

REQUIREMENTS TO TRANSACT BUSINESS IN RUSSIA THE CIS & EASTERN EUROPE

Although this paper focuses on the considerations required to position a foreign entity to transact business in Russia with Russian oil and gas entities, similar market entry consideration will apply to position a foreign entity to conduct business in other Russian industry sectors and in the Commonwealth of Independent States ("CIS") and the Eastern European Countries that formerly comprised the Soviet Union.

Russia, A Brief Overview - The Russian Federation, territorially, is the largest country in the world; and virtually every conceivable natural resource is found in Russia, including some of the world's largest deposits of oil and gas.

The Russian Federation consists of 89 regions, considered as equal members of the Russian Federation and classified either as republics, districts, territories, federal cities, autonomous regions and autonomous districts. Each of these regions has its own foundation laws, political institutions and local legislation; and about one half have signed bilateral treaties with the Federal Russian Government. Regional governments have delegated powers, authorities and responsibilities to local government bodies including limited powers of taxation but have done so inconsistently. Regions in Russia compete to attract foreign business and investment and have passed laws, regulations and other legal measures to encourage and regulate foreigners investing and conducting business. Some regions have adopted more favourable foreign business and investment laws than others; and several have created economic trade zones laws and privileges for foreign trade investment and business activities in the zone.

Following the collapse of the Soviet Union in 1991, the Russian Federation implemented a series of reforms and privatization programs to dismantle the Soviet planned economy and directed Russia toward a free market economy. Economic mismanagement, an ineffective tax system, corruption and the financial crisis of 1998 made Russia's transition to a free market economy difficult. Russia's strong recovery from its 1998 financial crisis along with renewed government efforts at free market structural reforms have Russia's economic indicators pointing in a positive direction and have raised business and investor confidence over Russia's prospects for its continued transition to a free market economy.

Some Quick Facts About Russia's Oil & Gas Industry - The Russian Federation has about 12 % of the world's proven oil reserves and is the world's second largest oil producer. Many industry analysts believe that estimates of Russia's proven oil reserves are vastly understated and that Russia's proven oil reserves could be two to three times larger than currently stated. Russia also has 33% of the world's natural gas reserves and is the world's largest producer and exporter of natural gas. Russian natural gas is exported primarily to Europe. Industry analysts forecast that demand for Russian natural gas will continue to rise significantly and by 2020, the European Union will be relying on Russia for up to 40% of its natural gas needs. By virtue of its vast oil and gas reserves, Russia will remain at the center of the global oil and gas market for decades.

Suppliers To Russia's Oil & Gas Industry - The suppliers market in Russia for oil and gas plant, equipment, products and related technology and services has been growing annually at an average rate of 8% in recent years and was valued at U.S. \$5.2 billion in 2004. The growth of this market is forecast to equal or exceed the annual 8 % rate in each year for the next decade. There also is a comparatively strong market for telecommunication, information technology, construction and other non-oil and gas plant, equipment, products and technology required by Russia's oil and gas industry.

REQUIREMENTS TO TRANSACT BUSINESS IN RUSSIA THE CIS & EASTERN EUROPE

Russia's domestic companies manufacture and supply a wide variety of basic plant, equipment, and products at comparatively low costs. However, the plant, equipment, and products of domestic suppliers are not as reliable or as technically advanced as the plant, equipment and products of foreign suppliers. Suppliers from the United States, Canada, Germany, Italy and Japan are very active in supplying the plant, equipment, products, technology and services required by Russia's oil and gas industry.

Market Entry Considerations – A foreign supplier interested in transacting business in Russia with Russian oil and gas entities will have to establish and maintain the requisite technical, legal and business presence in Russia, either directly or through an agency arrangement. Typically it will take approximately 6 months to make the applications, submissions and presentations to and attend the reviews with Russian government and industry officials for a foreign supplier to establish the required technical, legal and business presence in Russia and be accredited to transact business directly with Russia's oil and gas industry ("Direct Market-Entry").

As an alternative to or during the Direct Market-Entry process, market entry can be organized for a foreign supplier to Russia's oil and gas industry through an arrangement with an accredited local agent ("Agency Market-Entry"). The accredited agent will provide the requisite legal, technical and business presence in Russia for and on behalf of the foreign supplier and qualify the foreign supplier's plant, equipment, products and technology to be marketed and sold in Russia. Typically an agency arrangement can be organized within a period of 3 to 4 weeks. An Agency and/or Direct Market-Entry will require a substantial commitment of resources and market development costs from the foreign supplier.

Establishing A Technical Presence - To establish a direct technical presence in Russia as a qualified foreign supplier to Russia's oil and gas industry, the supplier's plant and operations will have to be certified by the appropriate Russian Ministries to be technically compliant with Russian technical standards. The procedure to obtain technical market entry certification requires submission of the appropriate applications together with completed questionnaires and supporting documents, in Russian, recommendations from the appropriate Ministry officials and, at times, an inspection of the foreign suppliers manufacturing facilities. During this review process, conferences often are required with Ministry officials to answer questions and provide additional information, data and documents. On completion of the inspection and conferences, a certificate of compliance and a permit will be issued by the Ministries qualifying the foreign supplier to market and sell its plant, equipment, products and technology in Russia. The compliance certificate and permit usually will be valid for a 3 year period and will be subject to renewal. If the applications and review procedures for the certificate and permit are correctly documented and facilitated, and all applications are made concurrently, the compliance certifications and permits should be issued to the foreign supplier within 3 to 6 months. After the foreign supplier obtains its technical market entry documentation, representatives of the foreign supplier will have to attend meetings between the supplier's Russian customers and Russian Technical Institutes to support the design, engineering and other technical requirements for the plant, equipment, products and technology that the foreign supplier proposes to deliver to its Russian customers.

Establishing A Legal Presence – A foreign supplier can establish a direct legal presence to conduct business in Russia by organizing and maintaining one of the following under Russian law: a representative office; a branch of the foreign supplier; a limited liability company; an additional limited liability company; a joint stock company (closed or open); or a partnership (general or limited liability). The limited liability companies, joint stock companies and partnerships are separate legal entities under Russian law and each can be wholly owned by the foreign supplier or co-owned with a Russian partner. Neither the representative office nor the branch has separate legal status under Russian law and each acts only on behalf of the foreign company that it is registered to represent. Each of these legal forms has

REQUIREMENTS TO TRANSACT BUSINESS IN RUSSIA THE CIS & EASTERN EUROPE

different registration, accreditation, setup and operating requirements with different resulting benefits, obligations, restrictions and costs.

Russian foreign investment law allows a Russian representative office to carry on “liaison and ancillary functions” to promote the business and the plant, equipment, products and technology of its foreign supplier but does not permit the representative office to conduct certain commercial activities or to import goods into Russia for resale other than goods for use in the premises of the representative office. In practice, the legal distinction between activities in Russia that will be considered commercial or non-commercial has been blurred and representative offices are doing more than merely observing and conducting liaison activities.

The representative office has fewer and less onerous legal obligations than the other legal forms; and foreign suppliers (other than large volume and low cost equipment and parts suppliers) often choose the representative office as the method of establishing their initial legal presence in Russia unless there are special reasons for establishing a different legal form. At a later date, if the supplier decides to provide engineering support for its equipment, warehousing of parts and equipment, some manufacturing capability and/or direct sales in Russia, another legal form can be structured for these activities.

To establish a representative office in Russia, application will have to be made on behalf of the foreign supplier to the Russian Ministry authorized to accredit foreign representative offices for suppliers of Russia’s oil and gas industry. The application to the accrediting Ministry will have to be accompanied by recommendations from Russian government and industry entities, some 12 to 14 different documents and a certificate confirming payment of the required registration fee. All documents must be notarized and/or apostilled (legalized). Documents supplied in a language other than Russian must be accompanied by a notarized translation. Accreditation is usually granted for a term of 3 years with rights to an extension. Following accreditation the representative office must carry out a number of post accreditation registrations and other procedures before it becomes fully operative. If properly documented and facilitated the accreditation and registration process will take approximately 6 months to complete.

Establishing A Business Presence In Russia - In Russia’s transition to a free market economy, Russian business and government entities have adopted many North American business practices. As a result, exporting to and/or operating a foreign business in Russia today is similar to doing business in many other foreign jurisdictions. However, there is a distinct Russian business culture which has to be respect and prevailing Russian business practices which have to be adopted by foreigners conducting business in Russia (“Russian Business Practices”). To source, bid on and be awarded supply contracts and otherwise conduct business successfully in Russia, a foreign supplier will have to follow Russian Business Practices such as the following:

- Establish and maintain an office presence in Russia staffed with employees and/or representatives in accordance with local laws and business practices.
- Develop or acquire the skills and competence to conduct business commercially and technically in the Russian language (written and spoken).
- Identify the senior industry and government officials who have the authority to conduct business with foreign suppliers; and establish a basis for a long term business relationship with these officials by arranging meetings, as and when required, to introduce senior supplier executives to these officials and providing the officials with commercial information and technical data in Russian to develop confidence in the supplier’s ability to deliver the required plant, equipment, products technology and services.
- Observe unwritten traditional Russian business customs, rules, procedures and practices.

REQUIREMENTS TO TRANSACT BUSINESS IN RUSSIA THE CIS & EASTERN EUROPE

- Understand and accept Russia's prevailing bureaucracy, political system, culture and customs.
- Develop region-specific marketing and sales strategies.

Markets In The CIS & Eastern Europe - When a foreign supplier establishes its Russian presence (directly or through an accredited agency), it can use its Russian office as a base for sourcing supply opportunities in the oil and gas markets of the CIS Republics such as Kazakhstan, Uzbekistan and Turkmenistan and Eastern European countries such as Romania, Ukraine and Bulgaria.

This paper has been prepared by Henry A. Smith, an international business lawyer and the President and CEO of International Projects Facilitator Inc. ("IPFI"), a company based in Calgary, Alberta, Canada. IPFI provides consulting services to assist clients with their international business ventures by finding, sourcing and facilitating prospective international business opportunities; advising clients on the technical, legal and business requirements for their international business opportunities; and assisting clients with the submission of their bids and proposals, the negotiation of their contracts and the government regulatory compliances for their international business opportunities. IPFI officers have over 15 years of experience transacting business in Russia, the CIS and Eastern Europe and have the competence and associations to establish accredited agency arrangements for foreigners conducting business in Russia.

International Projects Facilitator Inc. and BG Consulting Inc. ("BG") have formed an alliance to extend IPFI's facilitator services to companies interested in developing business in Russia, the CIS and Eastern Europe. For more information contact BG Consulting Inc.

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