comparison at the very beginning. I would say the legal system is like the circulatory system. It is very good. Judges are glands injecting the hormones of fairness and common sense into the system. This is how it should work, but I think that obviously the human factor is the most important in the legal professions. As we have heard, trust plays a role, because humans react to incentives. If they are afraid of stereotypes, which they sometimes are, they will take their case elsewhere. If they have a negative experience, they will always go elsewhere. Building up trust in

the system is a very difficult thing. It will have to be done by way of incentives. This is what I have to say. Civil law is fantastic in comparison to common law. It is much more flexible in a way. You will see this when implementing your code, providing that the literal interpretation of legal provisions does not prevail.

D. Afanasiev:

Thank you, Thomas. Christian, from the Austrian perspective. Christian Herbst is a Senior Partner in a major Austrian firm that has done a lot of work between Russia and Europe, so he has a practical view of things in many ways.

C. Herbst:

Yes, thank you. Given the time, I just want to stress the following. What is most important is that you make it unattractive to opt out of your local law. How do you make it unattractive? By making your local law attractive. That has already been said, and there is not much to add to that. But what is also important is what has been mentioned in the panel judiciary and in the independent bar. One thing that was mentioned just now but has not been mentioned in the independent judiciary is how to incentivize the best people to join the judiciary. One example from my country I can give is that judges have always been the best paid civil servants, so judges are clearly even more incentivized financially. It is not so high that they could earn more than in private practice, but it is enough to both assure their independence and to make it attractive to join the civil service.

The last point I want to make is competence on all levels. You can create that, as has been mentioned, through specialization, but you can also create it through training. And the last point is to constantly modernize. For example, if you watch what is happening within the EU and the European legislation, they are constantly adapting. Thank you.

D. Afanasiev:

Sergei Kuznetsov, Head of the Law Department at Vnesheconombank.

S. Kuznetsov:

Dmitry, thank you. I am the second representative of Vnesheconombank presenting on this panel, and will therefore be extremely brief. As practising lawyers, we really do actively participate in the task of improving Russian corporate legislation and civil law as a whole. We are doing this in the context of a non-commercial partnership that has brought together leading Russian legal firms. It is very pleasant to note the convergence of views on practically all the key questions that have been discussed within the framework of the partnership. The present amendments to the civil code are important for us because in the practical work of Vnesheconombank there are transactions which involve more than 50 parties. These transactions are arranged across two or three jurisdictions. The coordination of this process is fairly complicated. We would like to see an instrument in Russian law that is useful and applicable in practice. The issue of optionality in Russian legislation – the ease of entering into a transaction for all parties – is a key one. We hope very much that we will continue to participate in this project with our colleagues.

Vnesheconombank is currently not a single development bank, but a group of 13 legal entities, including commercial organizations, with a non-commercial organization at its head. We are very much hoping that the recommendation on improving corporate management will also be developed. The reform of Vnesheconombank itself, its metamorphosis into a public entity, also has many important legal aspects. We hope that our colleagues will help us in this work and, Dmitry, I look forward to further collaboration. Thank you.

D. Afanasiev:

Thank you, Mr. Kuznetsov for your kind words and support in this important task. Esteemed colleagues, we have somewhat exceeded the time limit and I would like to summarize what has been said.

Today, we have heard presentations from representatives of the Russian legal sector, as well as representatives from Russian companies, representatives of the

innovation community, representatives from foreign legal circles, and representatives of the state. All are in agreement about how to define the problem and the ways of solving it. This is the guarantee of our victory. When there is consensus in society about what needs to be done, and an approximate understanding of the course to take, then, most likely, everything will work out.

We do not have time for questions from the floor, but let us hear two questions anyway, following which we will probably be barred from coming here again. One from the left side of the hall, another from the right.

T. Firestone:

Thank you very much. Thomas Firestone, Permanent Representative of the US Department of Justice at the US Embassy. The President said that Mr. Titov will have the right to represent entrepreneurs in court and in certain situations suspend the action of regulatory agencies. What changes can be expected in the Arbitration Procedure Code and in the Criminal Procedure Code in connection with Mr. Titov's appointment to the ombudsman's post?

D. Afanasiev:

I thought that, as a representative of the US Department of Justice, you would have a question about the beneficiaries of Russian companies.

Boris Titov has gone. It would be inappropriate to comment in his absence on the process that he will direct. I will say only that the question is a very good one and that the answer to it is very complicated. It is still too early to say how this will be implemented. We all understand that even if we have received great authority, it is still hard to implement it in practice. On the other hand, if you have no authority, no one will take any notice of you. I am convinced that, with the support of all the participants of this process, Boris Titov will be able to find a balanced solution to the issue. I beg forgiveness for answering for him, but, I think, I answered quite neutrally. The problem still lies in the work.

Now a question from this side of the hall, and preferably addressing those who are present on the panel.

Even Dmitry has no questions.

A big thank you to all those who came to the session.