Joint Ventures 2020

Contributing editors
Gavin Williams and James Farrell
Herbert Smith Freehills

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Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the third edition of *Joint Ventures*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on China, the Netherlands, Saudi Arabia and Thailand.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Gavin Williams and James Farrell of Herbert Smith Freehills, for their continued assistance with this volume.

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FORM

Types of joint venture

1 What are the key types of joint venture in your jurisdiction? Is the 'joint venture' recognised as a distinct legal concept?

Historically, a typical joint venture structure for holding a Russian investment involved an offshore company (often located in Cyprus, the British Virgin Islands or the Netherlands) holding interests in Russian operating companies, with a shareholders' agreement (SHA) governed by English law. The popularity of offshore vehicles was owing to the greater flexibility in structuring the relationship between investors (typical in international joint ventures) and the benefits of double tax treaties and bilateral investment treaties offered by other jurisdictions. In addition, offshore structures enable parties in international joint ventures to choose a neutral governing law for the SHA governing their relationship.

Reforms to Russian law in recent years have increased the availability of western-style structuring options for onshore joint venture entities (which were previously considered unenforceable under Russian law). For example, Russian law now expressly recognises several key mechanisms commonly used in English law SHAs, such as put and call options, and makes it possible to effectively structure other commonly used mechanisms such as drag-along and tag-along rights. As such, an onshore joint venture regulated by Russian law is now generally a viable (although not routinely chosen) joint venture structure. The current trend of Russian parties seeking to move their joint ventures with foreign investors onshore will likely continue in the next year, and several high-profile Russian businessmen (such as Oleg Deripaska and Alisher Usmanov) have expressed an intention to move more of their business holdings onshore.

Typically, an onshore joint venture involves either:

- an English law SHA with respect to a Russian joint venture entity supported by Russian law instruments of transfer (used in option sales and other types of transfers); or
- a Russian law SHA or a combination of a Russian law SHA concerning corporate governance and some other matters and an English law agreement dealing with financing, dividends, share transfer, anti-dilution, shareholder information and some other matters.

While an English law SHA with respect to a Russian joint venture entity is allowed, certain Russian mandatory rules will apply irrespective of the choice of foreign law (see question 25).

The two most commonly used Russian joint venture entities are a limited liability company (LLC) (shareholders in LLCs are called participants and participants' stakes are called participatory interests) and a non-public joint-stock company (non-public JSC). While unincorporated joint ventures are recognised by Russian law, they are not commonly used by foreign investors.

Common sectors

2 In what sectors are joint ventures most commonly used in your jurisdiction?

The energy and natural-resources sectors account for a significant portion of joint venture activity in Russia. This sector is likely to continue to be a strong performer given Russia's abundant oil and gas reserves, and the complexity and expense involved in their development. Recently, market statistics indicate that there has been a relatively high level of joint venture activity in the innovations and technology, consumer markets, communications and media, and healthcare sectors. Looking forward, market commentators suggest that joint venture activity is likely to increase in consumer goods-related sectors (such as the retail, e-commerce, transport services, manufacturing and food production sectors), in line with the expansion of the Russian economy and the Russian government's policy of diversifying economic activity beyond the traditional extractive industries. In this regard, the acquisition of AliExpress Russia (a major e-commerce platform) by a group of investors consisting of MegaFon, Mail.Ru Group and the Russian Direct Investment Fund (RDIF) at a valuation of US$2 billion, the joint venture between Yandex and Sberbank to develop the Yandex.Market e-commerce ecosystem, the joint venture between Yandex and Uber to develop a taxi-booking service, and the signing of a letter of intent by Sberbank and Mail.Ru Group to establish a joint venture to create a US$1.58 billion online-to-offline services platform focused on food and transportation, might be early signs of more e-commerce joint ventures to come.

PARTIES

Rules for foreign parties

3 Are there rules that relate specifically to foreign joint venture parties?

Foreign investors are generally not subject to additional regulations above those that are applicable to other businesses operating in Russia; however, foreign investors do require additional governmental approvals in certain circumstances, such as when investing in strategic business sectors (see question 13) or certain other sectors (eg, when providing online audiovisual content).

That said, foreign investors are subject to a number of specific rules. For example, a maximum foreign ownership cap of 20 per cent applies to mass media companies, and foreign ownership caps also apply to insurance companies and banks. Foreign investors engaged in the exploration and production of subsoil fields are also subject to specific rules.

Some of the restrictions applicable to mass media companies were declared unconstitutional in January 2019 as a result of being overly broad and improperly vague. It is expected that the law will

be amended in the near future to bring it into compliance with the Constitution of Russia.

Recently, a draft law has been submitted to the Russian legislature which, if adopted, will set a 20 per cent foreign ownership cap in relation to the ownership of companies that control certain major online resources (such as software and websites that collect data about users located in Russia). The draft law is at an early stage of the legislative process and remains subject to change. If adopted, it will likely extend to large online retailers and service providers with a significant retail base in Russia.

In the energy sector, a regulatory change has been discussed that, if implemented, would remove the bar against companies other than Russian state-owned companies with five years of relevant experience (currently Gazprom group and Rosneft) engaging in oil and gas exploration on certain parts of the Russian continental shelf. If this happens, it would remove some obstacles under Russian law to setting up joint ventures (including between Russian private companies and foreign partners) in this sector.

From a tax perspective, special rules may apply to foreign investors where there are double tax treaties (DTTs) between the Russian government and the governments of states to which those investors belong. DTTs usually provide benefits in respect of taxes on, among other things, interest, dividends and royalties payable to those investors.

Ultimate beneficial ownership

4 What requirements are there to disclose the ultimate beneficial ownership of a joint venture entity?

There is no general obligation to disclose the ultimate beneficial ownership of a joint venture entity, subject to the following exceptions:

- disclosure of the ultimate beneficial owners may be required for the purposes of obtaining regulatory approval for a joint venture. See question 13 for the special rules applicable to foreign investors that do not disclose information about their ultimate beneficial owners or controlling shareholders as required by Russian law;
- disclosure may also be required for tax purposes, particularly to justify the application of reduced tax rates to the actual recipient of income under DTTs;
- certain providers of financial services (such as banks and pension funds) are required to disclose their ultimate beneficial ownership to the public;
- under Russian anti-money laundering legislation, Russian entities must take measures to identify persons who have more than a 25 per cent shareholding (direct or indirect) in, or who otherwise control, that entity;
- the ultimate beneficial ownership may need to be disclosed if the joint venture participates in tenders (especially public procurement tenders); and
- Russian residents holding shares in or controlling foreign companies or non-corporate entities must notify Russian tax authorities of such a shareholding or such control, subject to certain thresholds.

SETTING UP AND OPERATING A JOINT VENTURE

Structure

5 Are there any particular drivers in your jurisdiction that will determine how a joint venture is structured?

As with any jurisdiction, a number of factors drive joint venture structuring. Typical factors include:

- increasingly complex regulation;
- marrying the requirements of Russian mandatory rules with the governing law of the transaction;
- international sanctions;
- the rapidly evolving tax regime;
- the lack of established market practice to benchmark transactions against;
- the availability of recourse to international arbitration with a seat outside of Russia; and
- satisfying the requirements of Russian regulators, particularly if the transaction concerns a strategic business sector.

As mentioned in question 1, concerns about the enforceability of certain provisions of SHAs under Russian law have historically resulted in offshore joint venture structures.

Tax considerations

6 When establishing a joint venture, what tax considerations arise for the joint venture parties and the joint venture entity? How can tax charges be lawfully mitigated?

Russian legislation dealing with controlled foreign corporations (CFCs), which came into force in 2015, has continued to develop. Although broadly consistent with the approach of the EU and the Organisation for Economic Cooperation and Development, these rules remain widely untested in the Russian legal framework, especially in the courts.

The Russian legislation concerning CFCs sets out rules in four areas of tax structuring. First, it addresses the taxation of profits received by CFCs owned by Russian residents but not yet received by the Russian residents themselves. Second, it requires Russian residents holding shares in, or controlling, foreign companies or non-corporate entities to notify the Russian tax authorities of such a shareholding or such control. Third, it lays down the test for determining the tax residency of legal entities. Lastly, it introduces the concept of beneficial ownership of income for the purposes of DTTs.

The Russian government's aim is to restrict the availability of DTT benefits for recipients of passive income from Russian sources where offshore structures are deliberately established to obtain tax treaty benefits for the ultimate beneficial owners of such income.

Within the same trend, interest taxation rules have been heavily amended, with specific transfer pricing regulations introduced concerning interest in 2016 and thin capitalisation rules revised with effect from 2017. Amendments to thin capitalisation rules restrict the deductibility of interest under loans extended by foreign sister companies. However, according to the most recent amendments to these rules, there are certain exceptions to the rules in respect of the deductibility of interest payments under loans relating to investment projects. It is not yet clear, however, to what extent these exceptions will be available to foreign investors.

In addition, changes to certain obligations have been imposed on the members of international groups of companies. These companies are obliged to notify tax authorities that they are part of such groups. If the consolidated revenue of a group exceeds certain limits, its members are obliged to disclose various information, such as the structure of ownership and control of the group, main indicators of activity, profits gained and losses incurred, and taxes paid. Currently, a breach of these obligations is punishable by fines.

Apart from this, the Russian government has shown a trend towards increasing the tax burden on business. The value added tax (VAT) rate was increased from 18 to 20 per cent on 1 January 2019, and amendments to the profit tax regime (which are mostly disadvantageous for taxpayers) were introduced in 2017 and 2018. The ability of the Russian regions to introduce tax incentives on profits is gradually being limited. Loss carry-forward was amended so that only half of losses carried forward can be deducted in a given year (although the carry-forward itself is now unlimited by time).

These developments illustrate the continuing trend of Russian tax legislation becoming significantly more complex and nuanced. In tandem, Russian tax authorities are adopting increasingly sophisticated and rigorous approaches to assessing applications for relief under DTTs. In the past couple of years, there has been a closer examination of the substance of ownership structures and the nature of the relationship between, and the functions of, the different entities in these structures. Where foreign companies or non-corporate entities are found to be acting as mere conduits or agents for the true beneficial owners of income, they may be disregarded for tax treaty purposes. Investors need to be aware of this issue and seek detailed legal advice accordingly. It is also quite common for foreign partners to request indemnities regarding tax matters when buying into Russian joint venture companies.

Asset contribution restriction

7 | Are there any restrictions on the contribution of assets to a joint venture entity?

Russian law establishes minimum charter capital requirements for LLCs and JSCs, and provides that their net asset value must be equal to or exceed their charter capital. Non-cash consideration for shares or participatory interests may be satisfied by, among other things, securities, property, shares, participatory interests, state or municipal bonds, and intellectual property.

Certain restrictions apply on how contributions of proprietary rights can be made. Restrictions on non-cash consideration may be imposed by a company's charter. The value of non-cash contributions paid for shares or participatory interests at the incorporation of a company must be determined by an independent appraiser. Contributions of assets from shareholders are tax-free for the receiving Russian company.

Interaction between constitution and agreement

8 | What is the interaction between the constitution of the joint venture entity and the agreement between the joint venture parties?

Shareholders of LLCs and JSCs are permitted under Russian law to enter into SHAs to regulate the exercise of their corporate rights. Creditors and other third parties (such as lenders granting a convertible loan to the joint venture or option holders) may also be party to such SHAs. As a general rule, the provisions of an SHA are valid and enforceable between the parties even if they conflict with the company's charter. That said, this rule has not been extensively tested in the Russian courts.

Decisions of a company's management bodies may be invalidated if they breach the SHA, provided that all shareholders were party to the SHA at the relevant time. Further, transactions by a party or the company's management that breach the SHA or the company's charter (respectively) may be invalidated if the other party to the transaction was, or should have been, aware of the relevant restrictions in the SHA or charter (as applicable).

Russian law requires that any disproportionate voting or profit distribution arrangements be disclosed in the state register (although due to certain technical limitations of the register, the effectiveness of disclosure is limited). If the SHA contains restrictions on the disposal of shares (participatory interests), the existence of the SHA must be disclosed in the state register. Otherwise, there is no requirement to register or publish SHAs relating to LLCs and non-public JSCs (save for a requirement to notify the company itself).

Party interaction

9 | How may the joint venture parties interact with the joint venture entity? Are there any restrictions?

The traditional governance arrangement between joint venture parties is that the directors of the offshore holding company take all principal decisions regarding the joint venture, except for those decisions reserved to the shareholders by the SHA or the company's constitutional documents. This arrangement is traditionally mirrored at the level of the Russian operating company through equivalent provisions in the company's charter. Recent reforms to Russian law have increasingly enabled parties to replicate such governance arrangements in relation to Russian companies. For instance, in relation to non-public companies, there is now greater flexibility in allocating matters between different management bodies, regulating quorum or majority requirements, and other procedural matters.

Governance arrangements usually include an information-sharing regime. In addition, public disclosure rules apply to public JSCs, and other companies must disclose prescribed information to shareholders upon request (eg, general meeting minutes and statutory audit reports). That said, these statutory information rights were significantly narrowed in 2017, making it increasingly important that minority shareholders negotiate contractual rights to company information. Under Russian law, Russian businesses and individuals affected by international sanctions are exempt from certain disclosure requirements.

Exercising control

10 | How may the joint venture parties exercise control over the joint venture entity's decision-making?

As with any jurisdiction, the SHA and the company's constitutional documents may contain provisions protecting minority investors and regulating joint venture decision-making.

Decision-making can be regulated at shareholder level (eg, requiring unanimous shareholder consent for certain decisions) or board level (eg, giving minority shareholders the right to appoint directors with specified veto rights). Limits may also be placed on the authority of the joint venture's corporate officers. While these provisions are typically included in an English law SHA, it is increasingly viable to place such restrictions in the charter of a Russian company and a Russian law SHA. At the same time, while it is now possible in a Russian company to appoint several general directors, each with executive powers, there are still certain technical restrictions under Russian law that affect the enforceability of the exercise of joint signatory powers by several general directors.

As stated above, information rights are commonly negotiated to support minority investor participation in decision-making. Representation on company committees can also be an effective tool to ensure access to information.

Governance issues

11 | What are the most common governance issues that arise in connection with joint ventures? How are these dealt with?

The most common governance issues arising in Russian joint ventures are broadly the same as with any jurisdiction – for example, dividend policy, approval of business plans and budgets, board appointments, veto rights, deadlock provisions, financing provisions and exit rights. These matters are generally dealt with in the SHA or the company's constitutional documents. Other current areas of focus include compliance with sanctions, the rapidly evolving tax regime, and anti-money laundering and bribery standards. Recently, Russian law was amended to reduce the scope of statutory shareholder information rights and to

abolish an absolute requirement for prior approval of interested-party transactions, and so foreign investors are increasingly seeking additional contractual protection on these matters.

Nominee directors

12 | With an incorporated joint venture, what controls exist in your jurisdiction in relation to nominee directors? How should a nominee director balance the potentially conflicting interests of the joint venture company and the appointing shareholder?

Russian law requires directors of Russian companies to act in the company's best interests and to exercise their rights and discharge their duties reasonably and in good faith. Directors may also be liable for damage they cause to the company by acting outside the ordinary course of business. Russian law also regulates interested-party transactions and conflicts of interest.

Russian law does not recognise nominee directors, and directors are not considered representatives of a particular shareholder, even if appointed at their request. It is quite common in Russian joint ventures for shareholder procurement obligations to include actions by their nominated directors subject to directors' legal duties. Where there is a concern that directors' abilities to exercise their rights may be limited by their legal duties, this is often addressed by:

- giving such rights to the shareholders instead of the directors; or
- the concept of necessary duties, which may include the re-election of directors.

It is quite common for shareholders to indemnify directors or require that a portfolio company obtain directors' and officers' liability insurance.

Competition law

13 | What competition law considerations are engaged by the formation and operation of the joint venture? Is approval needed?

Subject to certain exemptions, the acquisition of control of Russian companies operating in strategic business sectors by foreign investors requires governmental consent. Strategic business sectors include the development of significant subsoil fields, major telecommunications and print media, and the nuclear, military and aviation industries. Companies incorporated in Russia and operating in any of these sectors are within the remit of the Strategic Investment Law. 'Control' is broadly defined and includes controlling the majority of votes at a shareholders' meeting, having the power to appoint a majority of the directors, and being entitled to appoint the CEO. The control thresholds for companies engaged in the development of subsoil fields of federal importance are stricter than those applicable to other strategic companies. Foreign sovereign investors are generally prohibited from acquiring control of strategic companies. In June 2018, the restrictions applicable to foreign sovereign investors were extended to any foreign investor who does not disclose information on its controlling shareholders and beneficiaries to the relevant Russian regulators as required by Russian law (a non-disclosing investor). In certain cases, the Federal Antimonopoly Service (FAS) may aggregate stakes held by several unaffiliated non-disclosing investors and sovereign investors, so that it may treat several such unaffiliated investors as if they were a single party and apply the strictest set of restrictions as if that party were a foreign state. The scope of contractual rights may also be relevant for determining whether control is being acquired.

In July 2017, Russian law was amended to provide that the Russian government may escalate any transaction involving a foreign investor to a lengthy and complicated strategic review process, not merely those where the target is a strategic business. At the time of writing, we are aware of only one instance where this procedure was followed in a sensitive yet not strategic business sector.

Separately, the consent of the FAS is required for the acquisition of control (including the acquisition of pre-determined equity thresholds in the event investment is made into Russian entities directly) over Russian businesses or businesses active in Russia subject to asset and turnover thresholds. As the thresholds are relatively low, it is often necessary to approach the FAS for its consent to transactions, including, among other things, the formation of joint ventures and the purchase of a joint venture partner's stake. Arrangements between competitors regarding their joint activities in Russia are also subject to control from the FAS.

Non-compete arrangements in the M&A context may generally be more problematic in Russia than in the EU or other developed jurisdictions. Non-compete arrangements may be enforceable in Russia if they are placed in proper joint venture agreements and meet a number of criteria.

Subject to certain thresholds, the approval of the Central Bank of Russia may be required to acquire an equity interest in a Russian bank or insurance company.

The merger-control regime and the regime under the Strategic Investment Law is suspensory, meaning that closing cannot proceed unless the clearance is in place. Gun-jumping is penalised. It is possible to sign transactions and make them conditional upon the receipt of FAS consent or approval under the Strategic Investment Law. Because the regulator is entitled to impose remedies, it is quite common to require, as a condition precedent to a merger, the receipt of regulatory approvals to the reasonable satisfaction of the buyer or parties jointly.

Provision of services

14 | What are the key considerations in your jurisdiction in structuring the provision of services to the joint venture entity by joint venture parties?

Separation issues are often important when structuring the provision of services and are particularly relevant when dealing with Russian majors that remain controlling shareholders. For instance, major energy companies commonly use their subsidiaries to provide operatorship and other services to a number of entities. The underlying service contracts may contain provisions that would be common for intragroup arrangements, but these may not necessarily work in a joint venture context. Joint venture documents commonly stipulate that services must satisfy arm's-length criteria and provide an order of priority to the parties' interests in case of any conflicts of interest between the parties (eg, as a service provider) and the joint venture. Interested-party transaction rules must also be considered.

Employment rights

15 | What impact do statutory employment rights have in joint ventures?

Since 1 January 2016, Russian law prohibits secondment arrangements. There is, however, an exemption for secondment arrangements between parties to SHAs in respect of JSCs that are implemented in accordance with (yet to be adopted) regulations, provided that the secondees have consented.

Intellectual property rights

16 | How are intellectual property rights generally dealt with on the creation, operation and termination of a joint venture in your jurisdiction?

Russian law specifies which intellectual property (IP) rights are recognised and protected in Russia and any applicable registration

requirements. For example, the protection of inventions, utility models, industrial designs and trademarks depends on registration with the Russian Federal Service for Intellectual Property (Rospatent). Russia is also a signatory to several international IP treaties.

As a general rule, Russian law provides that the author of IP (or the employer, if the IP is created by employees during their employment) owns all of the associated IP rights. The owner of IP rights can assign, encumber or license such rights to third parties, provided that this is only effective for trademarks, patents and certain other IP once registered with Rospatent.

FUNDING THE JOINT VENTURE

Typical funding

17 How are joint ventures generally funded in your jurisdiction? Are there any particular requirements relating to funding and security packages?

Equity financing via contributions to assets or increases in the charter capital of the joint venture company are common, although EU sanctions may limit the ability of EU investors to participate in these financings. Shareholder loans are also commonly used and tend to be unsecured.

Traditional bank financing is the most common source of external debt finance for Russian joint ventures. However, sanctions limiting the debt and capital-raising abilities of many state and state-backed companies have impacted their ability to finance transactions. Further, international nervousness around sanctions has made many foreign banks (particularly those with operations in the EU or the United States) generally cautious about lending money in Russia.

As with many jurisdictions, it is common for the joint venture parties to pre-agree the key terms of debt financing that may be granted to the joint venture (eg, the maximum interest rate applicable to the loan, term of the loan and composition of the security package).

Capital injection restrictions

18 Are there any legal or regulatory restrictions on the injection of capital into, or the distribution of profits or the extraction of cash by other means from, the joint venture entity?

Capital may be injected in many ways, with the most commonly used forms being shareholder loans, contributions to assets (in which the charter capital is not increased, and therefore shareholder stakes are not affected) and capital contributions (in which capital is increased through the issuance of new shares in JSCs, or by an increase in the charter capital of LLCs). Debt-to-equity swaps are also allowed.

The main considerations include:

- avoiding a breach of sanctions (for instance, EU sanctions prohibit the acquisition of new shares in Russian companies that are subject to EU sanctions); and
- structuring the contribution in a tax-efficient way (for instance, capital contributions and contributions to assets would be tax-neutral for the receiving Russian company, while shareholder loans would be taxed).

Additional restrictions apply to non-cash contributions. Capital contributions increase the tax cost of the company in the event of a future disposal by the shareholder, while contributions to assets do not.

JSCs and LLCs can only pay dividends from their net profits. Dividends in JSCs can be paid as a result of first-quarter, half-year, third-quarter or full financial year profits. Net profits in LLCs can be distributed quarterly, semi-annually or annually. Dividends or distributions cannot be declared or paid if the company does not satisfy statutory solvency tests. Disproportionate dividend distributions are generally possible in LLCs subject to being duly approved and reflected in the charter, and are possible in JSCs through the use of preferred stock. Cash can also be extracted through other means (eg, loans to shareholders); however, tax authorities may view such distributions as dividend distributions and tax them accordingly. According to the most recent amendments to Russian law, the difference between the income received on exit (on liquidation) and the price initially paid for the shares is also considered to be a dividend. At the same time, a shareholder's loss on the same occasion may qualify as an income tax expense and reduce the amount of payable tax.

Certain foreign currency control and repatriation-of-proceeds rules apply to Russian residents.

Tax considerations

19 What tax considerations should be taken into account in the operation of the joint venture?

Corporates that are Russian residents are liable to profits tax on their worldwide profits (calculated as gross income minus deductible expenses). Companies incorporated in Russia and foreign companies that have their place of effective management in Russia are treated as Russian residents. Non-resident foreign companies with a permanent establishment in Russia pay profits tax on the taxable profits attributable to that permanent establishment. Generally, the profits tax rate is 20 per cent. VAT is charged on goods, work and services supplied in Russia, and on imported goods. The standard VAT rate is 20 per cent.

Dividends paid by Russian companies to foreign shareholders are subject to a 15 per cent withholding tax, subject to reduction under applicable DTTs. Interest paid to non-Russian companies is subject to a 20 per cent withholding tax; however, this tax may be reduced (and even eliminated) under relevant DTTs. As stated above, the government is showing a trend towards increasing the tax burden on business. Starting from 2019, regions have the right to set reduced tax rates only if they are authorised to do so by the Tax Code. Reduced rates introduced before September 2018 will be valid until 2022, unless the region cancels them earlier. In line with the same trend, interest-taxation rules have been heavily amended in recent years, with specific transfer pricing regulation introduced for interest in 2016 and thin capitalisation rules revised with effect from 2017.

As with any jurisdiction, there are a range of other taxes that may be applicable to the operation of a joint venture, and specific tax advice should be sought.

Accounting and reporting issues

20 Are there any noteworthy accounting or reporting issues for the joint venture parties regarding their investment in the joint venture?

As a general rule, private Russian companies prepare their statutory accounting statements in Russian in accordance with Russian Accounting Standards. The reporting currency is the Russian rouble. Certain financial institutions, state-owned entities and public JSCs must prepare accounts in accordance with International Financial Reporting Standards (IFRS) and perform annual audits. In practice, foreign investors typically require that joint venture companies also prepare financial statements in accordance with IFRS.

However, special rules exist for those Russian companies that are recognised as members of an international group of companies (IGC). Such companies are required to notify the tax authorities of their participation in an IGC. If the parent companies of an IGC are Russian companies, or recognise themselves as Russian tax residents, they are, in addition, required to submit country reports with the Russian tax authorities.

Other notable reporting requirements include:

- foreign investors must notify the FAS if they acquire 5 per cent or more of the shares in strategic companies (directly or indirectly);
- certain acquisitions that do not require prior consent from the regulator (eg, the acquisition of less than 10 per cent of the participatory interests (shares) in a bank) require post-acquisition notification to the relevant regulator;
- a person who acquires control of more than 5 per cent of the voting rights in respect of a public JSC pursuant to an SHA must notify the company of such SHA; and
- certain capital injections in Russian mass media companies by foreign investors must be reported to the Federal Service for Supervision of Communications, Information Technology and Mass Media.

See question 4 concerning disclosure of ultimate beneficial ownership for more information.

DEADLOCK, EXIT AND TERMINATION

Deadlock provisions

21 What deadlock provisions are commonly included in joint venture agreements in your jurisdiction?

A wide range of deadlock resolution mechanisms seen in international joint ventures are commonly implemented in both English and Russian law SHAs. For example, it is common in Russia to see deadlock resolution methods that escalate board deadlocks to shareholder or CEO level for consideration without a hard rule for resolution of the deadlock (eg, by forced buyout). Forced buyout procedures are uncommon because of their unpredictable outcomes and difficulties raising finance owing to sanctions. In a few high-profile joint ventures, a third party with a very small shareholding was included to avoid deadlocks.

Notwithstanding recent reforms to Russian law, there is still uncertainty about the enforceability of deadlock resolution procedures under Russian law SHAs because of limited court practice. As such, flexibility in regulating deadlock resolution procedures is another factor in the use of a foreign holding company and English law SHAs remaining popular.

Subject to certain criteria, participants in LLCs and shareholders in non-public JSCs have a statutory right to apply to court to expel a participant or shareholder if that participant or shareholder grossly violates its obligations to the company. The company must pay the expelled participant or shareholder the actual value (determined by net assets) of its participation interests or shares. It is not possible to contract out of or limit this statutory right; however, court practice suggests that expulsion claims may not be enforced by courts in the context of corporate disputes in a 50:50 joint venture or where the claim is brought to expel the majority participant.

Exit provisions

22 What exit provisions are commonly included? Does the law restrict any forms of mandatory transfer provision or any basis of calculation?

As with any jurisdiction, SHAs typically contain provisions regulating share transfer and exit, including change of control provisions that are intended to prevent backdoor acquisitions of control by a third party. Any requirement to obtain regulatory consent to share transfers, and requirements to comply with sanctions and the terms of any relevant licences, should also be addressed.

It is common in Russian joint ventures to have a procedure that allows a joint venture partner to exit through the use of a put option (whereby one joint venture partner can require the other to purchase its shares) or a call option (whereby one joint venture partner can require the other to transfer its shares to it). Recently, in the context of sanctions, a particular focus in certain industries has been the continuation of the joint venture business (including the preservation of IP rights) in cases of the foreign partner's withdrawal.

Frequently, the non-selling shareholders will have a right of pre-emption. The non-selling shareholders may also have tag-along rights, under which a selling shareholder must procure that the purchaser of his or her shares acquires the shares of the tagging shareholders on the same terms.

Particularly in circumstances where one shareholder holds a substantial stake, the SHA may contain drag-along provisions, under which the shareholder is able, upon exit, to compel the other (usually minority) shareholders to sell their shares to the proposed purchaser on the same terms.

Exit through an initial public offering (IPO) has been rarely used historically. That said, there were a number of successful IPOs in recent years. These included leading Russian retailer Detsky Mir's IPO in 2017, which raised US$355 million on the Moscow Exchange (MICEX); gold producer PJSC Polyus' secondary placement of US$858 million in 2017; energy conglomerate En+ Group's listing on the London Stock Exchange in 2017 at a valuation of US$8 billion (although En+ Group's listing was subsequently made subject to sanctions, these sanctions were lifted in January 2019); and the listing of HeadHunter (a leading Russian online job search portal) on the Nasdaq exchange in the first half of 2019 (the first listing of a Russian company on the Nasdaq exchange since 2013). It remains to be seen whether this trend will continue in light of ongoing sanctions and other geopolitical factors.

Tax considerations following termination

23 What are the tax considerations on termination of the joint venture?

Russian tax resident companies are subject to 20 per cent tax on capital gains from the disposal of shares, subject to a five-year holding exemption applicable in limited cases. Foreign tax-residents are subject to Russian capital gains tax only in relation to the disposal of shares in Russian companies rich in real estate. If the joint venture company is liquidated and its assets are distributed to shareholders, as noted above, Russian tax authorities will tax the difference between the value of the assets and the shareholder's contribution as a dividend.

DISPUTES

Choice of law and resolution methods

24 In your jurisdiction, are there constraints on the choice of law or the method of dispute resolution provided for in joint venture agreements?

Shareholders may choose for foreign law to govern an SHA, provided that one party to the SHA is a non-Russian person or there is some other meaningful foreign element. Otherwise, the SHA must be governed by Russian law.

Litigation before Russian state *arbitrazh* courts and arbitration are the most common dispute resolution options. Foreign investors traditionally prefer arbitration because of its perceived neutrality, efficiency, confidentiality and the enforceability of its awards.

Recent reforms to Russian law have resolved long-standing uncertainty by establishing that disputes relating to the creation and management of, and participation in, Russian companies ('corporate disputes', in Russian terminology) are arbitrable, provided that the arbitral institution is licensed by the Russian government and (in some cases) the seat of the arbitration is in Russia. This means that the majority of disputes arising out of SHAs are arbitrable. A narrow

range of disputes relating to the internal administration and corporate governance of Russian companies are not arbitrable, nor, generally, are corporate disputes relating to Russian strategic companies.

Although foreign arbitration institutions can apply for a licence to administer Russian corporate disputes, at the time of writing only the Hong Kong International Arbitration Centre (HKIAC) and the Vienna International Arbitral Centre (VIAC) have obtained such a licence. There is, however, an argument that even the HKIAC and VIAC are not allowed to consider Russian corporate disputes arising out of an SHA, as these arbitration institutions have not yet published on their websites the special rules for the consideration of such disputes. While Russian law has recently lifted the requirement for the special rules, these changes have not been consistently reflected in all legal acts. The arbitration agreement can provide for dispute resolution by a permanent arbitral institution by default, with another preferred (foreign) institution to take the place of the default institution for any disputes that arise after that institution becomes eligible to hear corporate disputes.

Mandatorily applicable local law

25 | What mandatory provisions of local law will apply irrespective of the choice of governing law?

Russian civil law has become more flexible in recent years. However, it is still not always clear if a particular rule can be contractually excluded or altered, and there is no exhaustive list of the mandatory provisions of Russian civil law. A few notable examples of mandatory Russian laws include:

- certain corporate governance matters, such as:
  - the competence of the shareholders' meeting of public JSCs;
  - the right to seek the expulsion of other participants (shareholders) in non-public companies (see question 21); and
  - mandatory tender offer and squeeze-out rules;
- limited instances in which a company may purchase its own shares and relevant restrictions;
- a shareholder's/participant's right to forcibly transfer shares to the company in a number of circumstances (for example, in respect of LLCs, if a sale to a third party was prohibited under the LLC's charter or blocked by other participants; or in respect of LLCs and JSCs, a major transaction for more than half of the balance sheet value was made despite a shareholder/participant voting against the transaction or abstaining);
- limitations on the distribution of profits by Russian companies;
- limitations on the right of first refusal in public JSCs;
- notarial certification, which is required to effect the transfer of title to participatory interests in LLCs; and
- the application of Russian law to transactions concerning Russian real estate.

Remedy restrictions

26 | Are there any restrictions on the remedies a tribunal can grant that would have a bearing on the arbitration of joint venture disputes? Are there any restrictions on the arbitration of shareholder claims?

Russian state courts have wide powers to order interim remedies under Russian law, including seizing property, prohibiting a party from performing specified actions and requiring the defendant to perform specified actions. Interim relief may be ordered if there is a risk that the enforcement of a future judgment would be difficult or impossible without it, or to support arbitration or foreign court proceedings.

Russian state courts may order a variety of general remedies under Russian law, including the recognition of a right, restitution, invalidation of a voidable transaction, specific performance and damages. Russian courts may also now impose a judicial penalty for a failure by a party to perform a non-monetary obligation pursuant to a court order (the concept of astreinte). There have been instances where this mechanism has been used in practice; however, use of this mechanism is still not widespread.

As mentioned in question 24, the arbitration of disputes relating to the creation and management of, and participation in, Russian companies is subject to compliance with certain statutory conditions. A narrow range of disputes relating to the internal administration and corporate governance of Russian companies are not arbitrable, nor, generally, are disputes relating to Russian strategic companies.

Minority investor protection

27 | Are there any statutory protections for minority investors that would apply to joint ventures?

Although Russian law does not impose specific duties on majority shareholders towards minority shareholders, several minority protections exist under Russian law, including:

- anti-dilution rights for shareholders and participants in JSCs and LLCs;
- rights to challenge a limited range of major transactions and interested-party transactions;
- mandatory tender offer rules for significant acquisitions of shares in public JSCs;
- rights for shareholders of JSCs and participants of LLCs to withdraw and receive a price determined by statute for their shares or participatory interests (as applicable) following the passing of resolutions regarding certain fundamental matters where the withdrawing party voted against such resolutions; and
- cumulative voting for the election of board members in JSCs and LLCs (which may be changed unanimously in non-public JSCs and LLCs).

Liabilities

28 | How can joint venture parties have liabilities to each other beyond what is expressly agreed in the joint venture agreement?

Examples of where shareholders may be liable to each other beyond the terms of the SHA include:

- shareholders in non-public companies may bring a claim to enforce another shareholder's obligation to provide funds to the company if such an obligation is stipulated in the company charter;
- shareholders may challenge a limited range of interested-party transactions;
- as noted in question 21, a shareholder may seek to expel other shareholders; and
- shareholders exercising control of a company will be liable for any damage they cause to the company.

Disclosure of evidence

29 | Are there any particular issues that can arise in joint venture disputes in your jurisdiction concerning disclosure of evidence?

Wide-ranging discovery processes similar to those accepted in common-law jurisdictions are not used in Russia. Although Russian courts are entitled to require the production of any documents from a party to a dispute that are relevant to the proceedings, including legal advice from in-house or external counsel (which is not privileged under Russian law), in practice, requests are limited to a small number of specifically identified documents. Further, it would be unusual for a court to require the production of documents containing legal advice.

In limited circumstances, documents held by Russian advocates (regulated legal practitioners) may be protected by professional privilege. However, this does not preclude a court ordering clients themselves to disclose such documents.

As noted in question 9, the statutory information rights available to shareholders were recently narrowed, making it more difficult for minority shareholders to substantiate claims against other shareholders, the company or the company's management where the relevant evidence is held by the company.

MARKET OVERVIEW

Jurisdictional advantages

30 What advantages does your jurisdiction offer for parties wishing to set up and operate joint ventures?

The Russian government has, in recent years, introduced subsidies, guarantees, customs and tax benefits aimed at facilitating regional development and fostering growth in non-extractive economic sectors. This includes measures targeting specific industries (notably in the industrial, technology and innovation, tourism and recreation, and ports and logistics sectors) and particular regions and cities. According to information available on the website of Russia's Ministry of Economic Development, there are over 15 special economic zones in Russia.

For certain investments relating to industrial production, it is possible to conclude a special investment contract (SPIC) with federal, regional or municipal authorities. Among other things, a SPIC may provide for tax incentives in exchange for a guaranteed investment. For example, it has been reported that various SPICs have been entered into with the Russian government in relation to automobile production, with one, for example, involving AvtoVAZ and Renault-Nissan-Mitsubishi. In August 2019, the rules for the conclusion of SPICs were amended. These amendments place more focus on the transfer of technology, limit the participation of multiple investors and extend the maximum term of SPICs to 20 years, among other changes.

Landmark infrastructure projects are typically supported by intergovernmental agreements. For example, in the case of Yamal LNG, the Russian government committed to providing substantial tax and customs benefits pursuant to an intergovernmental treaty between Russia and China and acquired corporate bonds totalling approximately US$2.3 billion.

Export credit support is available to qualifying Russian exporters, and both Russian and international financial organisations, through the Russian Agency for Export Credit and Investment Insurance.

Requirements and restrictions

31 Are there any particular requirements or restrictions relating to joint ventures in your jurisdiction that could deter international investors?

At the time of writing, political events continue to have an impact on the Russian commercial landscape. International sanctions target key sectors of the Russian economy and apply to a number of major Russian entities and prominent business persons. The introduction of further sanctions by the United States in August 2019, with respect to the Russian government's failure to comply with the United States' demands in relation to the alleged responsibility of the Russian government for the use of a prohibited chemical substance outside of Russia, is generally unhelpful for maintaining an investor-friendly climate in the country. Rules introduced in 2017 allowing for any foreign investment to be escalated to the level of government review (although used very exceptionally) have not increased certainty in deal-making.

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UPDATE AND TRENDS

Key developments of the past year

32 What are the current trends affecting joint ventures in your jurisdiction? What recent developments in legislation and case law have had an impact on joint ventures?

Although investment conditions remain challenging in Russia owing to the application of international sanctions to certain industries and market participants, market conditions slightly improved in 2018 and the first half of 2019. In 2018, the overall number of deals increased by almost 20 per cent (principally driven by major Russian state-backed players such as Sberbank, VTB and RDIF, and Asian and Middle Eastern sovereign investors), although total deal value declined by 7 per cent (largely due to the absence of big-ticket M&A transactions) and the number of inbound deals fell by 21 per cent. This indicates that while there is an availability of buy-side opportunities for participants familiar with the Russian market and ready to deploy capital in search of yield, investors remain generally cautious of executing big-ticket M&A transactions, and certain foreign investors have adopted a wait and see approach, deferring M&A decisions into the second half of 2019 and 2020. Against this trend, recent high-profile investment into the major Arctic 2 LNG project is an example of strong competition between foreign partners for new energy projects in Russia.

With the Russian economy continuing its recovery from the 2016 recession and growing by 2.3 per cent in 2018, and with further modest growth predicted in 2019 and 2020, both investor confidence and market activity is on the rise. Growing investor confidence has been supported by Russian government policy aimed at maintaining an export-friendly exchange rate, efforts by the Central Bank of Russia to reform the banking and insurance sectors, the fact that the Ukraine conflict has not escalated and the fact that international and domestic investors have increasingly adjusted to the realities of both international sanctions and increased geopolitical risk.

For investors localising production in Russia for export, the low relative value of the rouble (which depreciated 15 per cent against the US dollar in 2018) means that production costs in Russia offer significant

competitive advantages, and the economic turbulence of recent years has gone some way to reducing valuation gaps between sellers and investors that have been prevalent in the Russian market.

Russian law has been subject to numerous amendments over the years, with the aim of enabling investors to implement at onshore Russian company level a number of typical western-style corporate governance and SHA arrangements. Conversely, the scarcity of court decisions interpreting these new provisions and the uncertainty around which private law rules can be contractually excluded have resulted in market participants remaining cautious about implementing the new arrangements. Overall, there are signs of increasing momentum for a bigger role to be played by Russian law. Further, the reforms to Russian arbitration law discussed in question 24 may see market participants increasingly willing to structure their investments through Russian companies.

We expect that the energy, innovations and technology, consumer markets, communications and media, and healthcare sectors will continue to be active areas of the Russian economy and will provide opportunities for investors during the rest of 2019.

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