

Joint Ventures in Russia

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Introduction

Joint Ventures in Russia are typically thought of by most people, including those in the legal profession as oil and gas ventures of one sort or another; however, joint ventures are formed in many more sectors. Why is it that joint ventures tend to be popular among clients and attorneys alike, especially when a foreign company is trying to break into a foreign market? Many businesses see this sort of corporate form as safer than the risk of opening a branch office in a country in which they have no presence and experience doing business.

The fact that a foreign company has no contacts within the foreign market makes it clear that there is one essential element that must not be ignored: the relationship between the partners

in a joint venture. Perhaps such a statement seems trite and overused in business law, of course the partners need to have a relationship, but the question becomes one of whether that relationship actually makes sense or does the relationship exist solely for the creation of the joint venture. If the relationship exists between the partners simply to create a joint venture and those partners have nothing in common absent the joint venture there are serious questions as to what the joint venture will yield for either party.

However, once the decision has been made to create a joint venture the counsel for the partners have little choice but to form that joint venture, or find alternative work. The following is meant to assist counsel in forming a joint venture in Russia; however this paper is only a short practice guide, designed to give counsel a general understanding of joint ventures in Russia. This guide should not be used alone, without any further resources; some good ones are to be found in the following footnotes.

Joint Venture Requirements

There are a number of requirements that must be fulfilled in order for a joint venture to be formed in Russia. These requirements include the basic government requirements for documents and whether the industry in which the joint venture will operate impacts a strategic interest of the Russian Federation.

Russian Government Filing Requirements

The Russian government requires that all joint ventures be registered with the Russian State Registration Chamber and documents must be submitted by the joint venture and both

partners.¹ All of these documents must be submitted to the relevant accrediting body of the Russian Government.² The specific accrediting body will depend upon the specific business of the joint venture or any foreign owned company the potential accrediting bodies include the Ministry of Justice's Federal State Institution State Registration Chamber; the Chamber of Commerce and Industry of the Russian Federation or other federal ministries and authorities.³

The Joint Venture must submit a written application from the founders requesting registration of the joint venture⁴, the best analogue to this requirement in Michigan law would be the sending in the articles of organization of a limited liability company or the articles of incorporation of a corporation to the Michigan Department of Licensing and Regulatory Affairs. An expert opinion must be rendered by an approved agency of the Russian government stating that any relevant examinations have been carried out by agencies of the Russian government⁵, this is a very case specific scenario and as such industry specific guidelines should be followed. Finally, the joint venture must submit two notarized copies of the founding documents of the joint venture.⁶ These documents would include the corporate charter of the joint venture, which is best to be organized as a joint stock company, as further explained below.⁷

¹ Embassy of Russia to the USA,
http://www.russianembassy.org/Embassy_eng/Consulate/business_in_russia.html#joint_ventures (last accessed Sept. 4, 2011).

² Russian Ministry of Justice, State Registration Chamber, *Accreditation of Representative Offices*,
http://www.palata.ru/en/visitors/faq1.php?ELEMENT_ID=38473 (last accessed Sept. 4, 2011).

³ *Id.*

⁴ Embassy of Russia to the USA,
http://www.russianembassy.org/Embassy_eng/Consulate/business_in_russia.html#joint_ventures (last accessed Aug. 31, 2011).

⁵ *Id.*

⁶ *Id.*

⁷ BAKER AND MCKENZIE, *DOING BUSINESS IN RUSSIA* 2011, 25 (Baker and McKenzie 2011) available at http://www.bakermckenzie.com/files/Publication/59e9cf56-c549-4f14-88fc-054561487138/Presentation/PublicationAttachment/cb6ea362-8fcf-486f-87a9-071090d0cf2f/bk_russia_dbi_11.pdf (last accessed Sept. 5, 2011) (hereinafter *Doing Business in Russia* 2011).

The Russian legal entities involved in the joint have to submit specific documents as well. First, all Russian legal entities participating in the joint venture must submit notarized copies of the entity's founding documents.⁸ In the case of both Russian limited liability companies and joint stock companies would be the charter.⁹ Second, a document stating that the joint venture's Russian property owner approved the establishment of the joint venture.¹⁰ The approval of the property owner can be a contractual provision if the property is owned by a single natural person or if the property is owned by a company a resolution approving the establishment by the governing body of the company.

The foreign investor also has specific documents that must be submitted to the Russian government. First, the foreign investor must submit adequate proof of the legal status of the foreign investor pursuant to the laws and regulations of the investor's home country.¹¹ Using a Michigan limited liability company as an example the document that must be submitted would be the articles of organization of the company. Second, the foreign investor must submit a document stating that the foreign investor is solvent that is issued by the bank or other financial institution providing services to the foreign investor.¹² This document does not have to be a full letter of credit, but rather more of a general statement by the bank that the investor actually has the money to back up the expected investment.

⁸ Embassy of Russia to the USA, http://www.russianembassy.org/Embassy_eng/Consulate/business_in_russia.html#joint_ventures (last accessed Aug. 31, 2011).

⁹ Doing Business in Russia 2011, 30-31 & 33.

¹⁰ Embassy of Russia to the USA, http://www.russianembassy.org/Embassy_eng/Consulate/business_in_russia.html#joint_ventures (last accessed Aug. 31, 2011).

¹¹ *Id.*

¹² *Id.*

Corporate Forms

There are multiple types of commercial legal entities recognized by Russian law including, general partnerships, limited partnerships, limited liability companies, additional liability companies, and joint stock companies.¹³ The two most common business forms are those that more or less mirror the two most popular in the United States, limited liability companies and joint stock companies.¹⁴ The best corporate form for joint ventures is probably the joint stock company.

The Russian Limited Liability Company Law has a number of features that are disadvantageous to corporate entities doing business together. A participant in a Russian limited liability company has the right to leave the company under certain circumstances and upon leaving take the participant's proportionate share of the value of the company's assets.¹⁵ Further, any participant or group of participants who collectively hold at least ten percent interest in the company's charter capital can seek judicial expulsion of a participant of the company.¹⁶ However, to actually expel a participant the petitioner must demonstrate "that the participant substantially hindered the company's operations or materially breached its obligations."¹⁷ Finally, and perhaps most troubling, there are a number of issues that the Russian Limited Liability Company law requires the unanimous consent of all participants to make a decision.¹⁸

¹³ Doing Business in Russia 2011, 25.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*, at 25-26.

¹⁷ *Id.*, at 26.

¹⁸ *Id.*

A charter must be drafted to create a joint stock company (hereinafter “JSC”). This charter must include:

- The name, address and type of the JSC (i.e. open or closed);
- The size of the JSC charter capital;
- The quantity, nominal value, and categories (common or preferred) of shares, as well as the classes of preferred shares issued and distributed by the JSC;
- The rights of the holders of shares of each category;
- The structure and competence of the governing bodies of the JSC, and their decision-making procedures;
- The procedure for preparing for and holding general shareholders meetings, including a list of issues requiring either unanimous consent or a resolution adopted by a qualified majority of votes;
- Information on branches and representative offices;
- Information on the existence of any special right of participation in the management of the company (a “golden share”) vested in the Russian Federation, a constituent entity of the Russian Federation, or a municipality of the Russian Federation; and
- Other provisions required by law.¹⁹

The charter of a JSC may include further provisions, as long as those provisions do not violate the JSC law and other laws.²⁰

¹⁹ Doing Business in Russia 2011, 33-34.

²⁰ *Id.*, at 34.

A JSC must maintain 2 governing bodies: the general shareholders meetings and the Executive Body.²¹ The Executive Body of a JSC is responsible for the day to day management activities of the JSC and any powers specifically delegated to it by a majority vote during a general shareholders meeting.²² The executive body may consist of one person or an external commercial organization but the delegation of the duties of the executive body's functions must be done only upon proposal of the board of directors or as a majority vote of the general shareholders meeting if there is not a board of directors.²³

The JSC form is one which seems to be best suited to create a joint venture in Russia, the form allows for majority control on most matters, without requiring the onerous requirement of unanimous consent for certain important decisions. Further, the JSC protects other partnership members from the potential of being dragged into court and having to come up with potentially half of the value of the company's assets should another member of the joint entire decide to leave. The JSC allows both members of the joint venture to stand on more or less equal footing when making important decisions.

Taxation

The impact of taxes on any foreign investment is a very complicated interplay of two or more different national tax regimes. The point of this guide is not to explore all of them in detail, but rather refer to some recent developments in the Russian tax code and how they might affect joint ventures in the future. As with any complicated corporate venture it is best to consult with your tax counsel before proceeding.

²¹ *Id.*, at 35.

²² *Id.*

²³ *Id.*

It is possible that a Russian partner to the joint venture may be able to avoid paying any of the normal nine percent corporate income tax on all profits earned after January 1, 2010. This exemption applies only to Russian entities and if the Russian entity is the recipient of the dividends held at least fifty percent of the charter capital of the dividends' payer or owned depository receipts entitling it to receive at least fifty percent of the amount of dividends paid and the share or depository receipt had been owned for at least 365 days on the day the dividends were due.²⁴ This exemption has always been on the books, but the amendments removed the requirement that the investment of the Russian entity had to be at least 500 million Rubles.²⁵ This means that under the new tax code smaller companies now have the option of allowing their Russian joint venture partners to take a large tax exemption. The ownership requirements should also be taken into account when determination is made as to how the corporate governance and share structure of the joint venture is being negotiated.

Further, the fixed assets, such as property, by any entity may qualify as depreciable fixed assets as long as the value of those assets totals at least 40,000 Rubles.²⁶ It is important to note that these are just two examples of beneficial aspects of the tax code. There are many other beneficial and less beneficial aspects and the best way to determine the structure of a joint

²⁴ Federal Law, "On Amending part II of the Tax Code of the Russian Federation and Federal Law "On amending chapters 23 and 25 of the Tax Code of the Russian Federation" and recognizing several provisions of the laws of the Russian Federation invalid" No. 368-FZ dated December 27, 2009) accessed from CMS, Russia | Home | CMS Russia Tax Outlook #17 | January 2011, <http://www.cmslegal.ru/CMS-Russia-Tax-Outlook-17--January-2011-02-10-2011> (last accessed Aug. 31, 2011).

²⁵ *Id.*

²⁶ Federal Law "On amending part I and part II of the Russian Tax Code and other legislative acts of the Russian Federation, as well as on recognition of certain legislative acts of the Russian Federation as ceased to be in force in relation to settlement of arrears in taxes, duties, fines and penalties and certain other questions of tax management" No. 229-FZ dated 27 July 2010 accessed from CMS, Russia | Home | CMS Russia Tax Outlook #17 | January 2011, <http://www.cmslegal.ru/CMS-Russia-Tax-Outlook-17--January-2011-02-10-2011> (last accessed Aug. 31, 2011).

venture is to include both Russian and American tax counsel in formation negotiations of the joint venture.

Corporate Governance

There is no specific joint venture law in Russia²⁷ unlike the People's Republic of China's Joint Venture Law.²⁸ Since there is no specific law governing the intricate details of the operations of joint ventures it is necessary for the parties to the venture to draft adequate protections into the joint venture agreement. Further, the Russia equivalent of the Sherman Anti-Trust Act is called the Federal law on Protection of the Competition this law applies both internally and externally.²⁹ Therefore, it is essential that a joint venture would not violate the elements of the Competition Law which include abusing a dominant position, agreements and concerted actions limiting competition, and others.³⁰

As previously stated the best form for operating as a joint venture in Russia would be the JSC, I have already covered a number of issues related to the business of a JSC, but further issues must be explored to more fully cover the JSC form. Pursuant to the Russian JSC Law a JSC has the ability to issue stock to raise capital and the shareholders of a JSC are generally not

²⁷ Hermann Schmitt, *Joint Ventures in the Russian Federation*, WHITE & CASE LLC, Jan. 2009, at 1 available at http://www.whitecase.com/files/Publication/255b764d-e306-417e-bd1a-3a6ab0bf8099/Presentation/PublicationAttachment/3f45c74f-1523-439a-b926-3b4ce60316e2/article_JointVenture_v3.pdf (last accessed Aug. 31, 2011).

²⁸ Law on Joint Ventures (P.R.C.), Article 21, http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/LawsonForeignInvestment/P020060620322310939539.pdf (last accessed Aug. 28, 2011).

²⁹ *Doing Business in Russia 2011*, 49.

³⁰ *Id.*

liable for the obligations of the JSC and bear risk only in the amount invested in the company.³¹ As previously stated there are two types of JSCs: open and closed. An open JSC can have an unlimited number of shareholders and the shares are freely transferable.³² A closed JSC on the other hand may have no more than 50 shareholders, and should this number be exceeded the JSC has one year to transform into an open JSC.³³ Shareholders in a closed JSC have the right of first refusal to acquire share sold by other members, for the same price offered to a third party.³⁴ Should either type of JSC decide to issue additional stock the shareholders are entitled to purchase that issue preemptively, if the shares are to be privately placed, in proportion to the shareholder's current ownership stake.³⁵

Further, if shares are offered publicly, realistically only possible in an open JSC, any shareholders maintain their preemptive right to purchase in proportion to their current ownership.³⁶ However, they do not have a right of first refusal to purchase third party sales from other shareholders.³⁷ It is mandatory for all JSCs to maintain a shareholder's register, similar to an American shareholder list, and should a JSC have more than 500 shareholders the register should be maintained by a licensed register.³⁸

³¹ *Id.*, at 32.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ Doing Business in Russia 2011, 32-33.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

The initial amount of charter capital of a JSC depends on whether it is an open or closed JSC.³⁹ If an open JSC the charter capital must be at least one thousand times the Russian statutory minimum wage.⁴⁰ If a closed JSC the charter capital must be at least one hundred times the Russian statutory minimum wage.⁴¹ Further, the entirety of the charter capital must be paid within the first year with the first half due within three months of the JSC's registration.⁴²

Home Nation Issues

The difficulty here is determining the home country of the foreign investor. In most cases lawyers in Michigan are going to be dealing with American companies and those companies' home nation will be the United States. Most American lawyers specializing in international business are familiar with the American requirements as they related to foreign investment and doing business abroad. Therefore, this guide's limited scope is not best suited to exploring these issues; however, the United States Department of Commerce is a good place to begin.⁴³

The issues that must be considered include United States import and export issues depending on what the purpose of the joint venture. It is also important to discuss with tax counsel how the payments from the foreign entity will be characterized because both pass through and corporate taxation carry their rewards and detriments. Keep in mind that the joint venture's partner's employees may have to travel for long terms or immigrate to Russia, and be prepared to work with the American Federal Agencies which will have to be involved. Finally,

³⁹ *Id.*, at 34.

⁴⁰ *Id.*

⁴¹ Doing Business in Russia 2011, 34.

⁴² *Id.*

⁴³ The United States Department of Commerce website is available at <http://www.commerce.gov/>.

be prepared to report about the joint ventures activities if the American partner of the joint venture is regulated under Sarbanes-Oxley.

Examples of Joint Ventures

Ford and Sollers have entered into a joint venture to produce Ford products in Russia for sale on the Russian market.⁴⁴ The Russian government has made it clear that they consider it necessary to partner with foreign automakers to increase the viability of their domestic automotive production.⁴⁵ However, this decision and the expansion of foreign investment in the automotive industry seems to parallel a surge in new car sales in Russia.⁴⁶

In the area of high technology and telecommunications Crossbeam Systems, Inc. and Russian Telecom Equipment Company have partnered in a joint venture: Crossbeam RT.⁴⁷ The joint venture was formed to meet the needs of entities requiring secure telecommunications systems with the most up to date security software such as the Russian and regional CIS governments.⁴⁸ Interestingly, this sort of joint venture would likely have to be specially approved because it would potentially violate the *Russian Law No. 57-FZ of April 29, 2008* “On

⁴⁴ Associated Press, *Ford Teams with Russia's Sollers in Joint Venture*, USA TODAY, Feb. 18, 2011, http://www.usatoday.com/money/autos/2011-02-18-ford-sollers-joint-venture_N.htm (last accessed Sept. 5, 2011).

⁴⁵ *Id.*

⁴⁶ Courtney Weaver, *Millions of Cars for Russia*, FINANCIAL TIMES, May 12, 2011, <http://blogs.ft.com/beyond-brics/2011/05/12/millions-of-cars-for-russia/#axzz1X8jGqSt5> (last accessed Sept. 5, 2011).

⁴⁷ Crossbeam Systems, Inc. & Russian Telephone Equipment Company, *US-Russian Joint Venture to Deliver Security Solutions in Russia and CIS*, EAST-WEST DIGITAL NEWS, May 19, 2011, <http://www.ewdn.com/2011/05/19/us-russian-joint-venture-to-deliver-security-solutions-in-russia-and-cis/> (last accessed Sept. 5, 2011).

⁴⁸ *Id.*

the Procedures for Foreign Investments in Companies of Strategic Significance for National Defence and Security.”⁴⁹

Dissolution of Joint Ventures in Russia

Perhaps the most important part of the negotiations creating a joint venture should be the determination of what sort of dissolution and dispute resolution clauses should be included. However, often clients will dismiss these elements as *pro forma* and not immediately necessary to negotiate and decide upon. It is essential that while the set up phase of the joint venture is viewed through the rose colored glasses of the start of the relationship it does not take long to lose that optimistic outlook on the relationship.

Court System or Alternative Dispute Resolution?

The Russian Judicial system has a number of different courts, similar to the American court system of state and federal courts.⁵⁰ However, in addition there are the Russian commercial courts, called “arbitrazh” courts, which grew out of the old Soviet “State Arbitrazh” system.⁵¹ The arbitrazh court system has four levels, trial court, court of appeal, court of cassation appeal; and the Supreme Arbitrazh Court of the Russian Federation.⁵² Interestingly, the arbitrazh courts tend to favor the same sorts of evidence commercial arbitrators tend to favor, namely written documentary evidence over witnesses and recordings.⁵³

The effectiveness of any national court system is limited by a number of factors. In the case of the arbitrazh courts there is a timeframe issue in which a final judgment may not be

⁴⁹ Doing Business in Russia 2011, at 17.

⁵⁰ *Id.*, at 7-12.

⁵¹ *Id.* at 7.

⁵² *Id.*, at 8.

⁵³ *Id.*

entered for over eight months.⁵⁴ Additionally, when dealing with international business ventures it is important to determine whether a judgment rendered in one country is likely to be enforced in another country. This is where International Arbitration comes into its own.

The Russian Federation has enacted the Federal Law on International Commercial Arbitration which is based on the United Nations Commission on International Trade Law (UNCITRAL) Model law.⁵⁵ In addition, Russia is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) which all but ensures the enforcement of a foreign arbitral award.⁵⁶ Further, Russia is a signatory to the European Convention on International Commercial Arbitration of 1961 (Geneva Convention) which grants the right to legal persons to contract for arbitration of their disputes.⁵⁷ Due to pro-arbitral environment created by the UNCITRAL and Geneva Convention Russian courts do not, as a rule, review the merits of an arbitral award, during recognition and enforcement hearings.⁵⁸ The Russian courts seldom step outside of the New York Convention for grounds to refuse the recognition and enforcement of arbitral awards.⁵⁹

It is important to note that arbitration is not the default dispute resolution system for anything in Russia, it is necessary for the parties to contract to refer disputes to arbitration or mediation.⁶⁰ Should parties decide to refer disputes to arbitration it is essential that the parties understand that certain disputes may not be arbitrated. Disputes that arise from tax, custom and

⁵⁴ *Id.*, at 8-10.

⁵⁵ *Doing Business in Russia 2011*, 13.

⁵⁶ *Id.*

⁵⁷ European Convention on International Commercial Arbitration, art. 2, ¶ 2, Apr. 21, 1961, 484 U.N.T.S. 364.

⁵⁸ *Doing Business in Russia 2011*, 13.

⁵⁹ *Id.*, at 13-14.

⁶⁰ *Id.*, at 12.

other administrative actions may not be arbitrated.⁶¹ Arbitration is also not available for issues that fall within the exclusive jurisdiction of the state arbitrazh courts including bankruptcy proceedings and disputes specifically regulated by Russian Law.⁶²

It is often popular to include a mediation clause in an alternative dispute resolution clause. There are some questions that arise if a mediator is used because there is no Russian legislation concerning mediators.⁶³ Therefore, the course of mediation is not necessarily protected from the national court system allowing documents used during mediation to be admitted into evidence and even the mediator herself or himself being forced to testify as a witness.⁶⁴

Conclusion

The joint venture will likely be a popular vehicle for foreign investment well into the future in Russia. The joint venture model allows partners to spread risk and share experience. It is important to remember however that a JSC is the best corporate form available and that all of the documents must be submitted to the Russian Government. Arbitration is a good idea for all commercial disputes because it allows for the widest ability to enforce the judgment and protects from the vagaries of a national court system. This guide would not have been possible without the assistance of Randolph M. Wright and Simon Edelstein of Berry Moorman, P.C.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*, at 14.

⁶⁴ *Id.*