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HOW TO INVEST IN RUSSIA

The AEB guide to investing in Russia

Adjusting to new realities, unfolding new opportunities

Foreign investment in strategic branches of the Russian economy

Transfer pricing and customs requirements for importers

Impact of the waste management industry on climate change in Russia

Investment protection and promotion agreements: outcomes and prospects

MAXIM RESHETNIKOV

MINISTER OF ECONOMIC DEVELOPMENT OF THE RUSSIAN FEDERATION

Dear friends,

Russia is a country with a robust, open, and sustainable economy. We have graciously survived the challenges of the global pandemic. And we deeply appreciate that at that time foreign companies kept on implementing active projects and launching new ones in our country. Now economic activity in Russia has returned to its pre-crisis levels. Our turnover with many countries is on the rise again.

Further economic growth is correlated with the increase in citizens' income, domestic market development, export growth, and last but not least investment development. That is why we are establishing partnerships with foreign companies, providing entrepreneurs with the conducive environment.

We have already repealed thousands of enactments concerning the requirements for business operation. We have transformed the way regulatory agencies function. We advocate for the interests of investors and offer consistency in conditions for launching investment projects within the investment protection and promotion agreements. The Russian regions now have newfound tools for building infrastructure required for new investment projects. That also includes infrastructure sites in special economic zones.

We look ahead with confidence and pursue long-term objectives. We have set our priorities straight — digital economy and innovation development, sustainable development and climate agenda, ESG financing and technological advancement of the economy. We are preparing regulatory framework for implementing climate projects in Russia. We are creating a unified investment support system in all the regions according to the Fast Track strategy. This way, any investor — local and foreign alike — can choose an area with the most favorable terms for their project.

We have developed and launched these solutions in cooperation with you as well as our other foreign partners. I want to thank the Association of European Businesses for your contribution in the development of the Russian economy, your trust in us and constructive suggestions. I have no doubt that we have an abundance of collaboration projects ahead. I want to wish the best of luck to every business owner who wants to partner with Russia in the future and to everyone who already has!

JOHAN VANDERPLAETSE

CHAIRMAN OF THE BOARD, ASSOCIATION OF EUROPEAN BUSINESSES

TADZIO SCHILLING

CHIEF EXECUTIVE OFFICER, ASSOCIATION OF EUROPEAN BUSINESSES

STUART LAWSON

AEB BOARD MEMBER, FINANCE & INVESTMENTS COMMITTEE CHAIRMAN

Dear readers,

Welcome to the 2021 edition of the AEB 'How to invest in Russia' guide which is the 13th edition and accumulates practical advice from professionals.

Year 2021 was another one dominated by COVID-19, which has had a wide range of effects and implications for politics, economics, and social attitudes. At the time of writing, Russia, with only 31% of its population vaccinated, remains vulnerable to a fourth wave, expected to last well into the winter 2021/22.

However, 2021 to date has seen a good recovery from the previous year, driven by the strength of the public sector, a recovery in energy prices, and a rebound in retail sales caused by pent-up demand. With inflation growing and currently running at around 6.7%, the Central Bank has maintained a conservative positioning and recently raised interest rates to 6.75% to control inflation and roll it back to the targeted 4% p.a. Overall, the GDP for 2021 is estimated to grow by 4.2%, followed by a more modest 3% growth in 2022 and 2023.

The trend toward an increase in state participation in the economy has continued with the SME sector suffering over the past year, particularly in the services sector. The state has developed a plan of action for national projects which, though delayed, remain a cornerstone of the strategy to grow the economy away from its reliance on extractive industries. However, the primary challenge still lies in creating a more productive economy that will rely on higher levels of investment in both the private and public sectors. As in previous years, this will require continued improvement in corporate governance and the rule of law.

This current edition of the 'How to invest in Russia' guide will bring you updates on the investment climate, tax, legal, financial and other aspects. In addition, it also provides insight into investments by regions and by industries, as well as into the opportunities and challenges when localizing in Russia. A separate section is devoted to the green agenda and climate policy.

We would like to thank all the authors who helped by making their valuable contributions to this guide, sharing their knowledge of the Russian market and their experience of running a business here. We are also most grateful to the Ministry of Economic Development of Russia and the Federal Antimonopoly Service, who have supported the guide over the years.

We hope this publication will serve its purpose, bringing more investment to Russia and promoting a business environment which is beneficial to all interested parties.

Contents

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Part 1

Strategic Initiatives

Foreign investment in strategic branches of the Russian economy: trends and innovations

MAXIM SHASKOLSKY

HEAD OF THE FAS RUSSIA

Maxim Shaskolsky has been Head of the Federal Antimonopoly Service (FAS Russia) since November 2020.

From January 2019 to November 2020, he used to be Vice Governor of St. Petersburg in charge of energy issues and tariff regulation.

From 2013 to 2019 Mr. Shaskolsky was General Director of JSC 'Petersburg Sales Company' after several years of leading positions in this company.

From 2001 to 2005 he was First Deputy General Director of CJSC 'Petroelektrosbyt'. Later – Deputy Director for work with consumers in JSC 'Lenenergo'.

Mr. Shaskolsky graduated from St. Petersburg State University with a degree in economics.

Foreign investments are inherently a method of transfer of international capital from one state to another. In order to manage such significant, from both an economic and legal perspective, financial flows, Federal Law dated July 9, 1999 No. 160-FZ, "On Foreign Investments in the Russian Federation" (hereinafter – Law No. 160-FZ), was put into effect.

The creation of a favorable environment for foreign investments in Russia is one of the objectives of the National Security Strategy of the Russian Federation, approved by Decree dated July 2, 2021 No. 400 of the Russian President, Mr. V.V. Putin (hereinafter – the Strategy). Despite this, national interests and the country's security cannot be encroached upon in favor of involvement of foreign capital. This is why the Strategy also provides for strengthening of control over foreign investments in strategically significant sectors of the Russian economy (Subparagraph 32 of Clause 67 of the Strategy).

The review procedure of such investments is stipulated by Federal Law dated April 29, 2008 No. 57-FZ "On the Procedure of Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security" (hereinafter – Law No. 57-FZ), namely Articles 8 (petition submission procedure) and 14 (notice of performing a transaction).

The Law No. 57-FZ uses the same concepts as those used by business entities performing strategic operations. Such a company is understood to mean a business entity that 1) has been created on the territory of the Russian Federation, and 2) performs at least one type of activity having strategic importance for ensuring Russian defense and state security and is listed in Article 6 of the Law No. 57-FZ (hereinafter – a strategic company).

Requests for preliminary approval of a transaction or notifications regarding a transaction are submitted to an authorized body. In accordance with the Regulations on the Federal Antimonopoly Service, approved by Resolution dated June 30, 2004 No. 331 of the Government of the Russian Federation and Clause 3 of Resolution dated July 6, 2008 No. 510 "On the Government Commission for Control Over Foreign Investments in the Russian Federation" (hereinafter – the Government Commission), the FAS Russia is a federal executive body authorized to exercise control over foreign investments in the Russian Federation. In order to exercise the powers granted to the FAS Russia by the abovementioned regulatory legal acts, in 2008 the Department for Control over Foreign Investment was created.

The procedure of petition review by an authorized body and, after submission for examination, by the Government Commission is regulated by Articles 9-12 of the Law No. 57-FZ.

During the period from 2008 (entry into force of the Law No. 257-FZ) to September 8, 2021, the FAS Russia contributed to holding 43 meetings of the Government Commission, where 303 petitions were examined. For 277 of them, a decision was made on preliminary approval of transactions (in 86 cases — with imposing conditions on foreign investors related to the activities of strategic companies, as per Article 12 of the Law No. 57-FZ). In 26 cases, the Government Commission made a decision to refuse preliminary approval of transactions.

The total volume of intended investments in transactions approved by the Government Commission amounted to 5,998.98 bln roubles (RUB). According to the USD/RUB exchange rate of the Central Bank of Russia as of May 31, 2021, this is about 81.52 bln USD. Out of this amount, RUB 2,938.14 bln were intended for development of business entities.

Foreign investments made in sectors of strategic significance of the Russian economy can be considered as a separate category of foreign investments, since they hold a sufficient share of the Russian economy.

Such statistics indicate a favorable environment for foreign investment in the Russian Federation, as well as the interest of foreign investors to invest in Russian organizations.

The request for submission of a petition for preliminary approval of a transaction or a notice of a transaction is submitted to the FAS Russia depending on the number of acquired shares (stocks) in the authorized capital of a business entity or other factors allowing to discuss the possibility of control by a foreign investor over such a company.

Transactions, which result in a situation when a foreign investor or a group of persons receive the right to dispose over 50% of shares (stakes) constituting the authorized capital of a strategic company, as well as the right to appoint a sole executive body and/or over 50% of the membership of a collegiate executive body of a strategic company and/or unconditional ability to elect over 50% of the membership of the Board of Directors/Supervisory Board or other collegiate governing body of that business entity, are subject to approval.

Transactions that are subject to preliminary approval also include other transactions/actions resulting in strengthened control of a foreign investor over a strategic company, as well as transactions providing for acquisition of ownership, possession or use of a property that pertains to the fixed production assets of a business entity of strategic importance and whose value amounts to 25% or more of the book value of assets of that entity.

Special threshold values (25%) are established for two types of activity: geological research of subsoil resources and/or exploration and extraction of mineral resources at plots of subsoil resources of federal significance; extraction (yield) of biological water resources.

It is notable that the list of types of activity covered by the threshold value of 25% of shares (stakes) has been increased by means of reduction of the permitted participatory share of a foreign investor in a strategic company by Federal Law dated July 2, 2021 No. 339-FZ "On Revision of the Federal Law "On Fishing and Preservation of Marine Biological Resources" and the Federal Law "On the Procedure of Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security" (hereinafter — Law No. 339-FZ).

Such a step was taken in connection with the importance of the fishing sector for the food and economic security of the country. The adoption of the Law No. 339-FZ has ensured the increased efficiency of state control over the implementation of foreign investments into the fishing industry.

This example should not be treated as the focus of Russia's investment policy on tightening the current requirements to foreign investors. For example, the FAS Russia developed and later approved with the State Duma of the Federal Assembly of the Russian Federation the Federal Law dated March 9, 2021 No. 40-FZ "On Revision of the Federal Law "On the Procedure of Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security" (hereinafter — Law No. 40-FZ).

The Law No. 40-FZ simplified and improved the procedure of the implementation of foreign investments into individual business entities, for which the strategic importance activity (water supply and water removal, activities related to the use of agents of infectious disease) is not the primary activity. The Law No. 40-FZ also partially revised the procedure concerning approval of transactions of foreign investors in relation to these business entities.

Currently, the State Duma of the Federal Assembly of the Russian Federation is examining another draft law aimed at improving the wellbeing of the investment environment in the Russian Federation namely the draft Law No. 1214051-7 "On the Revision of Articles 28 and 29 of the Federal Law "On Protection of Competition" and Federal Law "On the Procedure of Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security".

This draft law eliminates certain administrative barriers in the form of obtaining mandatory approvals when performing transactions aimed at restoration of previously lost control of the beneficial owner over a foreign company in case of registration of such a company in the form of re-domiciliation as an international company in special administrative regions of the Russian Federation. In particular, the draft law eliminates the obligation of preliminary approval of transactions resulting in the recovery of the control of the beneficial owner of the foreign legal entity registered in the course of re-domiciliation, lost after March 17, 2014, in accordance with the Federal Law No. 135-FZ "On Protection of Competition" in case the data on the beneficial owner be provided for state registration, said transactions are performed within ten years from the date of state registration and result in the restoration of control of the beneficial owner over the foreign entity within the same scope as had existed before its loss.

Let it be noted that the FAS Russia aims to create a favorable business environment in Russia to attract foreign investors. The Law No. 57-FZ provides for the applicant's (foreign investor's) right to contact the FAS Russia with a request for approval of an intended transaction (Part 6 of Article 8 of Law No. 57-FZ). Moreover, the FAS Russia is advocating fair and transparent competition rules. In particular, the Expert Council for Foreign Investments has been created, aimed at resolving the tasks for reduction of administrative barriers for foreign investors and application of leading world practices in the sphere of foreign investments. Employees of the Department for Control over Foreign Investments publish scientific articles on the cases arising in their practice and also prepare the scientific and practical commentary on the Law No. 57-FZ.

Russia's main tax policy directions in a post-COVID-19 era

OLGA ODINTSOVA

TAX COUNSEL, CMS RUSSIA

Olga Odintsova is a tax counsel heading the New Businesses and Product Development department at CMS Russia. Prior to joining CMS Olga used to work for over 15 years at Big Four firms.

Olga is specializing in corporate taxation for the clients of the banking, TMT, automotive and manufacturing industries.

Olga is the Federal expert at the Russian Export Center and an active member of the AEB Taxation Committee.

She graduated from Higher School of Economics and obtained MBA degree at Moscow School of Management SKOLKOVO (Russia) with further upgrade qualifications at HKUST (Hong Kong) and Haas School of Business Innovation Immersion, the University of California, Berkley (USA).

The pandemic lockdowns all over the world have interrupted the normal course of businesses of companies and governments, forcing them to either completely freeze their activities or switch into an emergency operation mode. It was impressive to observe that the Russian Ministry of Finance and Russian Federal Tax Service (FTS) not only did not stop working for a moment, but even acted more intensively than ever.

Looking back for a year and also into the future for a couple of years, we may cautiously claim that the Russian fiscal authorities are about to create a truly technological environment, where taxes will be calculated automatically, and risks identified instantly. All these changes are expected to be executed simultaneously with a strong representation of Russia's fiscal interests on the global arena when renegotiating the provisions of the Double Tax Treaties, attracting IT and innovative businesses to the country, and following the OECD initiatives on the taxation of multinational giants.

Let's go through the main milestones in Russia's current tax policy. Daniil Egorov, Head of FTS, admitted in one of his first interviews following his appointment that one of the FTS's main goals was to make tax payments "inevitable but comfortable" in the country by using an engineering approach to taxation and its administration:

» by deepening the risk-oriented approach, which enables it to concentrate all the necessary audit resources only on high-risk areas;
» by decreasing the threshold for participation in the tax monitoring regime that allows it to have an online access to taxpayers' accounting and tax records in order to forecast their tax obligations instantly;
» by automating the appealing process when taxpayers challenge the results of its tax audit;
» by creating tools that significantly simplify tax payments, like those created for micro businesses;
» by providing more opportunities to companies to conduct or verify due diligence of their vendors, for instance, by launching the Russian taxpayers accounting reporting database;
» and several others.

These measures executed by the fiscal authorities significantly increased the state budget from taxes collected in the first six months of 2021. Overall, the amount of taxes collected in the first half of 2021 was 29% and 15% higher than the corresponding amounts that were collected in the respective periods in 2020 and 2019. It is easy to forecast the FTS's main focus areas by looking at some of its key KPIs for different spheres of its responsibility, which are publicly available on its official website:

» the field tax audits success rate should be 96%;
» the amount of assessed taxes confirmed by courts as a result of litigation should not be less than 75%;
» the share of taxpayers that qualify for a tax monitoring regime should not be less than 11%;
» the share of electronically issued VAT invoices should be increased to 10%.

While the FTS is excelling in its primary role of tax payments administration, the Ministry of Finance, acting according to its powers, is establishing a wider landscape for taxation and is taking a strong stance about protecting Russia's national interests in the world community. When preparing this article for publication, Russia announced its intention to renegotiate the conditions of the Double Tax Treaty with Switzerland, another country in a row of revised treaties. Russia is not the only country, which is trying to tax profits as much as possible at home and consistently supports international initiatives in this area, such as the introduction of the 15% supranational corporate income tax rate for multinational corporations that operate in multiple jurisdictions.

There is no definite decision on the mechanism of such tax and Russia will assess its effects on its treasury and businesses. If the OECD is slow in its decisions on implementation of the supranational corporate income tax, Russia may consider an option of implementing the national Digital Services tax, like France and some other countries. All these developments keep international companies on alert about the potential changes in taxation as they may significantly affect their business models and profit margins in the country.

We expect a strong focus on international businesses both from the taxation and regulatory standpoints, a view, which may be confirmed by another recent novelty. As a step to strengthening its ability to monitor the localization of Russian users' data, the government has adopted a law that requires foreign online companies with significant local users (defined as at least 500,000 Russian users per day) to have a physical presence in the country, effective from 1 January 2022. Accordingly, companies that meet these conditions should be allowed to operate or be represented in Russia, otherwise such companies may be penalised up to a complete blockage of their Internet resources in Russia.

Demonstrating strong views outside the country, the Russian fiscal authorities have intensified their efforts in developing business-friendly tax regimes and incentives at home. These steps are aimed either at encouraging the repatriation of companies, which had previously opted for foreign tax heavens, back to the country or to fund/boost some local economy's priority sectors, such as IT. As a result of the former, Special Administrative Regions (SARs) have been established across Russia, including on the Island of Russky (Primorsky Krai) and on the Island of Oktyabrsky (Kaliningrad Region). Foreign legal entities can also operate in these SARs, if they change their foreign incorporation jurisdictions to Russian jurisdiction.

The COVID-19 pandemic has also made a significant contribution to the changes in Russia's tax policy, especially in the IT sector, which has been granted favorable tax conditions. Last year, the Russian Government introduced large-scale tax benefits, effective from 1 January 2021, which will help create conditions for domestic high-tech companies to further develop their IT competencies, as well as boost the country jurisdiction's attractiveness for international IT corporations.

First of all, these measures imply the provision of income tax benefits to two categories of companies working in the IT sector: Russian companies that develop and implement software, provide services for its modification, adaptation, installation, testing and maintenance of software and databases, as well as for firms, which design and develop electronic component database products and electronic products. The essence of the benefit is to reduce the income tax rate from 20% to 3%. Besides, to ease the fiscal burden on IT companies' employees' salaries, their social contributions rates have also been reduced from 14% to 7.6%. Both benefits are equally available to Russian companies and the subsidiaries of multinational businesses operating in the country. These incentives have increased the number of accredited IT companies by 3,500 to 15,300, which is more than three times higher the aggregated growth rate for 2008-2020.

As a tradeoff for making these steps and payoff for these incentives, the government has limited the VAT exemption on the provision of exclusive rights and software licenses. Now, such an exemption applies only to the software that is included in the so-called "Register of Russian Software." Along with Russian companies, the exemption is also made available to businesses owned by foreign corporations, but their shareholdings in such local businesses should be less than 50% and their revenues should not be more than 30%.

Companies, which are involved in R&D activities, are also waiting for the extension of the reduced income tax rate to their revenues as the Russian IP Agency had recently expressed its intention to extend the tax incentives to all companies, which generate revenues from their intellectual properties. Similarly, content producers have also requested for the extension of these incentives to their sector as well. Together with the existing tax incentives available to start-ups through the Skolkovo Innovation Centre and special economic zones across the country, the Russian IT sector is well equipped with the relevant fiscal stimulus that makes it a prospective industry for investors. It is worth mentioning that the global providers of software may face strengthening competition with the local developers since the market expects several tax incentives for the domestic producers, e.g. increased rates of depreciation and deduction of expenses in certain cases. Local gaming companies as well as other content producers are working on various measures stimulating their sectors. These and some other plans have already been announced in the Roadmap on "Creation of additional conditions for the development of information technologies" approved by the government on 9 September 2021.

Currently existing tax regimes may be summarized in Table 1 below, which should soon be updated though.

We expect a very productive autumn session of the State Duma in terms of making further changes to the existing local tax laws, as well as new developments in the FTS's IT infrastructure and software programmes. Both the amendments introduced so far to the Russian tax policy and the new changes expected in the near future require companies to constantly review their tax positions, as well as their internal corporate activities and processes that affect taxation.

Table 1

	SMB (if in the respective register)	IT company (if duly accredited)	Resident of the Skolkovo Innovation Centre	Residents of special economic zones
Corporate income tax rate	20%	3%	0%	Depends on the type of the special economic zone and the regional legislation
Social contributions	15%	7.6%	14%	

Transfer pricing and customs requirements for importers — how to find the right balance?

EVGENIA VETER

EY PARTNER,
TRANSFER PRICING SERVICES
GROUP LEADER IN THE CIS

Evgenia is a tax partner with more than 25 years of experience and practices in all fields of taxation and transfer pricing.

She is highly regarded as a Transfer Pricing professional by ITR's World Transfer Pricing. Evgenia was shortlisted as a finalist in the Transfer Pricing Lawyer of the Year category by the Women in Business Law Awards Europe 2021.

Evgenia has worked on transfer pricing studies for clients in various industries, including but not limited to industrial products sector, professional service organizations, retail and consumer sector (cosmetics, food & beverages, healthcare, electronics and home appliances, fashion, etc.), high-tech, telecommunication, chemicals, energy and utilities. Clients served are both Russian headquartered multinational groups and inbound businesses.

WILHELMINA SHAVSHINA

EY ASSOCIATE PARTNER,
GLOBAL TRADE SERVICES
LEADER IN THE CIS

Wilhelmina is a reputed expert in state regulation, and has vast experience in foreign trade, customs administration and customs policy implementation with respect to investment operations.

She supports clients in the structuring of international investment projects and foreign trade deals, including licensing relations, concessions and franchises. She consults on measures to minimize customs duties, as well as on foreign exchange controls and customs administration requirements.

Wilhelmina worked in customs agencies for seven years and has been engaged in consulting for over 18 years. She is a member of the Expert Council under the Budget and Tax Committee of the State Duma of the Russian Federation and of several ad-hoc groups of the Eurasian Economic Commission, as well as an expert of the Public Council and Expert Advisory Council under the Federal Customs Service.

Transfer price and customs value of imported goods: introduction

Integration of the Russian tax and customs authorities is ongoing. Despite the fact that both authorities are assigned different responsibilities, they remain in close cooperation and may exchange information on foreign trade participants and their activities.

In practice, when it comes to setting a transfer price on products imported into Russia, taxpayers have to meet both the tax and customs requirements, i.e.:

» from the customs perspective, they need to ensure that the customs value of imported goods is not understated due to the fact that interconnection between related parties may influence the transaction price;
» from the tax perspective, the transfer price should be set taking into account the established transfer pricing ("TP") policy, each of its elements must be compliant with the arms' length principle, and the transfer price should not be overstated.

It is critical to find the right balance meeting the regulatory requirements and to ensure that a transfer price set by a taxpayer is acceptable for both customs and tax purposes.

Key compliance requirements

The methodology for determining a defendable price for customs and TP purposes has its own features in each case, however, there are also similarities as outlined below.

TP aspects. A taxpayer is expected to apply the appropriate TP method in order to support an arm's length level of its intercompany prices. Although the TP methods are to a large extent similar to those recommended by the OECD Transfer Pricing Guidelines[1], there are some specific points to note:

» the comparable uncontrolled price ("CUP") is based on analysis of prices set in comparable third-party transactions with identical or homogeneous products;
» the resale price method is a priority method for a distributor and is based on gross margin analysis of the distributor;
» the cost plus method is based on analysis of the gross margin of a supplier;
» the transactional net margin method is applied based on analysis of the operating profit to be earned by the least complex entity in the transaction;
» the profit split method is based on analysis of the arm's length split of the consolidated profit earned by all participants of a transaction.

Customs aspects. When moving products across the customs border of the Eurasian Economic Union[2], the customs value of the products has to be determined.

In general, the starting point and primary customs valuation method is that method based on the invoice value of the products, also known as the transaction method. Application of the transaction method may be restricted in situations where the parties in the transaction are related to one another and such a relationship has influenced the transaction price.

In a case when the transaction method of customs valuation is not applicable, the following methods are applied sequentially:

» transaction value method of identical goods;
» transaction value method of similar goods;
» deductive method;
» computed method;
» fallback method (method of last resort).

The customs valuation methods have similarities with the TP methods, however, there is one significant difference between them: except for CUP, the TP methods may be applied to a group of homogeneous transactions whereby customs legislation requires the application of all methods on a transactional basis. This often creates a practical challenge where a taxpayer applies a TP method measuring its operating or gross profit on a bundled basis to a group of transactions or even to the whole entity. In these cases, the customs authorities would still expect application of the customs valuation methods on a transactional basis.

TP documentation for customs purposes: a practical view

Customs authorities pay close attention to the customs value of products moved between related parties. When the buyer and the seller are related, customs may examine the transaction in order to determine whether the relationship affects the price. Therefore, any importer which belongs to a multinational group of companies should be ready to demonstrate that their intercompany relationship did not have an impact on the price of the imported products. This requires a proper set of supporting documents.

The transfer pricing documentation can potentially be used for customs purposes to validate the customs value. However, in our experience, the transfer pricing documentation alone is not easy for the customs authorities to interpret. Moreover, in the worst-case scenario it may even be interpreted as evidence that the intercompany relationship did have an impact on prices. In this regard, in order to support the customs value, it is necessary for customs and TP professionals to work together in order to build up a defense case for customs purposes.

Case studies: practical aspects and highlights

Case study: TP adjustments

Where a TP policy targets an arm's length return of a Russian entity, it is common to observe that such a TP policy mandates a need for a TP adjustment where the reported margin of the Russian entity is different from the targeted level. Tax and customs implications of such an adjustment are quite controversial.

» Prospective TP adjustments, where prices are revised only in relation to future transactions, may be possible in Russia. The main practical challenge of prospective price adjustments relates to potential disputes with the Russian customs authorities, which tend to challenge the customs value of imported goods even in case of insignificant price changes. The most sensitive changes for customs are price decreases, however, price increases may also raise questions about the sustainability of prices applied to past deliveries.
» Retrospective TP adjustments which aim to bring the actual financial result of a taxpayer into line with the targeted result (margin) are not explicitly allowed under Russian legislation. Generally, they may be possible to the extent that they do not reduce the tax base in Russia. The only exception to this rule allowed for a cross-border transaction is an adjustment secured by way of a bilateral or multilateral advance pricing agreement. Practically, this means the following:

  – an upward TP adjustment (increasing the tax base in Russia) is generally possible and quite often used in practice. However, there should be an appropriate mechanism (form) used for these purposes in order to meet legal, accounting and tax requirements. From the customs perspective, such an upward TP adjustment would not qualify for a refund of customs duties and taxes;
  – a downward TP adjustment (decreasing the tax base in Russia, for example, a debit note) would most likely be challenged. The tax deduction of such an adjustment is likely to be an issue. Also, the customs authorities would most likely regard a downward adjustment as an understatement of the import price, assess customs duties and attempt to collect penalties for the customs value understatement.

In practice, when balancing between tax and customs requirements, a good strategy is to set prices in such a way that any need for a subsequent downward TP adjustment is minimized, also avoiding multiple and frequent price revisions. The TP adjustment mechanism needs to be developed upfront, taking into account all applicable requirements: tax, customs, legal and accounting.

[1] The Organisation for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017

[2] A single customs territory which includes Russia, Kazakhstan, Belarus, Armenia and Kyrgyzstan

Case study: a change of operating model

When a foreign investor is considering a change in its Russian operating model, customs and TP issues often come into play and need to be properly addressed. A common example is a switch from a direct sales model (sales between a foreign group entity directly to Russian customers) to a local sales model (sales through a local marketing and sales entity of the group). If a foreign company opts to stop its direct sales in the Russian market and to transfer the distribution function to a local subsidiary, this inevitably results in a reduction of import prices since the local subsidiary needs to cover its marketing and distribution costs as well as to retain an arm's length margin.

From the TP perspective, the local subsidiary becomes subject to local TP documentation requirements if its intercompany transaction value with each of its foreign counter-parties exceeds RUB 60m p.a. From the customs perspective, any reduction in the customs value (as compared to the direct sales model) is a trigger for the customs authorities to initiate control measures which, in the worst-case scenario, may lead to customs value adjustments, including penalties. In addition, the operational process of customs clearance may become more burdensome, thus potentially leading to business disruption. In order to manage such risks, it is important that the Russian subsidiary is fully equipped to justify its transfer prices to the customs authorities and that it has a defense file ready in case of questions around the customs value.

Case study: intragroup payments

The period 2020-2021 has become one of the busiest ones for the business community in terms of tax and customs controversy related to intragroup payments.

In terms of tax implications, the Russian tax authorities have issued special guidance on the tax treatment and qualification of intragroup services. In this guidance, the tax authorities define specific tests and requirements to be met in order to allow a tax deduction of the related charges, such as a reality test, benefit test, no duplication with any other function, proper documentary support, arm's length tests and no charges representing shareholder functions. Where services do not meet any of the above tests, the respective fees will not be deductible. Moreover, in case a service is reclassified into shareholding activity, the fees are likely to be treated as a hidden dividend subject to withholding income tax.

In addition to the tax implications outlined above, the customs authorities have also undertaken a significant number of customs audits during the last few years, where, inter alia, a common theme was the inclusion of various intercompany payments (including dividends) in the customs value of imported products. Court practice on this issue is still developing. Whilst there may be arguments that some of the intra-group payments should not be included in the customs value because they are not related to the imported products and (or) cannot be viewed as a condition of sale of such products, there is already an unprecedented number of controversy cases around this issue with some large multinational companies receiving customs assessments.

Conclusion

The import of products into Russia requires a foreign investor to manage a variety of complex TP and customs issues, as well as to find the right balance between them in order to meet all applicable requirements. The secret to success is a proactive approach in terms of the transfer pricing setup for Russia, with timely involvement of both tax and customs specialists within the organization who should work as a single team.

Overview of the legal framework for hydrogen energy development and greenhouse gas abatement

ELLA OMELCHENKO

COUNSEL,
CLIFFORD CHANCE
MOSCOW

Ella Omelchenko is Counsel at Clifford Chance Moscow office in corporate real estate, and is Head of the Construction practice in the Moscow office.

Ella is a key contact for construction and infrastructure matters, including ESG and other environmental and regulatory aspects.

Ella has more than 20 years' experience of advising on projects with a focus on energy, oil and gas, energy/renewables, metal and mining both in Russia & CIS countries.

Two of the fundamental challenges facing us in the 21st century are environmental pollution and climate change, the latter largely due to rising levels of greenhouses gases (GHG) in the atmosphere, most generated by the production and burning of fossil fuels. The issues of energy efficiency and the need to switch to 'clean' and renewable energy sources are now at the fore politically. One such source is hydrogen.

The global community's concern that the adverse consequences of human-induced climate impacts would be irreversible prompted the signing in 1992 of the United Nations Framework Convention on Climate Change, or UNFCCC, with the aim of keeping atmospheric GHG concentrations at climate-safe levels. One step toward implementing the Convention's goals was the Kyoto Protocol to it, which came into force in 2005, and another was the adoption of the Paris Agreement on 12 December 2015, which, among other things, set out a pathway for decarbonizing the economy. Russia ratified the Paris Agreement on 21 September 2019.

Russia has taken the following steps to implement the Kyoto Protocol:

- A national regulatory framework for monitoring GHG emissions is under development.
- A framework for investment projects to reduce GHG emissions has been created and a new law to curb GHG emissions has recently been passed.
- Russian officials have reported a 37% reduction in the country's GHG emissions over the past 20 years and a 31% reduction against the 1990 baseline, which is in line with Russia's commitments under the first phase of the Kyoto Protocol.

Although Russia has opted out of the second phase of the Kyoto Protocol, it is party to the Paris Agreement[1].

As part of the measures to reduce GHG emissions and implement the Paris Agreement, Russia has begun to develop and regulate hydrogen energy, one of the most important clean energy sources.

The following instruments, cornerstones of an extensive legal framework, have now been adopted:

- the Energy Strategy;
- the Hydrogen Energy Development Plan and Development Concept; and
- the Law on Limiting GHG Emissions.

Energy Strategy to 2035

The Government has approved an energy strategy for the period up to 2035. This provides a sustainable develop-

[1] Ratified by Government Decree No. 1228 of 21 September 2019

ment model for Russia, with a low-carbon economy in which hydrogen energy technologies are to play a special role ("Energy Strategy to 2035")[2].

One goal of the Energy Strategy to 2035 is to use renewable energy to improve energy supplies in remote and isolated areas through the use of renewable energy sources, by:

- improving national standards relating to renewable energy sources;
- supporting Russian exports of equipment and services for the design, construction, operation and maintenance of renewable-energy generating facilities;
- improving incentives for renewable energy development;
- stimulating voluntary demand for electricity generated from renewable energy sources;
- diversifying energy sources, i.e. promoting and developing low-carbon energy sources; and
- mitigating the adverse environmental impact of the fuel and energy sectors and adapting them to climate change.

Hydrogen energy technologies are to play a particular role in the development of a low-carbon economy. The plan is that hydrogen, which is chiefly used today in the chemical and petrochemical industries, will become a new major energy carrier, partially replacing hydrocarbon energy and shaping the new hydrogen economy.

Hydrogen energy

To promote hydrogen energy, the Ministry of Energy has produced a short-term action plan for hydrogen energy development in Russia up to 2024 (the "Road Map"). The Road Map lays the legal, scientific, technological and human-resource foundations for the use of hydrogen as a clean energy source. It envisages various hydrogen-based pilot projects to increase energy efficiency and reduce emissions, plus incentives for businesses to engage with these projects.

On 5 August 2021 the Government approved the Hydrogen Energy Development Concept for Russia (the "Concept"), which declares the development of a low-carbon economy to be a national priority.

The Concept places the initial, very precise focus on certain key areas that will be suitable for developing the hydrogen economy. At this stage the systems and priorities will be narrowly focussed. One particular priority is carbon capture technologies as used in nuclear power plants (where carbon dioxide gas is captured) and water electrolysis systems powered by nuclear plants, hydroelectric plants, and electricity grids to achieve the appropriate carbon footprint, and by tapping renewable energy sources in regions where it is cost competitive to generate hydrogen using renewable sources.

The Concept states that using hydrogen wherever it is economically feasible to do so on Russia's domestic market will help to attract investment, mitigate foreign-economic risks and meet the country's climate change obligations, but the Concept's main emphasis is on the development of hydrogen-based export products. Russia's hydrogen exports could amount to as much as 200,000 tonnes in 2024, 2-12 million tonnes in 2035 and 15-50 million tonnes in 2050, depending on the pace of development of the world's low-carbon economy and growth in global hydrogen demand.

The Concept outlines practical steps as a three-stage plan for hydrogen energy development:

- Stage 1 (to be implemented in 2021-2024): the creation in Russia of research and production hubs to develop hydrogen generation, with a target hydrogen export level for hydrogen pilot projects of up to 200,000 tonnes in 2024. These hubs will be set up in the North-West (for hydrogen exports to the EU), the East (for exports to Asia), the Arctic (low-carbon energy development in that region) and the South (developing the use of renewable energy sources and other low-carbon energy sources in Russia's southern regions).
- Stage 2 (2025-2035): launch of the first commercial hydrogen production facilities with target export volumes of up to 2 million tonnes in 2035 (best-case target – 12 million tonnes). This stage involves the creation of major export-orientated hydrogen production facilities and the implementation of pilot projects to utilize hydrogen in Russia's domestic market based on Russian technologies.
- Stage 3 (2036-2050): wide-scale development of a global hydrogen energy market. By 2050, hydrogen supplies to the world market could reach 15 million tonnes (best-case – 50 million tonnes). The cost of producing hydrogen using renewable energy sources comes closer to the cost of producing it from raw fossil fuel, enabling major projects for producing and exporting low-carbon hydrogen derived from renewable energy sources.

Limiting GHG emissions

As mentioned above, under its general emission-abatement policy, the government is developing a comprehensive legal framework for limiting GHG emissions.

In November 2020, the Russian President signed the Decree on the Reduction of GHG Emissions, which requires the Russian government to reduce GHG emissions to 70% of 1990 levels by 2030. The Ministry of Economic Development is now finalizing a draft of the strategy for up to 2050.

The Ministry of Natural Resources and Environment has adopted two directives, one in 2015 covering direct GHG emissions and another in 2017 covering indirect GHG emissions. Each di-

[2] Approved by Government Decree No. 1523-p of 9 June 2020

rective sets out a methodology for calculating GHG emissions, whereby data on GHS emissions is to be collected over 1-year reporting periods by companies whose commercial operations generate them. Companies will have to keep their GHG emissions data in hard copy and electronically for 5 years following the reporting period, as part of their official internal records.

On 2 July 2021, Federal Law No. 296-FZ On Limiting Greenhouse Gas Emissions was adopted; it will come into force on 30 December 2021 (the "GHG Emissions Law"). This law forms the legal basis for gathering complete GHG emissions data and creating a system for the public accounting of GHG emissions and the implementation of emission reduction projects. It marks a major milestone in the development of GHG abatement legislation that Russian has hitherto been lacking.

Under the GHG Emissions Law companies will be subject to mandatory carbon reporting requirements if:

- starting in 2023, their direct GHG emissions exceed 150,000 tonnes of carbon dioxide equivalent per year; and
- after 2024, their direct GHG emissions exceed 50,000 tonnes of carbon dioxide equivalent per year.

The government will state which industrial sectors will have to meet these requirements; companies in other sectors will be able to report on a voluntary basis. The state will use the mandatory carbon reports to monitor GHG emission rates. Failing to submit a report or concealing or wilfully falsifying information may lead to administrative charges and administrative fines.

The GHG Emissions Law provides a framework for climate projects. The government is going to develop a state-support system for climate projects and project outcomes will be subject to verification, although the verification mechanism has yet to be created. Climate project information will be entered in a register of carbon units. Carbon units produced by a climate project will be credited to the party implementing the project in the carbon units register and used to assess whether the target for reducing greenhouse gas emissions has been reached. The government will develop a system of state support for climate project implementers.

The carbon units put into circulation by implementing these projects will be recorded in a special carbon units register. The rules for keeping the register will be laid down by the government, which will also appoint a registrar operator.

It is thought that these carbon units might become tradeable, so the GHG Emissions Law is laying the foundation for the creation of a carbon units market.

Russia is definitely slowly but surely moving towards having a legal framework for meeting its commitments under the UNFCCC, the Kyoto Protocol and the Paris Agreement. Although the concepts, plans, and laws have not yet been elaborated in detail and contain numerous references to other regulatory acts (presidential, governmental and ministerial) that have yet to be passed or even drafted, 2020-2021 has seen statutory developments in this area peak compared to previous periods, generating the hope that a transition is taking place from concepts and plans to concrete steps and action.

Impact of the Russian waste management industry on climate change in Russia

VYACHESLAV NECHAEV

PROJECT MANAGER, TIARCENTER

Vyacheslav Nechaev is project manager in TIARCENTER, independent consulting and analytical company.

Vyacheslav is an expert in the consumer goods, energy efficiency and waste management spheres. He consults international companies and governmental authorities on effective policies and regulations in these arears. He also directs activities in the monitoring of legal and political changes in Russia and CIS countries as well as promoting legislation initiatives among key stakeholders.

The global waste management sector ranks fourth in terms of greenhouse gas emissions volume (right after energy, agriculture, and heavy industry)[1]. In Russia, municipal solid waste (MSW) contributes more than 65 million tons of CO_2-eq.[2] Now, the Russian government is at a crossroads to decide how to develop its national waste management and recycling industry: through the prism of global CO_2 reduction policy or traditionally, without reference to the sector's CO_2 emissions volume. This crossroads should also be considered by investors into the waste management sector.

In the past year, Russia has been actively involved in the climate change agenda. To counter the influence of the introduction of the European CBAM (Cross-Border Adjustment Mechanism) on national industry sectors, the Russian government has enacted a federal law On Reducing Greenhouse Gas Emissions, which sets a general framework for climate policy, and is participating in discussions with international community on the creation of a global ETS. Currently, a pilot regional ETS is being tested in the Sakhalin region and may later be expanded into all Russian regions.

In later stages of ETS development, the waste management sector, potentially, will be a part of the national and global systems: waste collectors and recyclers will be participating in the ETS on the same grounds as other industries.

Waste incineration or recycling?

About 65 million tons of MSW is generated annually in Russia. Only 7% (4.5 million tons) of that is recycled. The rest of the waste is sent to landfills. To deal with the problem of growing landfills, the national project *The Environment* was initiated by Russian President Vladimir Putin in 2018. According to the timeline for this project, the percentage of treated (sorted and handled) waste by the year 2024 should be no less than 60% of total MSW, while recycled waste should be no less than 36%.

The Russian government plans to reach these targets in such a short amount of time through the help of the company RT-Invest, which plans to develop energy recovery through the construction of 30 waste incineration plants all over the country. Their incineration capacity ranges from 550,000 tons/year to 700,000 tons/year[3] of MSW. While this measure could be considered efficient in terms of lowering landfilling volumes and boosting recycling rates (energy recovery is considered recycling in Russia), climate change effects should also be considered ahead of the launch of ETS.

According to Zero Waste Europe,[4] waste incineration of 1 ton of MSW releases from 0.7 to 1.7 tons of CO_2. According to these figures, 30 waste incineration plants (assuming they incinerate ~625 kilotons of MSW per year, totaling 18.7 million tons/year)

[1] Greenhouse gas emissions from waste — Products Eurostat News — Eurostat (europa.eu)

[2] National report on the inventory of anthropogenic emissions from sources and removals by sinks of greenhouse gases not regulated by the Montreal Protocol 1990 — 2019. 2021 г. p. 383

[3] Waste2energy

[4] ZWE_Policy-briefing_The-impact-of-Waste-to-Energy-incineration-on-Climate.pdf (zerowasteeurope.eu)

launched in Russia will be responsible for the release of at least 26 million tons of CO_2-eq per year. A rough estimate suggests that the same volume of MSW being landfilled (on untreated landfills) releases only ~14.7 million tons of CO_2-eq.[5]

Without a fully developed circular economy system — which allows for exclusion of all precious waste fractions from waste flows sent for energy recovery and incineration — energy recovery projects may bring additional expenses and problems to the waste management industry in Russia in case a global ETS is introduced.

sia is an abundance of waste sorting capacities and segregated waste collection infrastructure.

Depending on the type of polymer, logistics, and energy efficiency of recycling technologies, replacing 1 ton of virgin PET with recycled PET reduces greenhouse gas emissions by up to 1.2 tons of CO_2-eq[6]; replacing 1 ton of virgin aluminum with recycled aluminum results in reduction of 9 tons of CO_2-eq[7]; replacing 1 ton of glass with recycled glass results in reduction of 600 kg of CO_2-eq[8]. Keeping in mind that the morphological composition of Russian MSW recycling[9] consists of at least 50%

Balancing the waste management sector

Development of the circular economy simultaneously with construction of waste-to-energy plants could be beneficial for the Russian waste management system, as it could help solve complex issues: help to dispose of landfills, keep CO_2-eq emissions in balance with global trends, and recover precious materials. This would require the fine-tuning of the EPR mechanism, as well as regional waste management operators to attract investors into the system. Moreover, upcoming ETS could be beneficial for fu-

Circular economy and CO_2 emissions

Another potential path for the Russian government at this crossroads for waste management development with investors is to develop efficient sorting and recycling capacities in a circular economy paradigm. According to the Russian environmental operator (the state waste management company), Russia has the capacity to recycle 53% (34.5 million tons) of total MSW generated. These numbers show that the general problem in waste management in Rus-

of valuable fractions in MSW, along with the continued recycling of secondary raw materials, this can lead to reduction of emissions by ~23 million tons of CO_2-eq per year.

Full transition to a circular economy would reduce greenhouse gas emissions in Russia by 46 million tons of CO_2-eq. Moreover, these recycling projects could be climate positive and allow investors to sell available credits on future ETS — currently the price of 1 ton of CO_2-eq on European ETS ranges from USD 47 to USD 65.

ture waste management investors who operate with lower emission caps than other players on the market, as they could receive additional financial flows from selling emission credits. Such an approach would develop a new and more attractive niche for investors and companies in the waste management industry and create a high demand for the circular economy and environment-friendly goods and technologies in Russia.

[5] Paper-accounting-of-greenhouse-gases-from-landfills.pdf (afvalzorg.nl)

[6] APR-Recycled-vs-Virgin-May2020.pdf (plasticsrecycling.org)

[7] There are significant environmental benefits to recycling aluminium (alupro.org.uk)

[8] FEVE-brochure-Recycling-Why-glass-always-has-a-happy-CO_2-ending-.pdf

[9] Waste management in Russia, Russian environmental operator

Part 2

Green Agenda

ESG beyond environment

MICHAEL AKIM

ASSOCIATED PARTNER, VITUS BERING MANAGEMENT; PROFESSOR, GRADUATE SCHOOL OF BUSINESS, HSE; AEB BOARD MEMBER

Michael Akim is the founder and Chairman of the AEB Working Group on Modernization and Innovations.

Since September 2020 he has been Associated Partner with Vitus Bering Management Ltd. and Professor of Graduate School of Business at HSE University. Prior to that, he was Vice President of Strategic Development at ABB in Russia.

In 2006 he joined Emerson Process Management as Director of their European Pulp and Paper Business, and before that he worked at Fisher international management consulting firm as Vice President on Research.

Michael graduated from the Leningrad Technological Institute and from Latvian Academy of Science IWC with Ph.D. in Chemical Engineering. In 2000 he received MBA from IONA (USA).

Over the past twenty years, the topic of Environmental, Social, and Corporate Governance (ESG) has evolved in the US and Europe, as many sources show.

Accurate assessment of the real motivation behind the processes ongoing in ESG requires a comprehensive study of market players' interests, alongside geopolitical, technological, and resource-related opportunities and capabilities. The new European requirements for the carbon footprint of imported products (CBAM — Carbon Border Adjustment Mechanism — is only a small part of the ESG transformation). In many ways, ESG is associated with access to cheaper "green" capital. Therefore, it is crucial to analyze ESG best practices, global trends and challenges and their applicability to Russian conditions. Criteria for this purpose are currently both in development and under implementation.

"E" vs "S"

ESG created dilemmas, the optimal solution of which can potentially determine the priorities of human development in the coming decades. One of the main dilemmas is the possible contradiction between two Sustainable Development Goals: SDG 7 — *Affordable and Clean Energy* (related to "E") and SDG 2 — *Zero Hunger* (related to "S"). Under certain conditions, these SDG can compete for the use of land resources.

Agribusiness and the energy sector currently generate the most greenhouse gas emissions. Europe has initiated a huge transformation of energy, transport, and manufacturing to limit global warming. Achieving the decarbonization goals announced by both the Biden administration and EU leaders will require the aggressive construction of many wind and solar power plants, often combined with giant batteries designed to balance the grid. Princeton University and Bloomberg recently analyzed a range of direct and indirect land requirements for coal, natural gas, nuclear, hydro, wind, and solar electricity, including land used in the extraction of energy resources, power generation, transportation, and transmission, as well as waste storage. The evidence presented suggests that coal, natural gas, and nuclear power have the smallest physical footprint, about 5 hectares of land per megawatt of energy production. Solar power and wind require greater areas, using approximately 18 and 29 hectares per megawatt, respectively. The land footprint of hydroelectric power significantly exceeds that of any other generation technology, with large dams requiring an average of 128 hectares per megawatt. To meet its emissions reduction targets, the US needs an increase in renewable energy capacity of at least 150% by 2035. At the same time, the planned 10% annual expansion of wind and solar generation up until 2030 will require the use of land area equal to that of the state of South Dakota (four areas of the Moscow region). So by 2050, when the US is to attain carbon neutrality according to Biden's plan, it will need up to four additional South Dakotas to meet the clean energy requirements of the country's electric vehicles, factories, and other consumers. In this sense, Russia might have great advantage implementing renewables, thanks to plentiful land.

An equally important task is providing humanity with food while reducing the carbon footprint of production. More than one-fifth of the world's greenhouse gas emissions are generated by agriculture, over half of which comes from livestock. Without a technological solution to agricultural emissions, a 15-20% increase is expected by 2050, as the global population grows along with its need for food. Limiting environmental impacts through measures to reduce climate change will require changes in both our eating patterns and the use of agricultural land.

There is no clear path towards the total elimination of agricultural emissions, but organic farming appears to be one way to reduce them. Organic farming can contribute to healthier lifestyles and reduce greenhouse gas emissions by cutting the use of mineral fertilizers, whose carbon footprint is not to be understated. However, the carbon footprint of transitioning to organic farming is still poorly understood. Food consumption data by the German National Nutrition Survey — as well as carbon footprint and land use data, provided by German studies on the life cycle of conventional and organic foods, carbon footprint, and land use — show that organic farming uses about 40% more land (about 1900 m^2 and 2750 m^2 of land per person per year for conventional and organic diets, respectively).

Additional land is thus required to reduce emissions from both energy production and agricultural products. Perhaps modern technologies and a full transition to wind and solar energy cannot yet fulfill the stated objectives while simultaneously preserving the land area necessary to feed humanity and maintaining social well-being and affordable prices.

On "G"

The "G" in ESG stands for corporate governance, which the world's leading centers believe ultimately yields higher corporate returns. Good corporate governance builds investors' confidence and reduces their risks. Companies have collected data on "G" for longer than they have collected environmental or social data, and the criteria for what constitutes good governance, as well as relevant classifications, have been more widely discussed and accepted. Back in 2003, researchers at Harvard compiled the G-Index, consisting of 24 governance provisions that affect shareholder rights, and ranked companies based on their research.

"Governance" covers the company's leadership structure and management, policies, standards, disclosure, auditing, and regulatory compliance. Investors expect the company's accounting to be accurate and transparent and its business practices to be ethical. Criteria also require a clear policy regarding approaches to taxation issues, and awareness of additional financial risks associated with the company's tax practices. Boards of directors are expected to be representative and demonstrate diversity.

The requirements for representativeness are determined both by adherence to inclusive, liberal-democratic principles and by risk reduction considerations: different social groups may have varying points of view, as well as professional and life experiences. These policies enable a better understanding of the interests of all shareholders, stakeholders, and customers. Codes of business conduct relate to business ethics and compliance with requirements to prevent corruption in the organization. Companies operating in countries with weak anti-corruption legislation are exposed to additional reputational and legal risks. These risks determine the cost and availability of capital — i.e. the company's opportunities to attract investments.

Risk and crisis management practices included in the "G" field determine an organization's resilience to risk, including the effectiveness of mitigation measures, the identification of long-term threats and their potential impact, and the independence of risk management from business lines. Supply chain management is becoming increasingly important in terms of business sustainability as companies expand and operate globally. When a company outsources production, services, or business processes, it simultaneously outsources its corporate responsibilities and reputation, thereby increasing risks. Companies must have strategies to manage supply chain-associated risks and opportunities in place.

The relevance of supply chain risks was especially evident during the COVID-19 pandemic when global supply chains were disrupted. The most illustrious example of such disruptions is the shortage of computer chips that led to multibillion-dollar losses for automakers.

Governance criteria may also include disclosure of Government Relations (GR) practices and policy influence, including evaluation of funds allocated to lobbying organizations with influence on public policy, legislation, and regulations.

Executive compensation is a constant thorny "G" issue, with some differences existing between approaches in the US and Europe. It is a key element of the dialogue between institutional shareholders and recipient companies, aiming to optimize financial performance and promote sustainable behavior without creating or exacerbating systemic risks which could undermine investors' long-term interests. As new practices take shape, there is no "one-size-fits-all" or generally accepted guidance on how to link ESG metrics to executive pay or integrate ESG factors into incentive mechanisms for senior management, given the significant differences between industry sectors. The lack of a universal standard for boards, senior management, and ESG consultants raises the risk that incentives will be created without a holistic approach to sustainability. The issue of executive remuneration may be particularly sensitive for the implementation of the principles at Russian companies — particularly due to the shorter planning horizon, greater volatility, and shorter leadership time in office, especially as compared with the time required for the implementation of "E" initiatives.

Investors cannot ignore the governance principles and sustainability commitment of the companies in which they invest, since compliance with these principles determines the viability both of the companies and the entire planet's economy. This is fundamentally

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important for global players, representing a key guarantee of their ability to ensure investors' long-term interests.

Scope and skills

Sustainability will continue to determine risk management, portfolios, product development, and stakeholder engagement with companies. Companies are encouraged to consider ESG metrics relevant to their business, although this is challenging due to difficulties in measuring ESG factors, or a lack of evidence of these ESG factors' exact impact on the company's overall performance. The link between ESG and financial performance is growing, which requires higher data quality, standardized procedures, and a longer history of data collection. This drives increased interest in the assessment of ESG parameters and stimulates further research in the area.

ESG transformation, in addition to traditional business disciplines, requires a wide range of knowledge on subjects such as climate change, the principles of sustainable development and international standards, alongside skills including risk management, sustainable supply chain management, analysis of available technologies and those to be improved – all contributing to a strategy for decarbonization. Creating sustainable investment opportunities within the company is a process involving attracting people to bring in external competencies and further developing their skills and knowledge. In some cases, it may be costly or impractical to develop all the necessary competencies within the company. As such, in a globalizing market, companies need access to leading business schools and researchers to enable staff to monitor the constantly changing field of ESG, helping to reduce risks and build the firm's capacity.

Given the many dilemmas, a shift from "if" to "how" is needed, allowing a focus on the choices that the nation and its myriad stakeholders must make to move towards carbon neutrality. This requires examining the benefits, costs, and challenges for specific regions, industries, professions, and communities. Skills in assessing these are crucial to understanding how these effects will change over time, given changes in technology, geopolitics, and global markets.

Issues and discrepancies. To do

Markets are rapidly evolving and changing, along with environmental, social, and governance factors. There is a temptation for companies to address ESG criteria based on easily achievable and measurable metrics rather than issues that are more relevant to their business. It is possible that various efficiency factors, which, according to global practice, remain difficult to understand, will compete with each other in the framework of compensation packages.

While ESG ranking is still a young field, there is a wide range of methodologies and definitions for business sustainability. Studies conducted by MIT (Massachusetts Institute of Technology) have shown that the correlation between the ESG ratings of well-known agencies averages 0.61; (by comparison, credit ratings from Moody's and Standard & Poor's correlate at 0.92). This ambiguity between ESG ratings poses serious challenges for investors trying to achieve both financial and social returns. Several international research programs aimed to improve the quality of ESG measurement and decision-making in the financial sector, based on the more rigorous and consistent methods of ESG integration adopted by the corporate community. Furthermore, there are a number of common tasks for all: improving the measurement accuracy of certain categories of ESG – such working conditions, carbon emissions and product safety – aggregating ESG factors into composite indices, understanding the impact of ESG financing on the price and behavior of company shares, and individualizing and adapting ESG indices in accordance with investors' values and interests.

Since the EU and other regions aim to become carbon neutral by 2050, by this time, figures for GHG emission-specific benchmarks should be reduced to almost zero (considering the use of carbon capture, use and disposal technologies). CBAM has essentially initiated a race to reduce the carbon intensity of industrial products and enterprises. Learning how to record results, i.e. measure and compare carbon intensity levels with benchmarks according to globally accepted methods, is a prerequisite for participation in this race. In the context of the global environmental agenda, the Russian economy's development will be closely linked to the definition of priority climate action for the next decade.

There are discrepancies between the strategies, national projects, and long-term forecasts adopted in Russia so far, prepared with almost a complete lack of understanding of the large-scale changes and significant challenges imminent in the world economy due to integration of ESG – particularly the climate agenda. The goal of future work is to provide confidence that several real paths to net-zero by 2050-2060 – considering the company, region, and country levels – must be adopted and to provide a corresponding plan for priority action covering the coming decade.

Beyond the new normal toward a climate reality

ART FRANCZEK

PRESIDENT OF AIBEC

Art is currently the president of The American Institute of Business and Economics in Moscow (AIBEc).

He holds degrees in History and Political Science. He has an MBA, CPA and Masters of Taxation from DePaul University in Chicago.

Art has also lectured on financial regulations, financial markets and taxation at the Finance University.

Prior to AIBEc, Art served as a business consultant in Togliatti after he had worked for many years as Corporate Tax Manager for a Fortune 1000 company.

ELENA ROBAKIDZE

BUSINESS DEVELOPMENT MANAGER, AHLERS

As a Business Development Manager at Ahlers, Elena Robakidze specializes in route-to-market solutions between China and Russia and the rest of the CIS region.

She is a native Russian with four-years working/living experience in Shanghai, China. Elena's expertise reaches beyond international logistics with experience of working with the biggest e-commerce platform in China.

With a degree in global economics, and fluency in Russian, Chinese and English, Elena is focusing on e-commerce development in Russia and China.

Climate change is the most daunting issue facing the world today and there is a virtual consensus among countries and companies that strong action must be taken. Hundreds of reports encompassing thousands of pages can be found on this topic. Our intention is not to conduct a comprehensive study, but rather to highlight some of the multinational agreements and, more significantly, discuss some of the opportunities that companies may unlock by addressing the issue of climate change.

The recent 4000-page UN study on climate change is a hot topic in the world today. This report concludes that failure to greatly reduce greenhouse gas emissions would lead to what some climatologists call "hell on earth". Some in the media are saying we are facing our "last best chance" to save the world from a climatic apocalypse. The report also states that there is unequivocal evidence that these increases in temperature are due to human activity (mostly by burning fossil fuels). This report will be a main point of discussion between the leaders of 196 countries during The United Nations Climate Change Conference in Glasgow, which is scheduled for the first week of November 2021. The agenda of the Glasgow conference will include:

» ending the use of coal;
» stopping deforestation;
» switching to electric vehicles;
» investing in renewable energy;
» the circular economy.

Since taking office in January 2020, US President Biden has made climate change a top priority of his administration by doing the following:

» reentering the Paris Agreement, a major commitment in Paris by developed countries to jointly

ESG issues are becoming financially material. Thirty years ago, these issues were not considered a substantial investment risk. However, companies are now under rising pressure to outline credible plans for decarburization and explain how they intend to achieve them.

mobilize USD 100 billion for developing countries in support of climate action;

» appointing John Kerry as climate envoy;
» committing the US to reach 100% carbon-free electricity by 2035;
» reducing carbon pollution in the transportation sector;
» allocating a substantial portion of the multitrillion-dollar infrastructure spending on climate action;
» banning the sale of new vehicles with internal combustion engines in California beginning in 2035. This follows a worldwide trend already underway in the EU, China, and the UK.

The EU aims to hit net zero in greenhouse gas emissions by 2050 and plans to achieve this goal by doing the following:

» Revamping its carbon pricing system. Carbon taxes are widely considered the best way to drive down fossil fuel emissions. The OECD has proposed a global solution that is not favored by the US, China, or India.
» Planning to impose a levy on imports based on their carbon footprint.
» Potentially ending the production of internal combustion engines by 2030 — although some member states would prefer 2040.

A massive reduction in carbon emissions is needed to achieve the climate target established in Paris. This goal places significant pressure on countries and industries to act quickly. Climate change has a major impact on the economy of China, which has been the world's largest emitter of carbon dioxide since 2006 and is now responsible for more than a quarter of the world's overall greenhouse gas emissions. Coal has been the country's main source of energy for decades, and its use is increasing. To achieve their goal of being carbon neutral by 2060, China will need to stop using coal for generating electricity by 2050, and instead rely entirely on nuclear and renewable energy production.

China is already taking several measures in favor of green development. First of all, China is currently the world's largest producer of solar panels and alternative renewable energy and has more solar energy capacity than any other country in the world. More than 60% of the world's solar panels are made in China, and 8 of the top 10 solar panel manufacturers are Chinese.

In keeping with international trends, China is also banning fossil fuel cars. The Chinese government has declared that all new car sales in China must be either full EVs or hybrids by 2035. Today, the country has the biggest growth in electric vehicles and is making their vehicle emissions standards more stringent year by year. Experts have determined that carbon taxing is one of the important carbon-cutting measures for the coal industry. Although China is currently lacking a carbon tax, the recently-introduced national carbon trading market is seen as a big step. This market operates by limiting the amount of carbon dioxide companies can release, creating competition to encourage energy efficiency and the adoption of clean technology.

Russia is warming about 2.8 times faster than the global average. According to Minister of Natural Resources and Environment of Russia Alexander Kozlov, the melting of permafrost caused by climate change could cost Russia about USD 67 billion by 2050.

By signing the Paris Agreement, Russia has agreed to do the following:

» by 2030, reduce gas emissions by 70% compared to 1990 levels;
» provide voluntary support for developing countries to achieve their goals from the Paris Agreement.

Russia may be significantly impacted by a European carbon footprint tax because of the products it exports to the EU, its largest trading partner. A considerable proportion of these exports are carbon-intensive materials like steel, cement, and fertilizers, which are subject to the tax. As a result, Russian companies may need to pay an estimated EUR 3.8 billion in tax.

Rusal has split off higher carbon assets in order to focus on the production of "green aluminum", which has a lower carbon footprint and can demand a premium price. As the largest exporter of nuclear power technology, with a 60% share of the global market, Russia may also benefit from the shift to low-carbon energy. In addition, Russia is a major producer of natural gas, which is an excellent low-carbon alternative to coal that can also be used to produce hydrogen. In its latest annual report, Gazprom emphasized its low carbon footprint.

In greater numbers and at greater speed, environmental social and governance (ESG) issues are becoming financially material. Thirty years ago, these issues were not considered a substantial investment risk. However, companies are now under rising pressure to outline credible plans for decarburization and explain how they intend to achieve them. Last year, a group of investors with USD 100 trillion in assets under management endorsed guidance from the International Accounting Standards Board that said material climate-related matters had to be incorporated in IFRS financial reporting. Recently, the Securities and Exchange Commission announced that it is preparing requirements for public companies to disclose more information about how they respond to climate-related threats. These are clear signs that international standards will evolve to induce companies to accurately report their climate policies in order to protect investors.

Following years of opposition, major energy companies are only just beginning to support a green agenda. The American Petroleum Institute (a major oil lobbyist) recently issued a white paper entitled "Climate Action Framework" that proposes a new set of measures to lower emissions and support cleaner fuels. Exxon and BP have formed a new business to support carbon tax initiatives. Clearly, Big Oil has signed on to the New Normal.

Due to the rise of globalization and increased demand, the logistics industry has become a major contributor to climate change. It is currently ranked as the second leading industry in terms of CO2 emissions and greenhouse gas production. Road and ocean transportation are the most environmentally harmful forms of logistics, because of their widespread effects. Climate change results in extreme weather events, which affect the supply chain industry and cause damage to ships. Longer droughts, higher temperatures, and increased flooding have a detrimental effect on the agricultural supply chain. The booming e-commerce industry has been largely driven by the COVID-19 pandemic. Last mile delivery costs account for 50% of the logistics cost and create a significant carbon footprint. Companies are mitigating this effect with the use of robotics and EV.

Transportation companies are targeting, on average, a 30% emissions reduction by 2030. However, the 1.5°C scenario established by the Paris Agreement requires a 50% drop across the industry by that year and a 100% decrease by 2050. Nevertheless, more and more companies are declaring their commitment to climate action, with leading companies such as Maersk, CMA CGM, MSC proactively driving the push towards sustainability by committing to become carbon neutral in the coming future.

Companies need to employ common actions to remain competitive and optimize the supply chain. Several available solutions include optimizing truck loading and routes; integrating a CO2 calculator to include emissions data and make the company more attractive for investors and stakeholders; monitoring and managing the supply chain via real-time maps; and using carbon neutral transportation vehicles to make logistics more efficient and cost-effective.

The world currently operates on a primarily linear economy. We make a product, such as a toaster or a mobile phone, use it, and throw it away as soon as it breaks or when there's a better model available. In this scenario, all of the resources (energy, metals, and water) used to make that product are lost. In Europe, an average of 95 percent of a product's material and energy value is wasted this way.

A circular economy would address these issues by eliminating waste and inefficiency at each stage of the product cycle, from reducing the amount of time cars and machinery sit idle to increasing the scope for reparability or modular re-manufacturing of used components. This broad definition of the circular economy incorporates practices such as the sharing economy and the performance economy. It is concerned with the element of productivity resource efficiency, which is often overlooked.

This concept has its roots in biomimicry. There is no waste in the natural world. Instead, when an organism reaches the end of its life, it provides nutrients for another part of the system. Industrial symbiosis is one example of this principle, whereby waste or by-products from one industrial process become input for another.

The Paris Agreement calls for a transformation of our production and consumption patterns, particularly in well-developed countries. This transformation implies the use of circular economy principles: using fewer resources and more sustainable materials, and recycling the materials we have used. Energy supply, transport, buildings, and waste management remain priority sectors for immediate climate action.

The Boston Consulting Group estimates that USD 4.5 trillion in GDP growth could be unlocked by transitioning to a circular economy.

There are many examples of European companies that have adopted circular principles and are currently doing business in Russia:

» IKEA, which began its sustainability journey 50 years ago due to the internal conviction that sustainability was a matter of corporate responsibility and, if done correctly, a way to lower costs.
» Michelin, which is working to develop innovations that address environmental challenges associated with transportation. The company began its circular implementation by focusing on process innovation to improve resource efficiency and has appointed a Head of Sustainability to oversee the circular working group.
» Philips, which began to ask itself questions concerning sustainability more than two decades ago, such as: What is our carbon footprint and how can we reduce it? Since then, the company's focus on sustainability and circularity has been steadily increasing.

Scientists generally agree that the earth's climate has vacillated between warm and cold temperatures for millions of years. These variations are due to slight changes in the earth's orbit around the sun and the tilt of its axis. The relatively warm and stable temperature over the past 10,000 years supported the rapid development of civilization. The real question is not whether the earth has warmed recently, but rather to what extent this warming has been caused by humans. Researchers are being encouraged to work to more precisely define what percentage of climate change emanates from humans and what percentage is a natural occurrence.

LeasePlan

Victoria Solovenchuk

General Manager,
LeasePlan Russia

«GREEN» MOBILITY OR HOW CORPORATE FLEETS CAN FIGHT CLIMATE CHANGE

About 60% of new cars sold in Europe are company cars, which are used on average 2.25 times more often than private cars. At the same time, about 32% of the companies' vehicle fleets are in operating lease.

In Russia, about 2% of corporate vehicles out of 4.5 million are in operating leasing, that is more than 85 thousand. The operating leasing market is dynamic and active, includes many international and local players and demonstrates positive dynamics with further growth potential.

An increasing number of Russian and International companies are coming to understand that the vehicle fleet is an important but labor-intensive asset, which, with professional management, allows not only to optimize the company's resources, but also to achieve the goals for sustainable development.

By transferring a car fleet to operational leasing (long-term lease), you do not buy cars, you use them as a turnkey service. We always select the appropriate portfolio of services based on a detailed study of the needs of our clients. Our mission is to free the client of unnecessary worries and allow him to focus on the main areas of his business.

We offer not just a car, but mobility with a focus on sustainable development. LeasePlan is a leader in sustainable development and is actively developing the Zero emissions initiative, which aims to reduce harmful emissions.

Since 2000, emissions from global transport have grown by 1.9% per year, however, in 2019 they have increased by less than 0.5%. The reason is not only the lesser extent of the use of cars, but also the increased use of biofuels and the increased use of electric vehicles.

Reductions in emissions from road transport are expected to accelerate in the future as consumption of electric vehicles increases. In 2020, global electric vehicle sales jumped 41% (to about 3 million vehicles), even as the pandemic resulted in a 6% decline in overall vehicle sales. As a result, the share of electric vehicles in the global market is 4.6%. In the first half of 2021, more than 2.6 million were sold (an increase of 160%), according to forecasts, the number of electric vehicles sold in 2021 will be 6.4 million (an increase of 200% by 2020).

The global electric vehicle fleet is projected to grow from 10 million today to 145 million in 2030.

We, as a company that cares about the environment, think about electric cars in Russia and believe that the transition to them is inevitable and only a matter of time. The move to electric corporate fleets can make a significant contribution to realizing the vision of a zero emissions world.

«ЗЕЛЕНАЯ» МОБИЛЬНОСТЬ ИЛИ КОРПОРАТИВНЫЕ АВТОПАРКИ КАК ИНСТРУМЕНТ УСТОЙЧИВОГО РАЗВИТИЯ

Около 60% новых автомобилей, продаваемых в Европе – это служебные автомобили, которые в среднем используются в 2,25 раза чаще, чем частные. При этом, около 32% автопарков компаний находится в операционном лизинге.

В России в операционном лизинге находится около 2% корпоративных автомобилей из 4,5 млн – более 85 тыс. Рынок операционного лизинга динамичный и активный, включает множество международных и локальных игроков и демонстрирует положительную динамику с дальнейшим потенциалом роста.

Все большее количество международных и российских компаний приходит к пониманию, что автопарк – это важный, но трудоемкий актив, который при профессиональном управлении позволяет не только оптимизировать ресурсы компании, но и выполнить определенные цели по устойчивому развитию.

Передавая автопарк в операционный лизинг (долгосрочную аренду), вы не покупаете автомобили, вы используете их как услугу, предоставленную «под ключ». Мы всегда подбираем необходимый портфель услуг на основании детальной проработки потребностей клиентов. Наша миссия – избавить клиента от ненужных забот и позволить ему сосредоточиться на основных направлениях своего бизнеса.

Мы предлагаем не просто автомобиль, а мобильность, с фокусом на устойчивое развитие. LeasePlan является лидером в области устойчивого развития и активно развивает инициативу Zero emissions, которая направлена на сокращение вредных выбросов.

С 2000 года выбросы от мирового транспорта росли на 1,9% в год, однако, в 2019 году они увеличились менее чем на 0,5%. Причина не только в меньшей степени использования автомобилей, но и в более широком использовании биотоплива и увеличении использования электроавтомобилей.

Ожидается, что сокращение выбросов от автомобильного транспорта в будущем будет ускоряться по мере увеличения потребления электромобилей. В 2020 году мировые продажи электромобилей подскочили на 41% (более 3 миллионов автомобилей), несмотря на то, что пандемия привела к снижению общих продаж на 6%. В результате доля электромобилей на мировом рынке составила 4,6%. В первом полугодии 2021 продано более 2,6 млн (рост 160%), по прогнозам количество проданных электромобилей в 2021 составит 6,4 млн (рост 200% к 2020). В мировом парке электромобилей прогнозируется увеличение с 10 миллионов сегодня до 145 миллионов в 2030 году.

Мы, как компания, которая заботится об окружающей среде, задумываемся об электрокарах в России и верим, что переход на них – неизбежность и лишь вопрос времени. Переход на электрические корпоративные автопарки может внести значительный вклад в реализацию концепции мира с нулевыми вредными выбросами.

Sakhalin — a front-runner of Russian climate policy

ROMAN ISHMUKHAMETOV

ASSOCIATE,
BAKER MCKENZIE

Roman Ishmukhametov is an associate in the St. Petersburg office of Baker McKenzie. He focuses his practice on M&A transactions, joint ventures and major projects.

He also advises international and Russian companies on a wide range of transactional and regulatory matters in carbon regulation and climate projects, renewables, hydrogen, waste, other cleantech and sustainability areas. Roman is a member of Baker McKenzie Global Hydrogen working group, Global Environmental group and North America-CIS Initiative.

Roman is a member of the Working Group on Carbon Regulation and Carbon Trading of the Central Bank of Russia, AEB Green Initiative, Commission on Economics of Climate Change and Sustainability of the International Chamber of Commerce (ICC Russia), energy working group at Russian-German Chamber of Commerce (AHK) and the co-chair of the Industrial Committee at St. Petersburg International Business Association (SPIBA).

Russian climate package in brief

In July 2021, Russia adopted its first ever law on reducing greenhouse gas (GHG) emissions ("Core GHG Law").[1] The Core GHG Law establishes the framework for federal-wide mandatory carbon reporting and voluntary climate projects. It does not set a price on carbon — either as a carbon tax[2] or as an emission trading system (ETS).[3]

Taken broadly, in addition to the Core GHG Law, the Russian climate package will include the following:

» **Regional carbon pilot schemes:** to test heavier GHG regulation for a given region without burdening the rest of Russia (Sakhalin will pioneer such experiment with its local ETS, and Kaliningrad Oblast, Khanty-Mansi Autonomous District, Altay Krai, Bashkiria Republic and some other Russian regions may follow).[4]

» **Low-carbon development strategy until 2050:** to define Russia's strategic vision of possible paths and targets of decoupling economic growth from GHG emissions with some prospects of carbon neutrality.

» **National green and transitional projects taxonomy:** to mobilize finance into projects with positive climate and environmental impacts, with potential incentives for both lenders and borrowers.

» **Carbon polygons and farms experiment:** to ensure scientifically validated stock taking of Russian forests and other plants, soil, swamps and other natural systems' absorbing capacity (in case of polygons) and running carbon sequestration projects (in case of farms).

» **Related cleantech policies:** to ramp up the development of new industries and to modernize the existing ones while reducing GHG; for instance, Russia recently extended its renewables program until 2035,[5] announced its plans in the hydrogen[6] and electric vehicles industries,[7] and it plans to increase the ambitions of its energy efficiency improvement plan and to tighten its waste management system.[8]

1 See Baker McKenzie, Russia: Government adopts its first ever greenhouse gas law — The core of its national climate package

2 Per today, there are 35 carbon pricing initiatives on a national or a subnational level. Examples of national systems are Canada, Mexico, Argentina, Colombia, South Africa, Japan and several European countries. Subnational examples are Catalonia, several US states and several Canadian provinces. See World Bank, Carbon Pricing Dashboard

3 Per today, 38 jurisdictions have or are about to set up their ETS or so-called cap and trade systems on regional (EU ETS), national (China, Indonesia, Turkey and Chile) and subnational levels (several US states, and several Canadian and Chinese provinces). See World Bank, Carbon Pricing Dashboard. ETS implies that its regulator sets upper limits for GHG emissions (caps) for companies participating in the ETS. Companies that exceed their caps in a given year have to purchase the emissions allowances (right to emit) from companies that manage to decrease their emissions lower than their caps. Companies that fail to comply with their caps or that fail to purchase the required number of emissions allowances must pay a fine, which is usually much higher that the costs of buying the allowances.

4 According to media reports. No information about legislative initiatives in those regions is available yet.

5 See Baker McKenzie, Russia to kick-off second round of its renewables program in September 2021

6 See Baker McKenzie, Russia Taking a Stand in Global Hydrogen Race. The targets for hydrogen exports have grown following the date of the publication

7 See Baker McKenzie, Russia: Jump-start of a national electric vehicles industry

8 For further details on Russia's climate, cleantech and environmental protection policy, see Section 25 of Baker McKenzie's Doing Business in Russia guide

Why is Sakhalin so special?

The Sakhalin region is located on an island in Russia's Far East, north of Japan. It is geographically isolated from continental Russia and, therefore, it has unique geographical and climate settings.

It is also a home for several landmark oil and gas (including liquefied natural gas (LNG)) projects run by joint ventures of Russian and global energy giants, many of which are now pursuing ambitious decarbonization plans. For that and other reasons, Russia is beginning to see Sakhalin as a hub for blue and green hydrogen exports to Asia Pacific.

Some say that Sakhalin has a great potential in renewables – primarily wind and geothermal, to develop electric and gas-powered vehicles, to switch its diesel power generation to LNG and to increase GHG absorptions.

planned for implementation between September 2021 and February 2023 – with the first outcomes of such projects to be entered into the carbon registry by July 2022. The first transfer of emissions reduction units (offsets) should take place by July 2022.

In April 2021, the Russian Ministry of Economic Development submitted a draft law on the special regulation of GHG emissions and absorptions in Sakhalin ("Sakhalin GHG Bill").[9] If adopted, the Sakhalin GHG Bill will become law effective 1 January 2022. The experiment will run from that date until 31 December 2025.

Effective 1 January 2023 the Sakhalin GHG Bill will apply to companies CO_2 emissions no less than 50,000 tons in 2022 and 2023. Such entities will be viewed as 'regulated entities'. Effective 1 January 2025 the Sakhalin GHG Bill will apply to companies with CO_2 emissions no less than 20,000 tons in 2024 and onward.

» **Experiment program:** The Sakhalin government will develop such a program by coordinating with the federal authorities. It should also discuss the program with regulated entities. The program will define the set actions needed to achieve carbon neutrality and the respective timeline. The authorities will monitor the implementation of the program based on the annual carbon reports of regulated entities.

» **Mandatory carbon reporting:** Regulated entities will have to report on their emissions in accordance with the Core GHG Law, subject to lower (more stringent) emissions criteria.[10] The reports will have to be verified in accordance with international standards by expert organizations certified by VEB.RF, the Russian development institution responsible for sustainable finance, among other things.

» **Cap and trade system:** The authorities will set the caps annually based on the verified carbon reports of regulated entities in accordance with a federally approved methodology. The authorities should also oversee the discussions on the program with regulated entities, as well as the pace of the progress toward carbon neutrality.

To comply with the caps, regulated entities may purchase and retire[11] the emissions allowances, as well as the carbon offsets. Regulated entities that fail to meet their caps will pay a charge equal to: (i) the amount of CO_2 equivalent in excess of the cap; multiplied by (ii) the ratio to be defined by the federal government. Failure to pay the charge will trigger an additional penalty payable per day of delay.

Unique location, presence of energy market majors, great potential for renewables and hydrogen make Sakhalin a perfect region to test local emissions trading system. Several other Russian regions already announced their plans to develop alike systems and other carbon initiatives.

With the above in mind, the Sakhalin authorities plan to reach net-zero emissions by 2025.

Experiment timeline

In December 2020, the government approved the roadmap ("Roadmap") for the trial regulation in Sakhalin to: (i) establish a framework to implement GHG reduction technologies; and (ii) test methodologies to record and verify GHG emissions and absorptions.

In particular, the Roadmap provides that the regional ETS should be set up by February 2022 and be integrated with international systems by July 2022. The priority climate projects are [...]

What does the Sakhalin GHG Bill specifically provide?

The objective of the experiment is for Sakhalin to reach carbon neutrality – a scenario when annual GHG emissions equal their annual absorptions. The key tools to achieve this objective include the following:

» **GHG cadastre:** The Sakhalin authorities will develop the cadastre following assessment of the local GHG emissions and absorptions. They will do so in accordance with the standards of the Federal Ministry of Natural Resources and Environment and confirm the results with the Federal Service for Hydrometeorology and Environmental Monitoring.

[9] This publication is based on the version of the Sakhalin GHG Bill of 15 September 2021, available at Regulation.gov, which is the official resource for draft laws and regulations.

[10] Companies must commence reporting on 1 January 2023 if their annual GHG emissions exceed 150,000 tons and if they meet the criteria of "regulated entities"; for companies with emissions in excess of 50,000 tons, the date is 1 January 2025. The Russian government is to define the criteria for regulated entities and reporting forms.

[11] Exercise of the right to utilize the allowance or the offset against the cap. This implies transferring the allowance or offsets to a specific "retirement account" in the carbon registry, following which the allowance or offset can no longer be sold.

» **Climate projects:** Regulated entities and possibly other companies will be able to implement projects that result in GHG emissions prevention, reduction and absorption in line with the Core GHG Law. Following such projects, they will be able to sell the carbon offsets (verified outcomes of climate projects). Regulated entities may be able to comply with their emissions caps by retiring their carbon offsets registered in a separate Sakhalin-devoted section of the carbon registry under the Core GHG Law.

» **Economic incentives for GHG reductions and implementing the best available technologies:**[12] Such incentives may include regional tax, subsidies and other benefits.

Several Russian banks and commodity exchanges are discussing possibly setting up organized auction trades of the allowances and offsets under the Sakhalin GHG Law, as well as the offsets under the Core GHG Law.

Will the Sakhalin ETS protect Russian companies from the European Union (EU) "carbon tax"?

As part of the EU Green Deal, the EU has set a binding target for itself to achieve a 55% GHG emissions reduction by 2030 and carbon neutrality by 2050. This implies the substantial tightening of the EU ETS for its participants by: (i) expanding the ETS to new sectors that were previously uncovered, such as shipping, road transport and buildings; and (ii) reducing the free quotas (caps) for industries like steel, cement, plastic, paper, glass, fertilizers and sugar.

The ETS reform presents risks of "carbon leakage", meaning that carbon-intensive companies may migrate their production outside of the EU and then import back. To prevent such risk, as well as to generally equalize the ETS participants and third countries' importers, the EU is developing a carbon border adjustment mechanism (CBAM).

The CBAM implies that the importers will have to purchase CBAM certificates in the amount corresponding to the "embedded emissions" of their products. The price of the CBAM certificates will be linked to the prices of the emissions allowances under the EU ETS.

The CBAM design to date provides that the importers may be able to decrease the amount of the needed CBAM certificates if they have made a payment for GHG emissions that is mandatory in their home country. This means that the EU regulators will most likely not recognize purchasing carbon offsets on a voluntary basis (under the Core GHG Law or otherwise) as a valid tool to reduce CBAM payments. Similarly, purchasing renewable energy certificates is also unlikely to be exempt from the CBAM.

The Sakhalin GHG Bill and potentially other Russian regional ETSs aim to introduce a mandatory carbon payment for regulated entities. Conceptually, if such entities export their products to the EU, they may try to reduce the amount of CBAM certificates. However, the legitimacy of such a reduction will have to be additionally verified depending on the evolving CBAM design, the recognition of relevant methodologies chosen by the Russian regulators and other intricacies.

In addition, CBAM reduction may only be effective if the prices of emissions allowance under the Sakhalin ETS (or another regional ETS) is comparable with those under the EU ETS. Otherwise, a Russian regulated entity importing products to the EU will still have to purchase the CBAM certificates to "catch up" with the EU ETS participants in terms of the price they pay for the allowances.

Climate policy objectives beyond the CBAM

The CBAM is just one of a few incentives for Russian companies to decarbonize and participate in carbon trades in Sakhalin and the rest of Russia.

Other important incentives include the following:

» **Divestment:** Numerous pensions funds, sovereign wealth funds and asset managers continue to withdraw their funds from carbon-intensive industries and to redirect them into more sustainable ones. This is especially relevant for Russian entities with foreign equity investors and/or that are listed on global stock exchanges. Climate-responsible companies may secure existing and attract new equity investors with "green investment mandates".

» **Access to debt finance:** A number of major global banks are starting to refuse to finance carbon-intensive projects. Simultaneously, they are developing new preferential types of green and sustainability-linked finance, making borrowings cheaper. Similar trends are taking place in insurance and some types of professional services.

» **Supply chains:** Numerous automakers, tech companies, equipment producers and many other companies are voluntarily moving toward carbon neutrality for their whole supply chain. At the same time, companies that produce commodities and products with a lower carbon footprint gain competitive advantages.

» **General business efficiency considerations:** GHG emissions reductions under the ETS or voluntary climate projects may trigger industrials and other companies to mobilize investments into technological upgrades that have positive economic effects, for instance, linked to fuel or other resource efficiency.[13]

[12] It is unclear whether the best available technologies under the Sakhalin GHG Bill have the same meaning as in general Russian environmental law.

[13] Subject to compliance with basic principles of climate projects, such as additionality, which requires the company implementing the project to justify that the project would not have taken place due to economic unfeasibility, if the company were not able to sell the carbon offsets following the project's implementation.

Decarbonization challenges and opportunities for the automotive industry in Russia

VAKHTANG PARTSVANIA

HEAD OF SUSTAINABILITY AND GOVERNMENT RELATIONS, SCANIA RUS

Since 2017 Vakhtang has been Sustainability and Government Relations Director at Scania Rus. He is also Associate Professor at the Russian Presidential Academy of National Economy and Public Administration (RANEPA).

In 2014-2017 he used to work as Head of the Federal Government Relations Department at Renault Russia. He also was Deputy Head of Foreign Economic Affairs Office at the Department for External Economic and International Relations in the Government of Moscow.

Vakhtang graduated from the State University of Management and holds Ph.D. in economics.

Vakhtang is the Chairman of the GR Working Group of the AEB Commercial Vehicles Committee.

When world leaders adopted the Paris Agreement, a legally binding international treaty on climate change, on December 12, 2015, then French Minister for Foreign Affairs Laurent Fabius hailed the event a "historic turning point" on the path to slowing global warming. Over the years, global warming has not slowed down, but the agreement has not lost its historical significance. The climate theme has given a new drive to the global sustainable development agenda, and the decarbonization challenge has not only strengthened its political overtones, but has also become part of the business strategy for many corporations. On July 14, 2021, the European Commission adopted a very ambitious series of legislative proposals to achieve climate neutrality in the EU by 2050. They in particular are aimed to accelerate the transition to zero-emission mobility by requiring average emissions of new cars to come down by 100% from 2035 and significantly decarbonizing road transport. In this context, decarbonization becomes for businesses a matter of surviving in the market and even entering new market niches. The challenges arising from this and the attempts to overcome them are being well tracked in the automotive industry. In Russia, this industry directly and indirectly provides about 6% of the country's GDP annually, accounts for 2.2 million jobs (including employees from related industries), makes a significant contribution to the development of the financial and insurance sectors and in the business of training and development of personnel.

At the same time, road transport is one of the main sources of atmospheric pollutants: according to various calculations, today annual greenhouse gases (GHG) emissions from this sector in Russia are estimated from 5 to 15 million tons.

Environmental requirements

Regulatory pressure on the automotive industry all over the world is increasing every year, with the restrictions on the level of GHG emissions from vehicles being the main concern. Many cities (Amsterdam, Brussels, London, Paris, Stockholm, Oslo and others) are following the path of toughening environmental legislation and are already prohibiting the entry of vehicles with an internal combustion engine (ICE) or low environmental standards into urban areas.

Manufacturers of commercial vehicles see this challenge not only as limitations, but also as new opportunities and, in the context of the still underdeveloped electric charging infrastructure, are backing alternative fuels. Many of them already offer trucks with engines powered by ethanol, vegetable oil, biogas, natural gas and hydrogen. Today, thousands of trucks on alternative fuels operate in many countries, making a significant contribution to the reduction of GHG emissions. For example, Scania sold 6,063 vehicles that use alternative fuels in 2020, which accounted for 9.1% of the company total sales.

In accordance with this trend, Russia is developing the natural gas vehicle (NGV) market (CNG or LNG). However, the shortage of gas filling stations and the focus of state support measures exclusively on highly localized vehicles are still holding back the rapid growth of the NGV vehicle fleet and the prospects for decarbonization of the Russian automotive industry. The green transformation of the industry is also hindered by the fact that today it is compliant with Euro 5 environmental standard, whereas an increase to Euro 6 standard is expected no earlier than 2025.

The EV market

Competition for leading positions in this market is getting more intense. Almost all global vehicle manufacturers are actively developing electric transport solutions and launching an increasing number of new models into serial production. The development of this market has become a part of the environmental policy for a number of countries.

In Russia, the market for electric vehicles is practically non-existent, which imposes restrictions on the goals of the Russian government to integrate the automotive industry into the global industry and strengthen its position in export markets. The Export development strategy for the Russian automotive industry by 2025 assumes an increase in the export of conventional cars from 124 thousand units in 2019 up to 390 thousand units in 2025, which, given the global trend for the electrification, looks almost unattainable.

In turn, the Russian government is already making efforts to create the electric vehicle industry in the country: in August 2021, the Concept for the development of production and use of electric transport by 2030 was adopted, which provides for a number of measures to develop charging infrastructure and stimulate demand for EV, subsidize local production of EV, launch the production of batteries and more.

In Russia, the renewable energy market is developing slowly: the General scheme of electric power facilities provides for an increase in the share of renewables in the energy balance by 2035 from today's 0.2% to only 4%. Such unambitious target not only limits investment in green energy, but also inhibits the transition of the Russian automotive industry to carbon neutrality.

The supply chains

An increasing number of companies from different industries are refusing to work with suppliers whose activities are associated with significant CO2 emissions. Many brands are committed to minimizing their carbon footprint and achieving a zero emission targets. Corporations such as Siemens, Apple or AstraZeneca plan to achieve carbon neutrality by 2030, which poses new challenges for logistics companies that transport goods and use ICE vehicles fleet in their operations. If these companies do not expand their fleet with

The investment attractiveness of businesses is increasingly dependent on their impact on the environment. From year to year, the requests of investors and local communities for decarbonization of production and capacities are increasing.

In Norway, thanks to all kinds of support measures, electric vehicles have become cheaper than many traditional cars and accounted for 54% of all new cars sold in 2020. In Germany, last year despite the coronavirus pandemic and a large-scale economic recession, the car market saw an increase in sales of electric vehicles by 207% and plug-in hybrids by 342%. China, the largest electric vehicle market, has seen a surge in new entrants thanks to incentives: there were about 500 EV manufacturers in 2019, and the Chinese electric and hybrid car market stood at 1.3 million in 2020, or 41% of worldwide sales.

Commercial vehicle manufacturers are also moving towards electrification, launching an increasing number of battery electric and hybrid truck models. Scania expects that electrified vehicles will account for around 50% of its total vehicle sales volumes by 2030.

The use of renewable energy

The investment attractiveness of businesses is increasingly dependent on their impact on the environment. From year to year, the requests of investors and local communities for decarbonization of production and capacities are increasing. Therefore, vehicle manufacturers are actively switching to supplying their facilities with energy generated from renewable sources (solar and wind). The equipment is installed directly at production facilities and dealer stations. Some companies (Audi, Renault, Scania, Seat, Volvo Cars and others) have already equipped the roofs of some of their factories with solar panels and placed wind turbines in the surrounding area, fully covering their need for electricity. Car manufacturers such as Volkswagen and Toyota have created subsidiary energy companies — Elli Group GmbH and Toyota Green Energy, which, among other things, generate green energy for their own industrial facilities.

low emission ones, they will lose their main customers. Vehicle manufacturers face the same challenges, and they are investing billions of euros in the electrification and alternative fuels technologies today in order to maintain their customer base in the long term.

Large Russian retail and logistic companies have already taken up this trend: they have begun to tighten requirements for their transport solution providers and started to estimate indirect CO2 emissions along the value chain. Russian offices of, for example, IKEA or Leroy Merlin have already begun implementing a decarbonization strategy for their supply chain.

Shifting emphasis in industrial policy

In recent years, the focus of industrial policy in developed countries has shifted from supporting local production and import substitution to the creation of new markets and the provision of preferences to end consumers of products, regardless of these products' country of origin and the degree of localization. This also applies to the EV market, the emergence of which in the EU demanded a variety of subsidies and benefits for their buyers and owners. At the same time in Norway local politicians do not resent the fact that the citizens can receive a subsidy for the purchase of electric vehicles produced in other countries and even continents. A similar situation is in Germany, where the authorities enthusiastically embraced Tesla's decision to build an EV plant near Volkswagen's headquarters. Moreover, local politicians are not at all embarrassed by the fact that the American company is the main competitor of the German auto giant for global leadership in this market, as well as the fact that German customers can receive subsidies for the purchase of any electric vehicle, even imported into the EU. At the same time, it is interesting that, as the market matures and becomes saturated, the amount of state support is reduced, and the manufacturers of electric vehicles are gradually starting to get less support and compete on equal terms both with each other and with the manufacturers of conventional cars.

The Russian government, on the other hand, is purposefully tightening up the requirements for the localization of vehicles, adjusting the state support system strictly to "made in Russia" products, which, in turn, reduces the potential for the development of new markets and innovative solutions.

Some guidelines for the policymakers

In our opinion, the global trend for decarbonization is setting the following guidelines for the policymakers:

» Environmental requirements set by the state authorities will continue to tighten, reducing the competitiveness and market prospects of vehicle manufacturers that are not active in shifting to the development and production of low emission vehicles.
» The volume of the global market for zero emission (primarily electric) vehicles will grow steadily, narrowing the opportunities for the development of production and export of conventional vehicles.
» The share of renewable sources in the energy balance of many countries will increase, creating opportunities for making green energy widely available for vehicle manufacturers and eroding the competitive position of companies that do not have such access.
» The need to minimize businesses' carbon footprint will increase, leading to increased environmental requirements for providers of logistics and other services and displacing conventional commercial vehicles from the market.
» Industrial policy will continue to shift from supporting domestic producers and import substitution to forming breakthrough markets and support of the end customer without linking the products to the country of origin and level of their localization.

Part 3

Localization and Investments

Localization as a form of investment: latest news from the Russian market

ANGELINA ANOKHINA

TEAM LEAD CFO SERVICES, SCHNEIDER GROUP

Angelina joined SCHNEIDER GROUP in 2019. She advises Clients on financial management, business planning, implementation and evaluation of investment projects, M&A across multiple industries, including engineering, food production, FMCG, retail, construction and infrastructure, professional services.

Before SCHNEIDER GROUP Angelina was responsible for corporate finance management in Russian and international companies and ran startups.

Angelina actively participates in the activities of the functional committees of international business associations, she is a well-known speaker at conferences on supporting business in Russia, investments and finance management.

She has 13+ years' experience in financial and corporate management.

EVGENIA UVAROVA

LOCALIZATION PROJECT MANAGER, SCHNEIDER GROUP

Evgenia is a localization project manager at SCHNEIDER GROUP. She has deep knowledge in the field of production localization for both foreign and domestic companies from different industries, the selection of locations for production throughout Russia and project structuring, including negotiations with government authorities and potential business partners in the case of contract manufacturing.

Evgenia specializes in supporting companies from the planning stage and site selection, to detailed analysis of the most suitable sites for the project implementation, negotiating and accompanying the investor when visiting sites throughout Russia, and long-term project support at all stages of implementation.

The decision to localize a production plant in Russia, or any other country, is always a decision about investment.

Most companies decide to invest in Russia because they have customers in the local market and the conditions for realizing the project are favorable. These conditions are usually understood as: local infrastructure, costs of labor and land, availability of raw resources and components, and additional benefits such as subsidies. Nowadays, subsidies for foreign companies have become a beneficial instrument for both enterprises and the government.

For enterprises, Russia's so-called "long-cheap money" is usually necessary for the project's starting budget and can be invested directly, for example in infrastructure development or equipment. The Russian government uses subsidies as a support instrument for investors in order to boost the budget of projects and help itself by developing a future manufacturer that will pay tax, create employment, develop new technologies and, of course, produce goods.

Statistics, figures, industries and benefits

In 2020 foreign companies invested in 107 industrial projects in Russia, which now holds 11th place in the investment climate rating among European countries. However, it is difficult to analyze these numbers because of the crises raised by the coronavirus in 2020. Already in the first half of 2021, investment grew by 30% compared to 2020. In 2020 the main investment sectors were mining and quarrying (24%), manufacturing (21%) and wholesale and retail trade (including repair of motor vehicles) at 15,7%. The fact that the manufacturing industry took second place as one of the most invested-in sectors of the Russian economy should indicate two important messages to foreign businesses:

» It is a good time to invest in the Russian manufacturing sector.
» The Russian manufacturing industry is in high need of technological innovation.

Looking into the details, from approximately USD 10 billion of foreign investment, USD 3,5 billion was invested in the automotive industry, USD 1,15 billion in the food sector and USD 0,8 billion each in wood processing and the production of rubber and plastic products.

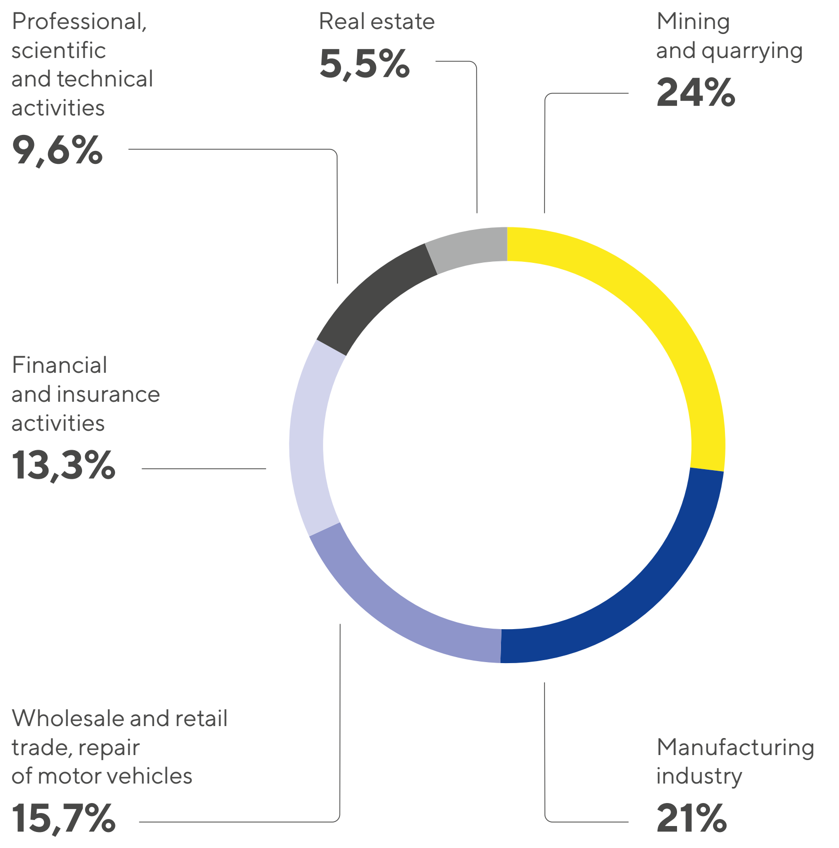
Russian government support: flexibility and accommodating business requirements

In recent years, the Russian government has continued to actively expand the list of tools available to support investors, balancing its own interests and the interests of business. Improving the investment climate in the country is an important task.

Since 2015, it has been possible to observe new approaches to stimulating investments in the production sector using SPIC 1.0 (Special Investment Contract, under which the investor undertakes to implement an investment project that meets certain criteria, and the state provides various incentives for implementation and tax benefits). An evolving SPIC 2.0 version introduced in 2019 focuses on technology as a driver of economic growth (a mandatory condition is the introduction of modern technology that makes it possible to produce products that are globally competitive).

SPIC 2.0 has a number of significant differences. An emphasis is placed on innovation, competitive selection is introduced, the period is increased from 10 to 15 years (and under a number of conditions up to 20 years), and it can be used both for the introduction of new technology from scratch and for the localization of foreign developments. The predecessor SPIC 1.0 had a high minimum entry threshold for investments — from 750 million roubles and a period of up to 10 years. Now the minimum threshold has been eliminated, making the SPIC 2.0 instrument open to a wider range of investors. The automotive industry, chemicals sector, pharmaceuticals, and most of all engineering use special investment contracts.

Invested sectors in Russia



IPPA will increase the attractiveness and predictability of the economy for investors

In November 2019, the Government of the Russian Federation submitted to the State Duma a package of draft laws on the IPPA (Investment Protection and Promotion Agreement), called SZPK in Russia. The draft legislation was discussed for a long time both within the government and with businesses, and as a result underwent very significant changes. On April 1, 2020, Federal Law No. 69-FZ "On the Protection and Promotion of Investment in the Russian Federation" was issued. In October 2020, two Decrees of the Government of the Russian Federation (No. 1577 dated October 1, 2020 and No. 1599 dated October 3, 2020) governing the rules for concluding the IPPA and the procedure for granting subsidies were added from the federal budget. Accordingly, from October 2020 it became possible to conclude the IPPA/SZPK.

What is IPPA?

IPPA is an agreement between a business and the state, in accordance with which the business undertakes to implement an investment project on the territory of the Russian Federation and the state undertakes to ensure the stability of conditions for investment activity and its stimulation.

Unlike SPIC, which can only be used by manufacturing sectors, IPPA makes it possible to implement an investment project in any sector of the economy, including IT, except for the gambling industry, trade, and the construction of administrative and business centers, shopping centers, and residential buildings. At the conclusion of the IPPA, a tender is not required. The procedure for concluding the agreement is declarative.

For many projects, co-financing of infrastructure will also be an advantage. The agreement guarantees the provision of subsidies and other measures of state support, including the creation of infrastructure. A special guarantee is provided for the construction of transport infrastructure.

It's possible to include a condition in the agreement stipulating that a public law entity will not implement a public investment project for the construction of transport infrastructure if it could negatively affect the financial performance of a similar project implemented within the IPPA.

One of the important points is also the presence of a stabilization clause with a differentiated approach, which confirms that acts or decisions that negatively affect conditions for conducting activities related to the implementation of this project, determined at the time of the conclusion of the IPPA, will not be applied to an organization implementing an investment project.

What does the stabilization clause mean in practice?

In practice, we often encounter, for example, the emergence of acts and decisions that increase the time required for the implementation of the project, establish additional prohibitions or requirements, increase the amount of payments, change the procedure for granting land plots, etc.

Thus, the stabilization clause makes the economics of the project more predictable and stable for the investor. The term of application of the stabilization clause is determined by the volume of investment in the project, excluding funds received from the budgetary system of the Russian Federation. For amounts less than 5 billion roubles, the term of the stabilization clause is 6 years. For investments from 5 to 10 billion roubles, the term of the stabilization clause will be 15 years, but if the volume of capital investments is greater than or equal to 10 billion roubles, the project will receive a maximum stabilization clause term of 20 years.

The IPPA also provides for the possibility of recovering losses from a public-law entity of the Russian Federation in case of violation of its terms.

The IPPA may include the terms of a related contract. In this case, if a public-law entity violates the terms or volumes of subsidies or changes the parameters for calculating prices (tariffs) of natural monopolies, then it will be obliged to provide compensation.

Guarantees and infrastructure

Unlike classic investment agreements, IPPA provides for a guarantee of compensation for real damage if the subsidy is not provided on time or in the wrong amount, or is not provided at all.

In addition to guarantees in relation to related contracts, the organization implementing the project can also be allocated other measures of state support in the form of reimbursable costs, such as: for the construction or reconstruction of supporting or related infrastructure, which may be in public ownership, and for the payment of interest on loans and coupon income on bonds raised for the creation and reconstruction of infrastructure.

The maximum volume of reimbursable costs is not more than 50% of the actual costs incurred for the supporting infrastructure (transport, energy, utilities, digital and social infrastructure used exclusively for the purposes of the project) with a maximum reimbursement period of 5 years and 100% of the actual costs incurred for related infrastructure (such infrastructure can be used not just for the purposes of the project and can be transferred to the ownership of a public-law entity of the Russian Federation) with a maximum compensation period of 10 years.

The maximum amount of reimbursable costs and reimbursable real damage, if there are grounds, may not exceed the amount of taxes and mandatory payments paid within the framework of the project.

Changes

As the mechanism is used in practice, proposals for its improvement and refinement naturally arise. Thus, already in 2021, a number of changes have been made. The most interesting of these are related to the expanded list of economic spheres for which the IPPA is applicable, as well as the possibility of implementing a project and concluding a private initiative of the IPPA by several organizations that can conclude an agreement with each other on the delineation of responsibilities and the allocation of costs for the creation, modernization and reconstruction of the supporting and related infrastructure necessary for the implementation of several investment projects.

Also, under consideration are possible changes related to the taxation of IPPA participants. One of these provides for the introduction of a tax deduction mechanism for a number of taxes for IPPA participants as an alternative way to reimburse the costs incurred in the framework of the investment project.

Favorable conditions

The transformation of the business climate in Russia makes it possible to conduct a productive dialogue between businesses and the federal and regional levels of the Russian Federation. Depending on the needs of the project, it is possible to achieve substantial support and additional individual conditions for the implementation of an investment project using various mechanisms.

As an example, we can cite a company engaged in the production of building materials, already present in the Russian Federation, but planning to build the third and largest site in the Russian Federation. Two main points are important for the company — the availability of a railway and cheap electricity. The specific nature of manufacturing the product is such that the transportation of components is 80% by rail, and a significant part of the cost of production is occupied by electricity. Thus, the company is considering the possibility of reconstructing the existing unused railway for its own needs to deliver components directly to the production site, as well as building an electrical substation, which, within the framework of a dialogue with the state, will allow the project to receive cheap electricity.

The state and the regions are willing to negotiate, and reliable providers are able to help you choose the most suitable region that meets your requirements, then calculate and help to obtain maximum support.

It is important to have detailed information on terms and conditions. When preparing the IPPA, for example, it is also important to be especially careful about the choice of measures that will be included in the stabilization clause, since the grounds for changing the IPPA are limited.

Forecast for 2022

Today we can say that localization processes in Russia in the last five years have changed for the better for both sides: business and government. Even more importantly, cooperation between these two parties has become a constant dialog. It is also clear that this positive dynamic will become more established and develop new instruments and structures in order to make the investment climate more favorable.

Moreover, in the coming years governmental institutes will elaborate new instruments for the development of already localized companies in order to make it possible to expand their businesses. Already today we see that foreign localized companies are opening new production plants in Russia. Such a new approach — to work on the investment climate for companies new to the Russian market and develop producers already operating in Russia — will provide stable growth in the Russian production industry.

New localization opportunities: Servier Russia CMO capabilities

CHRISTOPHE WLODARCZYK

PLANT DIRECTOR, SERVIER RUSSIA

Christophe Wlodarczyk received a degree in bioprocess engineering.

He joined the Servier team as a bioprocess engineer at the Bolbec (France) production facility in 1999.

In 2005 he was promoted to the position of production unit manager, and in 2015 he became GM of the Servier production facility in Brazil.

Since 2020 — General Manager of the Moscow-based "SERVIER RUS" manufacturing complex.

Contract manufacturing (CMO) is one of the emerging trends in the pharmaceutical industry all over the world. Experts say that this is one of the most prospective sectors and will increase in the upcoming years: according to the estimation of Mordor Intelligence Agency data, 2019, it will grow up to 7,75% by 2024.

Contract manufacturing emerged 20-30 years earlier in European countries than it did in Russia. Its development was enabled by the division of pharma industry players by their competences.

While some companies focused on research and development activities and delegated manufacturing to third parties, other companies began to specialize in manufacturing and strove for large-scale production with optimal unit costs. There were also the ones who chose a third option: effectively combining development and manufacturing with the ability to share expertise in both area with their partners. Servier is an example of this approach, both internationally and locally. In Russia, we have Servier RUS plant, which has been in operation for almost 15 years and is now able to offer extra production capabilities.

One of the main drivers of full-cycle localization in Russia is the import substitution policy that the Government has consistently maintained. For this decade, this policy is focused on the development and dissemination of new technological competences, the manufacture of export-oriented products, and the development of innovative industrial sectors, with the pharma industry being key among them.

However, there are still other economic incentives for businesses to increase local pharmaceutical production. One good reason is that a local plant can rearrange its production processes more quickly in response to changes in market demand. A potential order from a European plant must be placed about six months in advance and cannot be changed in the process. Local manufacturing in Russia allows for more flexibility.

How to choose a partner for contract manufacturing: compliance, competences, location

When companies wish to localize their portfolio in Russia, they have several options:

- First, they can choose to set up their own manufacturing, which involves not only the construction of facilities, but also many other expenses, such as the transfer of technology, hiring and training of specialists. This leads to massive investments in total which can be economically unjustified.
- Second, companies may use the opportunity of localization via packaging. The Government, however, has recently considered this mechanism an insufficient level of localization.
- The third option is localization of the full-cycle pharmaceutical production in partnership with local manufacturers.

There are not many European companies operating in Russia that are able to offer access to their manufacturing facilities for drug production. Therefore, in choosing a partner for contract manufacturing, it is important to pay attention to a number of key factors.

First, it is important to study a potential partner's manufacturing facilities. When and how the plant was built is an important consideration from a technical standpoint. Our plant, for example, was a green-field project, meaning that it was built from the ground up, in accordance with the strictest European requirements for drug production, and it has opportunities for further improvement and increases in scale.

For international companies which plan to localize their production, the approval of a new local site by headquarters may be a long and difficult process. Whereas if we consider localization on the local site of a European partner already complying with international standards and best practices, both compliance and technical audits can be conducted and passed rather easily.

It is also worth considering the technical capabilities of the plant. It is important not only having modern equipment in use, but also that regular investments are made in upgrading it. At our site, we manufacture different types of solid dosage forms, pills, and solid gelatin capsules. In addition to our own Servier portfolio, our manufacturing facilities can produce 20 million additional packs per year and our warehouse has capacity for 3,700 pallets.

At the same time, we take a flexible approach, and we are able to modify our existing equipment or purchase additional items if needed. For a current contract manufacturing project, for example, we have purchased advanced equipment for sealing vials.

Another important issue in choosing contract manufacturing partners is competent staff who are capable of transferring even the most complex technologies. A system of continuous education and development for personnel helps to guarantee consistent and stable production. For its almost 15 years of history, the Servier RUS pharmaceutical plant in Moscow has conducted more than 15 transfers and validations of technology for Servier's portfolio (today, 90% of our portfolio is produced locally on a full-cycle basis) and has begun CMO for a partner, a large international company. In total, since the launch of the plant in 2007, our manufacturing site has produced more than 400 million packages and is ready for new projects.

It is also worth paying attention to a potential partner's modus operandi. European companies are more likely to have similar attitudes to business conduct and transparency of operations, which helps to ensure a supportive environment for communication and cooperation. Sharing a common language with a partner simplifies the team's interaction and reporting.

Plant location plays a vital role: a good location offers an advantage in terms of interaction (prompt conduct of

Projects timelines vary depending on the specificity of the product and the time it takes for authorization. On average, it takes about a year from the launch of a project to the production of the first batches and the registration of stability data.

meetings, audits, and so on) and logistics (including existing logistic platform and network already established in Russia and the EAEU countries), and may also offer support from the authorities. For instance, as our plant is situated in Moscow, we benefit from the industrial complex status granted by the Moscow Government. This gives us the opportunity to use tax benefits. The savings may be used for the renewal of fixed assets, the purchase of new equipment, the broadening of capabilities, and the implementation of strategic projects, including those with partners. Moreover, Moscow, as one of the most dynamically developing regions of the country, provides its enterprises with serious communication and information support which is strategically important for business development.

Cost-savings in investments

The issue of economic effectiveness is another important consideration in localization. In this regard, the experience and capabilities of CMO partner affect not only the final cost of the finished product, but the whole process of localization.

For instance, if there is an option to produce pilot batches, it will allow a significant reduction in expenses at the product authorization stage and stability data may be collected more quickly. The production of small batches is quicker in general, and it is simpler to prepare documentation: there is no need to use industrial equipment for a new product at once. In fact, stability assessment requires at least three batches, and it is better not to consume the active pharmaceutical ingredient (API) required for three industrial batches, but to produce three pilot ones, since the cost of APIs for pilot series is substantially lower. Moreover, production of pilot batches makes it possible to finely tune the technological pathway so that the production of large industrial batches can be launched with lower financial risks.

Localization step by step: from NDA to commercial release

When planning a localization project, a deep understanding of the whole process is a great advantage, since every step requires special attention and a careful attitude to investments.

For partners, localization projects consist of several stages: technical assessment, preparation of documentation, analytical transfer, production of first batches and stability tests, dossier application and drug authorization, technical transfer and validation, and the final commercial rollout.

It is less complicated and more productive to make a quick reference visit to the site to get acquainted with the plant and the team as well as to see it with one's own eyes how the whole production process is carried out. In fact, every project begins with just such a visit.

Projects timelines vary depending on the specificity of the product and the time it takes for authorization. On average, it takes about a year from the launch of a project to the production of the first batches and the registration of stability data. During this period, documents are prepared, raw material are purchased, pilot batches are produced, and their stability is studied. The timing mostly depends on the product—faster turnaround is possible in some cases, sometimes as little as 8-10 months.

After an NDA is signed, the company familiarizes its CMO partner with the product specifications. After that, the companies work up two plans and two protocols — for analytical and technical transfers.

Then the technical teams focus on the process at the site of the transferring plant and configure the manufacturing site. The commercial and quality agreements are prepared and approved. In our case, we prepare the whole set of documents in CTD format, which fully frees our partner from work on this task. Most of the technical documents, such as plans and reports for transfer and the study of stability, validation documents, parts of the dossier, and so on, are prepared in both English and Russian, which makes our work with foreign partners comfortable and simple.

Example: Servier Russia's experience partnering with a global pharmaceutical company

Servier RUS has been cooperating with GSK/ViiV as a CMO partner since 2016 and is now producing a modern HIV-treatment drug. Today we produce over 1 million batches per year. Additionally, in June 2021, at the Saint-Petersburg International Forum (SPIEF'21) in the presence of the Russian Ministry of Industry and Trade and the Government of Moscow, Servier and GSK/ViiV signed two agreements to broaden our cooperation. These agreements make it possible to increase production and to expand the portfolio of HIV drugs produced locally at our manufacturing complex in the near future.

We are grateful to our partners for their trust in our competence and reputation. Our cooperation serves as a fine demonstration of how a CMO partner can help a company to maintain flexibility and respond promptly to patients' needs.

To sum up, collaboration with reliable sites, totally compliant and transparent and operating in accordance with the highest international standards and requirements, is exceptionally valuable. Modern machinery, optimization of the costs of transfer processes (thanks to the ability to produce pilot batches), a team with solid experience, and flexible interaction with partners are very important for the successful localization of pharmaceutical products.

The amended Pharma-2030 Strategy is intended to further drive innovation by intensifying the localization. At the same time, the government seeks to attract foreign investments. Contract manufacturing, as one of localization models, allows foreign investors to launch local production quickly while also offering manufacturers the opportunity to make additional use of their facilities and invest in further modernization and new projects.

Localization challenges for foreign SME on the Russian market

OLGA MELNIKOVA

OPERATIONS MANAGER AT METAPRO S.R.O. CZECH REPUBLIC AND COO FOR METAPROACTIVE LLC IN RUSSIA

Olga started her career in the Czech Republic in 2011 as a Marketing Manager in a group of SME focused on start-up projects and attracting investments into the Czech Republic.

Since 2011 she has been an honored participant in many events promoted and supported by different Czech Trade and Czech Tourism missions.

Since 2016 she has been responsible for Operations Management at METAPro.

Currently Olga is taking a managing role for Business Development in the frame of the localization project on the Russian market.

Localization for the past few decades has become one of the most frequently discussed issues and challenges for many businesses seeking to integrate their products in foreign markets.

If your company belongs in the SME category, what are the right steps to integrate your products and services into foreign markets while avoiding big investment losses? This was the question we faced in 2016 when we aimed to further introduce our products and services in the Russian market.

In this article we would like to share our experience with localizing our products and services in the Russian market.

METAPro is a quite young and intensively developing EPCM type company with HQ in Prague, Czech Republic. An EPCM company is a company that provides Engineering Procurement and Construction Management services. These types of companies are mainly working on EPCM contract basis in civil engineering and construction, as well as in industrial engineering and construction area.

Localization in general is a set of rules that determine a country of origin for a product. Localization may be done by using local components, transfer of technology to a resident, or through performing business operations (manufacture) in another country.

prcrussia.com

Understanding local context

Terminology used in Russia in the fields of import substitution and localization may be confusing. Understanding the nuances of the "Made in Russia" status and the importance of terminology cannot be stressed enough. This was one of the first key steps made by METAPro prior to commencing our localization project.

Localization of production is a national industrial policy tool aimed at facilitating domestic production, increasing foreign investment capital inflow and bringing new technologies to the country. The Russian Federal Law No. 488-FZ "On Industrial Policy" introduced in 2015, directly affected foreign companies working on the Russian market. This law has changed public procurement in terms that foreign and domestic products cannot compete on equal terms, as the priority is now given to locally produced goods.

At the same time, it is important not to confuse locally produced goods with the so-called national brand "Made in Russia", which has nothing to do with localization of production or a product/service. This brand promotes Russian companies and culture. Participation in this brand will not significantly help to localize goods. When METAPro was considering the best way to arrange its localization, we first had to determine whether our products/services had to meet the criteria for "Made in Russia" brand, such as:

» Criteria specified in Government Decree number 719 "On Confirmation of Industrial Products Origination on the Territory of the Russian Federation", effective July 17, 2015 apply to goods listed in the Appendix to Decree number 719.
» Criteria of CIS Agreement "On the Rules for Determining the Country of Origin of Goods Produced in the CIS" effective November 20, 2009 (hereinafter referred to as the CIS Agreement) apply to goods not listed in the Appendix to Decree number 719 effective July 17, 2015 (criteria for sufficient processing of goods).

After clarifying the localization specifics and legislative aspects, METAPro took further strategic steps.

How to choose the best way to localize foreign SME

The next step for METAPro was defining the best suitable localization method. This choice normally depends on the company's regional strategy for development, existing investment opportunities, and projected demand.

As we all know, currently exist 3 major methods of localization in the Russian market:

» special investment contract (SPIC);
» local production that meets the localization criteria;
» recognition of a foreign made product as a unique industrial product.

Through a thorough analysis by our Business Development team none of these methods completely corresponded to our products and services, or our vision on the Russian market. Therefore, we had to create our own *Localization mix* that includes different combinations of market integration tools within the framework of above-mentioned methods.

Localization strategy for foreign SMEs

Setting up a strategy for localization in the Russian market is one the most challenging steps for foreign SMEs. The investment volume is quite limited, the own resources are usually insufficient to be fully localized in the Russian market, the range of original products may not be fully implemented due to different technical regulations and industrial standards in Russia. METAPro's strategy contained the following steps:

» Specify product(s) to be localized.
» Define your Localization mix:

  - to work on a regional level and federal level;
  - to access governmental investment programs for foreign SMEs at a regional level (similar to SPIC but with more flexible conditions);
  - to access bilateral governmental programs for foreign SMEs, when one of the parties is the country of origin of the foreign product;
  - to cooperate with local manufacturing plants for components and auxiliary appliances for your localized products already accredited with your major Clients;
  - to recognize a certain part of the complete and assembled product as a unique foreign product.

» Use the most effective networking and collaboration platforms.
» Follow your localized product and services development.

2019 saw significant changes in our Clients' procurement policies and procedures, which further limited participation of foreign companies in tenders. This was a starting point for METAPro to launch its localization project. From the range of our products and services we selected aftermarket services, retrofit and revamp projects, innovative technologies for energy saving applications, and our Clients' plants and innovative technologies in aftermarket services.

We commenced our localization project with the setting up of a legal entity in the Northern-Western region as part of METAPro business group. Our localized product is mostly related to heavy

For a better business networking, it is also quite helpful to attend special networking events, forums, congresses, and summits organized in Russia.

machinery, metallurgy, petrochemical and oil & gas industries.

An important part of an SME localization is participation in networking platforms and business associations. We find the AEB networking concept to be quite efficient, as it helps foreign companies to remain updated on legislation and possible obstacles. A wide range of legislative challenges facing foreign companies working on the Russian market is constantly discussed by AEB Committees as well as included in agenda of online and offline meetings with key Russian officials.

While AEB Committees' agenda helps foreign companies deal with legislative challenges, the Chamber of Commerce and Industry of the Russian Federation acts as a liaison on the federal and regional levels. As a member of Saint-Petersburg Chamber of Commerce, METAPro received significant help on cooperation with different governmental and non-governmental entities as an SME investor.

For a better business networking, it is also quite helpful to attend special networking events, forums, congresses, and summits organized in Russia. PRC organized by an international vendor BGS group, is great for petrochemical and refining companies. The event agenda contains not only sessions prepared by major market players, end users and scientists, but also a discussion panel, and B2B and B2C networking. Such sessions help you identify the current Client's needs and modify your localized product more efficiently. In 2021, METAPro joined a sponsorship program for PRC which gave us brilliant opportunities to expand our localization plans to a wider audience and target new Clients and Partners.

Goals and perspectives for the near future

Successful localization is always about defining your goals and perspectives in a fixed time frame. For SME industrial localization projects in North-Western region, there are 10 to 15 mln euros investment programs currently available. As a foreign SME company, METAPro aims to set up a 500-1000 m2 technological platform with a capacity of 30 permanent working places and additional 50 outsourced employees by 2026. Innovative technological equipment, such as 3D scanner, 3D printer and other additive technologies integration will be a key factor to the success of our localization project. Built in accordance with modern industry standards, this multi-functional technological platform could become a joint venture for our local partners and foreign SME production plants.

Long-term investment agreements: legal and tax implications

BILGEIS MAMEDOVA

PARTNER,
ADVANT BEITEN

Bilgeis Mamedova is Partner in the Commercial Law Practice Group at ADVANT Beiten in Russia. Her core activities include consulting on the market entry, set up of production facilities and localization issues.

Ms. Mamedova has extensive experience in the areas of international and Russian contract law, securities and project financing in Russia.

She is the author of numerous publications and regularly lectures at conferences in Russia and abroad.

Bilgeis graduated from Moscow State Law Academy. She obtained an LL.M. degree at the University of Bremen and a Ph.D. at the Moscow State Institute of International Relations (MGIMO) of the Ministry of Foreign Affairs of Russia.

ANNA LESOVA

COUNSEL,
ADVANT BEITEN

Anna Lesova is a Counsel in the Tax Law Practice Group at ADVANT Beiten. As a Russian lawyer and German-certified tax adviser, Anna leads the firm's German-Russian Tax Practice. She advises clients on local and cross border transactions and investments, including M&A, with a particular focus on tax related aspects of the transaction, on a broad range of Russian and international tax matters and tax planning. Anna has an extensive experience in structuring corporate and contractual relations within Russian and international holdings.

She is the author of numerous publications and regularly lectures at conferences in Russia and abroad.

Anna graduated from the Moscow Institute of Economics, Management and Law, and earned a Master degree (LL.M.) in taxation from the University of Cologne.

When deciding whether to invest in Russia, an investor usually considers preferential investment arrangements, tax benefits and government support available to the project, enabling the investor to maximise profitability.

The ability to leverage such support in Russia is usually contingent on the conclusion of long-term investment agreements.

In this article, we analyse three long-term investment agreements (Special Investment Contract, Investment Protection Agreement[1] and a Special Economic Zone Agreement).

Selecting the appropriate investment agreement

First of all, the investor must understand whether a specific investment agreement is appropriate to the project, taking into account planned business activities.

Special Investment Contract (SPIC) is intended solely for industrial projects involving technology transfer, implying industrial production in Russia. The technology to be transferred must be approved by the Russian Government, including the production of medical products, automobile components, mechanical engineering and electronics products, and a whole range of other industrial products required in Russia.

Unlike SPIC, an Investment Protection Agreement (IPA) is intended for broader

[1] Up-to-date detailed rules on the conclusion of Investment Protection Agreement are currently under government review.

use and may also apply to industrial projects involving the setup of production facilities in Russia. Investors may also conclude IPA to engage in healthcare activity, the setup of educational, cultural and sports facilities, transport infrastructure, hotels, tourist complexes, logistics centres, for investments in agriculture, implementation of environmental protection projects, and in the digital sector. An IPA is also applicable to natural gas liquefaction investment projects.

A Special Economic Zone Agreement (SEZA) intended for industrial production implies the production or processing of any goods or logistics activities within a Special Economic Zone (SEZ).

Procedure for concluding an investment agreement

The conclusion of an investment agreement implies that the state will become a partner of the investor.

Who concludes an investment agreement?

SPIC are concluded with the participation of federal and regional governments and municipalities.

IPA may be concluded independently at federal and regional levels.

SEZA are concluded with the federal government or the regional authority (if authorized) and Management Company of the Special Economic Zone.

How is the investment agreement concluded?

SPIC may be concluded on the initiative of the investor and the state.

If an investor initiates the conclusion of a SPIC for industrial projects, it submits the proposal to the Russian Ministry of Industry and Trade. The Ministry considers the investor's proposal and decides whether to hold competitive bidding regarding the investment project open to all interested parties.

The Ministry may also announce, independently of the investor, the holding of competitive bidding to implement a specific investment project and invite investors to participate.

The competitive bidding procedure is regulated by the law, with the key criteria for winning related to:

» the shortest period for transferring technology;
» the largest production volumes;
» the highest technological level of localization of production.

Like SPIC, IPA may be concluded based on both a private and public initiative.

A private initiative implies that the investor submits an application to the state.

The federal or regional government may also propose the conclusion of IPA. Here, the government publishes a declaration on implementation of a specific investment project and indicates the planned government support.

The investor is selected on a competitive basis. The competitive bidding procedure is regulated by the law, with the key criteria for winning related to:

» the largest capital investments;
» the smallest amount of government support;
» the shortest implementation period of the investment project and the highest level of efficiency.

A SEZA is concluded on the investor's initiative, subject to approval of the project's business plan by the competent authority.

Capital investments

Capital expenditure is one of the investor's key obligations under an investment agreement. In several cases, the law does not establish the minimum level of capital investment, but frequently makes specific measures of government support and the term of the investment agreement contingent on the level of capital expenditure.

SPIC presumes that the investor acquires or leases land plots for the construction or reconstruction of manufacturing facilities, invests in fixed assets, R&D and IP.

Under IPA, the law considers capital expenditures not only in R&D, construction of real estate or fixed assets intended for investment activities, but also creation of related and supporting infrastructure. Supporting infrastructure includes transportation, energy, social or digital infrastructure facilities used exclusively for the investment project. Related infrastructure includes the same facilities, but also intended for collective use by the state or third parties.

To conclude SEZA, capital expenditures must equal at least RUB 120 million (other than intangible assets), with at least RUB 40 million invested in the first three years from the conclusion of the agreement.

Legal effect of concluding an investment agreement

The key issue is the specific benefit of the investment agreement, and the specific support, guarantees, or special terms provided in exchange for the investor's obligations. This legal effect is summed up below.

Simplified procedure for obtaining "Made in Russia" certificate

The investor obtains the certificate "Made in Russia" for products manufactured under the SPIC under the simplified procedure. During the first three years the products are declared "Made in Russia" even if they do not yet meet all the statutory localization requirements. The investor thereby accesses an additional market if "Made in Russia" status is key importance to sales of the products.

The simplified procedure is not applicable to IPA and SEZA.

"Stabilization clause"/"grandfather clause"

The "grandfather clause" is a key legal guarantee for SPIC investors, whereby legislative and regulatory acts do not apply for the duration of the SPIC if they were adopted after the SPIC was concluded and introduce restrictions or prohibitions on the investor's rights or business activities under SPIC.

The "stabilization clause" is a key incentive for concluding IPA. The "stabilization clause" is a legal guarantee for the investor, as legislative and regulatory acts will not apply to the investor for a defined period if they worsen the terms of doing business related to the investment project. Under the "stabilization clause", the volume or term of government support cannot be reduced. In addition, changes in the procedure for using land plots, and additional administrative procedures established for design work or construction, are not applicable. Additionally, the investor can (dependent on the project) expect a freeze in the rate of export customs duties and adverse environmental impact fees. Here the "stabilization clause" is contingent on the level of investment.

A successful long-term investment decision requires not only a substantiated financial plan and clear business targets but also a deep analysis of the most appropriate legal approach and tax benefits to make the investment project more secure and profitable.

The "stabilization clause" is not applicable for SEZA.

Other government support

Concluding a SPIC can grant the investor access to industry subsidies. However, the terms and conditions of the subsidy should be considered.

In IPA the state may reimburse capital expenditures of investors on the construction of related and supporting infrastructure and paid interest costs, as well as R&D costs and interest paid related to the set-up of investment facilities and IP. Under IPA, investors may also be eligible for other support (subsidies, etc.) stipulated by the law. However, the terms and conditions of the subsidy should be considered.

In SEZA the Management Company may be charged with creating certain infrastructure facilities for use by the investor. Investors can use land plots on preferential terms (lower lease rates). Duty-free customs arrangements may apply to goods (components for the manufacture of end products).

Tax effect of an investment agreement

Guarantee of tax stability

In SPIC, the current overall tax burden when the SPIC was signed remains unchanged during the contract.

This guarantee is implemented as follows:

» any rules increasing the tax rates established for SPIC participants or revoking tax concessions do not apply to SPIC participants;
» the guarantee remains in effect until the investor loses the status of SPIC participant, or the end of the effective term of the established tax benefits, whichever comes first;
» the guarantee applies to profit tax, corporate property tax, transportation tax, and land tax.

When concluding an IPA, the investor does not obtain tax preferences in exchange for any obligations and is guaranteed that the tax arrangements in effect on the date of the agreement will remain for the period specified in the agreement ("stabilization clause"). New rules changing the procedure for calculating the tax base, rates, concessions, the procedure and deadlines for paying taxes do not apply to the investor if they entered into force after the effective date of the IPA. This rule applies to different taxes, depending on the specific party to the agreement, e.g. the Russian Federation, a Russian region, municipality or more than one of them. Investors are eligible for property, transportation and land tax concessions even if they were introduced after the conclusion of the agreement. The "stabilization clause" remains in effect until the expiry of the agreed term or termination of the IPA.

Taxation of income and dividends

SPIC participants enjoy the following concessions:

» federal tax rate of 0%;
» the regional tax rate may be lowered to 0%.

The concession may not exceed 50% of capital expenditures on the investment project. The existing rules do not stipulate concessions on the taxation of dividends distributed to the shareholders of SPIC participants.

For income from activity in SEZ:

» the federal tax rate may be 2% or 0%;
» the regional tax rate may be lowered and should not exceed 13.5%.

SEZ residents may apply an accelerated depreciation rate (up to 2), which lowers taxable income.

Property tax

The book value of buildings and structures is subject to property tax (maximum rate 2.2%), regardless of taxpayer turnover or income. Accordingly, concessions on this tax represent a significant part of regional investment policy.

Russian regions introduce concessions up to 0% for SPIC participants, usually for assets created or modernized under the SPIC.

SEZ residents are exempt from this tax for 10 years from the commissioning date of the assets. The buildings and structures must be located and used for activity in the SEZ.

Land tax

Municipalities may lower or abolish the tax rate for land plots used under SPIC.

SEZ residents are exempt from this tax for five years from the month when they purchase the land plot provided that it is located in the SEZ.

Conclusion

Our experience shows that in SPIC investors are attracted by the "Made in Russia" certificate and related market access or industry support. Tax concessions play a material role, but are not the overriding factor.

In a SEZ investors are attracted by the location, infrastructure benefits, the quality of the management team, preferential leases, administrative support with the reimbursement of VAT.

In an IPA, the key factor is the application of this regime to a number of economic sectors, the "stabilization clause" and the possible reimbursement of costs.

Investment protection and promotion agreements: outcomes and prospects

ALISA MELKONIAN

PARTNER, TAX AND LEGAL, KPMG IN RUSSIA AND CIS

Alisa is Head of tax regional development, KPMG in Russia and CIS and is a Fellow Member of the Association of Chartered Certified Accountants (ACCA).

Alisa has experience in advising on state support programs, including special investment contracts, Investment Protection and Promotion Agreements, tax concessions in different regions of Russia, Special Economic Zone regimes and Priority Social and Economic Development Areas.

As a co-chair of the Tax committee of the American Chamber of Commerce in St. Petersburg, Alisa has access to the most recent and up-to-date information on the regional tax matters including tax concession matters.

NATALIA NIKITINA

DIRECTOR, TAX AND LEGAL, KPMG IN RUSSIA AND CIS

Natalia is Director in Tax and Legal Department and Automotive sector Leader in Tax and Legal at KPMG in Russia and CIS, Co-Chair of the Automotive Committee of the American Chamber of Commerce in Russia.

She has significant experience in advising on various state support programs, including special investment contracts, Investment Protection and Promotion Agreements, various preferential tax regimes/tax concessions, subsidies and other mechanisms of state support and helps the clients in obtaining these measures of state supports.

She also actively participates in legislation development activities relating to various state support programs.

ANTON CHERNYKH

DIRECTOR, KPMG LAW IN RUSSIA AND CIS

Anton is the Director of Legal Practice in KPMG. Previously Anton worked for "Gazprom neft" PJSC, where he held various senior positions, including Deputy Head of Division for Legal Support of Major International Projects and Integration, and Head of Division for management of intellectual property.

Anton leads the legal support of SPIC 2.0 and Investment Protection and Promotion Agreements conclusion projects, specializes in international O&G upstream projects, joint venture transactions, M&A projects and legal support of construction projects (green-field projects).

What does IPPA mean

An Investment Protection and Promotion Agreement (IPPA) is an investment agreement between a public partner and a private partner (in certain industries) according to which the private partner is entitled to seek for stabilization of regulatory acts that may influence the investment project and other state support measures.

A public partner is the respective Region, and (or) the Russian Federation, and (or) the municipality.

A private partner is a Russian legal entity (other than state-owned or quasi-state company) intended to implement the investment project.

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What projects qualify

An investment project is a time-limited project designed to construct (or reconstruct) and operate immovable assets and (or) a complex of immovable and movable assets, and (or) to create and use intellectual property in order to gain profit and (or) achieve another useful effect, including preventing or minimizing negative impact on the environment.

The investment project qualifies if:

» The private partner decided to implement this investment project and, inter alia, determined the amount of capital investments (costs) required before the effective date of the IPPA Federal Law, however, not earlier than on 7 May 2018, and met the following conditions:

  – received a permission for the construction of immovable assets or began making capital investments not earlier than on 7 May 2018 (depending on the project); and
  – filed an application for the conclusion of the IPPA in accordance with the IPPA Federal Law no later than on 31 December 2022.

» The private partner decided to approve the budget for capital investments (expenses) after the effective date of the IPPA Federal Law and filed an application for the conclusion of the IPPA no later than one year after this decision was taken.

Why is it worth entering into IPPAs for investors

Stabilization

Stabilization clause means non-application of the acts (decisions) specified in the IPPA Federal Law to the private partner if they worsen the conditions for conducting business related to the investment project compared to those provided when the IPPA was concluded.

The worsened conditions for conducting business may be as follows:

» increase in the time for the procedures necessary to implement the investment project;
» increase in the number of procedures required to implement the investment project;
» increase in the amount of payments made by the private partner in order to implement the investment project;

Terms of the stabilization clause (general rule, subject to certain exceptions)	Amount of capital investments
6 years	≤ RUB 5 billion (excluding agriculture, food and manufacturing industry, education and healthcare)
10 years	≤ RUB 5 billion for agriculture, food and manufacturing industry, education and healthcare
15 years	> RUB 5 billion, however, < RUB10 billion
20 years	≥ RUB 10 billion

» additional requirements established with regard to the conditions for the implementation of the investment project, including the requirements for the provision of additional documents;
» additional prohibitions that impede the implementation of the investment project.

Tax stabilization clause

Conclusion of an IPPA enables the investor to apply the so called "tax stabilization clause" — a guarantee that the provisions of certain tax legislation acts that may take effect after the conclusion of an IPPA will not apply to the investor in relation to the legal relationships connected with the execution of the IPPA.

The scope of the tax stabilization clause depends on the combination of the public parties to the IPPA (the Russian Federation/a Russian region/a municipality). The time during which the tax stabilization clause may be applied depends on the amount invested in the investment project.

We would like to highlight a number of issues that should be taken into account in relation to the tax stabilization clause:

» Generally, tax stabilization clause does not cover any changes in legislation that improve a taxpayer's situation (except for certain exclusions).
» Current legislation does not provide rules or clarifications on how the tax stabilization clause should be applied when an investor concludes an IPPA and obtains other government support measures, e.g. concludes a SPIC or applies preferential tax regimes at the same time.
» A guarantee that an investor will not have to pay new taxes or levies imposed after the registration of the IPPA with the corresponding register is only provided to an investor if the Russian Federation is a party to the IPPA.

Subsidiary programs: reimbursement of infrastructure costs

An investor can have reimbursed its costs incurred to build, renew or reconstruct the infrastructure (e.g. transport, energy, utility, social and digital infrastructure) as well as the interest expenses incurred under the loans taken out for the above purposes. Recently the list of costs that may be reimbursed was expanded by, inter alia, the utility and transport network connection expenses and R&D expenses. The list of purposes for which loans may be taken out with a possibility of being reimbursed for interest expenses was also expanded.

It should be mentioned that there are certain conditions and requirements an investor must meet to obtain a subsidy, including:

» separate tax accounting must be implemented;
» infrastructure costs must be actually incurred;
» technological and pricing audit must be completed;
» the options of the financial assurance of the costs must be assessed.

Furthermore, the amount of costs that can be reimbursed is limited and may not exceed:

» the amount of compulsory payments to be made into the state budget in connection with the investment project (certain taxes, import customs duties, automobile excise duties);
» 50% of costs actually incurred for supporting infrastructure (infrastructure that is only used to implement the investment project);
» 100% of costs actually incurred for related infrastructure (infrastructure used not only for the purposes of the project).

There are other reimbursement limits that should also be considered.

The following stabilization terms may be applied:

Nos.	Type of document	Stabilization (non-application of amendments) time after the effective date of the amendments	Investment amount requirement for the stabilization to be applied
1	Acts changing the scope and terms of granting government support measures (reimbursement of expenses, tax refund)	This term is provided in the respective investment protection and promotion agreement (IPPA) and equals the term during which the government support measures are granted	**If the Russian Federation (RF) is not a party to the IPPA, and:** 1. Moscow or St. Petersburg is a party to the IPPA, then – **at least RUB200 m** 2. for other constituents of the RF, – **RUB200 m to RUB1 bn** **If the RF is a party to the IPPA, and:** 1. those are new investment projects, then: – **at least RUB250 m** in the area of healthcare, education, culture, physical education and sports, construction of houses under agreements on complex development of the territory, etc. – **at least RUB500 m** in digital economy, ecology, agriculture, environment, travel, etc. – **at least RUB1.5 bn** in processing industry, air terminals, public transport, transport and logistics hubs – **at least RUB5 bn** in other sectors of the economy 2. in other cases: – **at least RUB10 bn** (additional acts can be stabilized, which acts are listed in items 1, 4 and 5 of clause 3 of Article 9 of the IPPA Federal Law)
2	Land and urban development acts	Three years after the effective date of the respective acts subject to a valid IPPA	
3	Acts providing increased export customs duty rates	The term is set in the respective IPPA	**If the RF is a party to the IPPA:** – **at least RUB10 bn**
4	Acts providing increased rates of environmental impact fee and charges for water, disposal, ecology, and forest resources	Three years after the effective date of the respective acts subject to a valid IPPA	

We see some potential issues and risky areas that an investor may face when applying for a subsidy and which we recommend analyzing beforehand, for example:

» A long, complicated, and complex procedure of obtaining subsidies, including the need to conclude a number of agreements.
» To have the right to obtain subsidies at various stages of project implementation, these stages should be included into the IPPA. There are also a number of requirements to be met to obtain a subsidy on completion of a certain stage.
» Subsidies may not be obtained if as a result of a technological and pricing audit no positive opinion was provided.
» Potential drastic reduction in the amount of the subsidy if the investor that has concluded an IPPA applies preferential tax regimes at the same time, as in this case, one of the cost reimbursement limits (the amount of compulsory payments into the state budget) decreases.
» Regional legislation that provides rules of obtaining of subsidies at regional level (under regional IPPAs) is currently under development.

Current status of IPPAs in Russia

As of 1 April 2021, 36 IPPAs were concluded in various sectors (manufacturing enterprises, urban transport infrastructure, airport terminals, production and logistics complexes, municipal solid waste neutralization plant). The amount of investments totaled RUB 1.28 trillion (approx. USD 13.8 billion). The Russian Federation and its regions represent the public partner.

After 1 April 2021, a new procedure came into force, which is so far only expected to be implemented in practice.

The new procedure allows to use the State Informational IT-system "Kapitalovlozheniya" to conclude an IPPA or to file a "paper" application. However, as of now, the IT-system "Kapitalovlozheniya" is not ready.

Draft Regulations on conclusion of IPPAs where the Russian Federation is one of the parties representing the public partner is now in progress.

Draft Regulations set forth, inter alia, rules of concluding of IPPAs via the private project initiative, an IPPA template, which stipulate that an authorized organization may be engaged to support the IPPA conclusion process and monitor the implementation of the terms of these agreements.

The State Development Corporation "VEB.RF" and banks that meet the specified requirements may be such an authorized organization.

Areas for development

Notwithstanding, some key aspects were not covered by IPPA Federal Law and these Draft Regulations.

A spectacular example concerns the amount of investments.

The investments do not include debt (bank) funding (subject to certain exceptions). This approach may have significant influence on the efficiency of using an IPPA.

A possible option may be to decrease the threshold for capital investments for investor and (or) to include debt (bank) funding in the amount of capital investments.

Short-term perspective: what the investors should expect

First Deputy Minister of Economic Development Andrey Ivanov said that in October 2021, pilot regions will begin preparing investment declarations, development agencies and investment committees according to the new rules.

By the end of the year, the Ministry of Economic Development is planning to approve a set of investment rules, the procedure for drafting the investment map and the Register of Investment Projects. Development agencies will attract investors and support investment projects. Investment committees will become a platform for resolving disputes between the investor, state bodies and organizations in a pre-trial manner.

Besides, the state authorities are currently considering a new alternative option of cost reimbursement. The planned changes to the Russian Tax Code provide to investors an opportunity of claiming tax deductions (on corporate profit tax, property tax, transport and land taxes). It will potentially make it possible to reduce the amount of taxes to zero.

In certain cases, this option may be more preferential for an investor compared to subsidies, as the procedure for obtaining of tax deductions is more straightforward and less complicated.

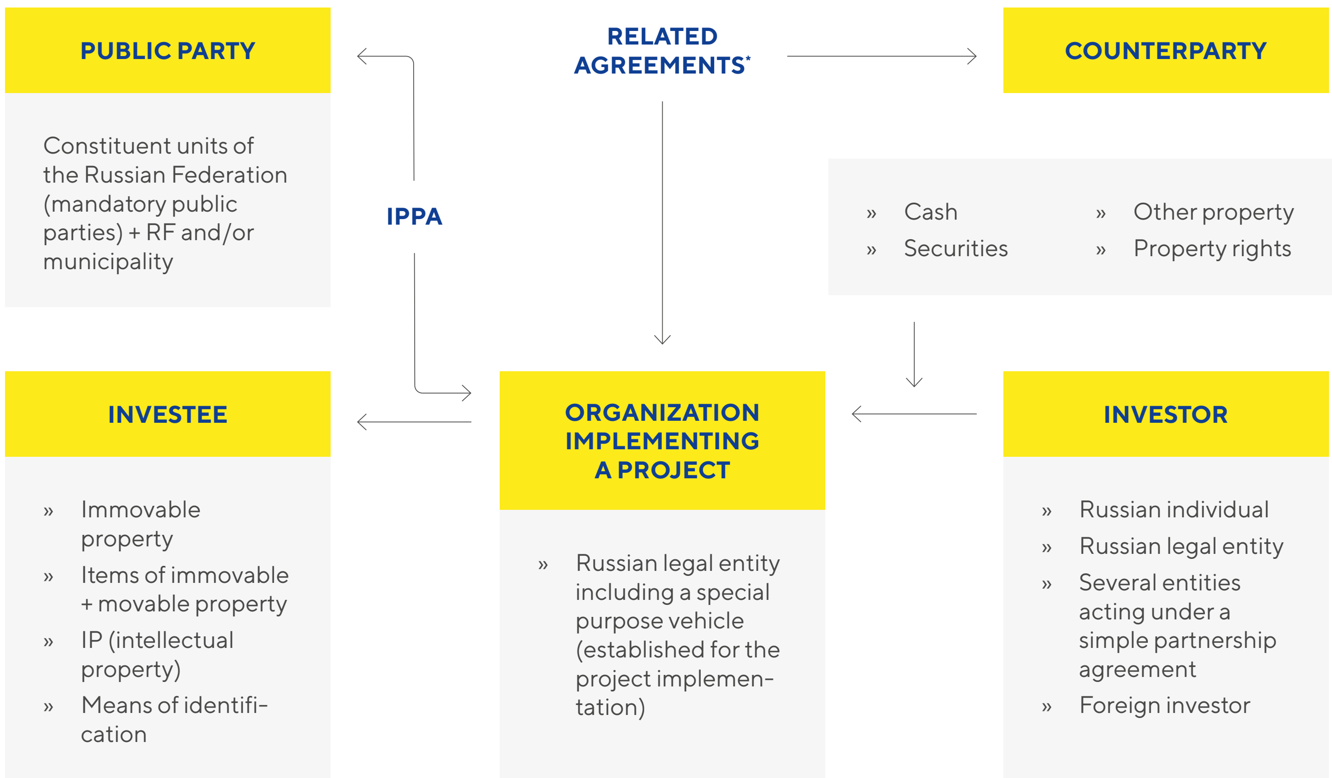
At the same time, we see a number of ambiguous questions in relation to the planned changes in the legislation, in particular:

» They do not regulate whether and how the tax deduction mechanism may be combined with other preferential tax regimes and infrastructure subsidies under an IPPA.
» The transfer of losses incurred when executing an IPPA is limited by the tax base calculated in relation to the IPPA. Therefore, a situation may occur when investor may not obtain corporate profits tax deductions.
» These changes do not regulate whether it will be possible to charge depreciation in case the investor's tax refund claim is denied.

IPPA

In accordance with an IPPA, public law entities (one or more constituent units of the Russian Federation (mandatory public parties) + RF and/or municipality) undertake to ensure stabilization of the acts for organizations implementing projects, while the organizations implementing projects may demand non-application of these acts

An IPPA must be entered into on or before 1 January 2030



* The purpose of recognizing an agreement as a related one is to be reimbursed by the public party for the real damage if the latter breaches the related agreement or any other agreement as provided in the Investment Protection and Promotion Law

0% Dividend tax rate to be taken away — what to do?

EVGENY TIMOFEEV

PARTNER, BRYAN CAVE LEIGHTON PAISNER

Evgeny Timofeev is partner with Bryan Cave Leighton Paisner and heads its tax practice in Moscow. He practices tax law since 1991 and is highly regarded in the Russian and international legal communities.

He has been ranked in Chambers Tier 1 since 2010 and is recommended by all other reputable legal directories. Among the awards are "Lawyer of the Year" from Best Lawyers and MGIMO.

Evgeny authored books (including co-authoring the very first Russian tax law textbook) and many articles, sits on tax committees of most international associations (including AEB) and presides on many legal conferences in Russia and abroad.

The tax trap

A few years ago, Russia introduced a concept of Russian tax residency for foreign companies. Should a foreign corporate declare itself a Russian tax resident, it will be treated tax-wise like a Russian company. Many Russian and foreign investors have accepted this offer moving their tax residencies to Russia. I know quite a number of those, including some listed on NASDAQ or LSE.

The choice has been driven by two reasons: (1) they wouldn't have to worry about proving the status of the beneficial owner to achieve lower (up to 5%) dividend withholding tax rate under a double tax treaty; and (2) they would enjoy 0% rate on qualifying incoming dividends — utilizing the Russian participation exemption alongside their Russian counterparts. Should it be a JV with Russian partners, the latter would also benefit from decreased overall dividend taxation (assuming the country of the corporate does not tax outbound dividends). But this seems to have been a trap, and the trap has now been slammed shut.

Last year, an amendment to the Tax Code explicitly deprived foreign companies, which recognized themselves Russian tax residents, of the right to utilize the 0% tax rate on incoming dividends. While currently they can still use it under stricter conditions, as of 2024 they can kiss the 0% rate goodbye completely — the applicable rate will be 13%, the same rate Russian companies with non-qualifying participations pay. It is a mystery, why Russia is sending a message to foreign investors that beneficial rules cannot be trusted and that discrimination of foreign companies can strike at any moment. The more important question though is what can be done about that if at all? In fact, there are a number of ways to deal with the issue.

Option 1. Abandon Russian Tax Residency

This is basically about backing off and returning to square one. But now, however, this square one has changed drastically. Double tax treaties with Cyprus, Malta, and Luxembourg (Switzerland seems to be the next) have been amended and do not provide for rates below 15% any more (unless you are a listed company, in which case you may have a chance to get back to 5% rate). The treaty with the Netherlands will as of 2022 go away completely, hence again 15%.

This option is only feasible in case the holding company in question is in its turn owned by a company from a jurisdiction with the 5% treaty rate still intact and the holding company is not the beneficial owner of the dividend flow while its parent is (the beneficial owner is the person in reality determining the economic fate of the dividends, not just passing these through). In such case the Federal Tax Service in its practice recognizes applicability of the 5% rate under the treaty with the beneficial owner's country of residence (although Ministry of Finance hesitates), but you should be prepared to fight proving the beneficial owner status. Unless the beneficial owner is a publicly listed company or engages in active trade, this could be a tough task.

Please also make sure that all links between the company moving out and Russia (in terms of management) are terminated — to avoid the risk of the tax authorities bringing the company back into Russian tax residency by their decision.

> A foreign company being a Russian tax resident with qualifying participation in a dividend paying entity is definitely in the same circumstances as Russian companies with such participations.

Option 2. Do Nothing

I personally like this one even though it probably means a fight. The option assumes that the company in question is from a treaty jurisdiction, and that the respective double tax treaty contains a non-discrimination clause pretty close to standard. Let me quote the Russia-Cyprus treaty as an example of such clause:

"Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected".

Well, a foreign company being a Russian tax resident with qualifying participation in a dividend paying entity is definitely in the same circumstances as Russian companies with such participations. Hence, the foreign company as a national of another state is protected by this non-discrimination clause, which takes priority over Russian law per this law itself and, more importantly, Russian Constitution. Even though Russian judiciary seems to be too flexible in the application of tax law (so long it benefits the treasury) over the last years, this rule here seems too direct to find a way of circumventing it. In fact, I would think that the Russian legislator must have considered the existence of non-discrimination clauses, so the rules seemingly depriving foreign companies of the 0% rate are in effect targeted at the companies from non-treaty (i.e. less internationally important) jurisdictions. There is a good chance this position can be accepted by the Federal Tax Service, which headquarters consistently demonstrate a strong inclination to follow the rule of law.

Option 3. Become Russian

Generally, unlike laws of many jurisdictions, Russian corporate law does not provide for the change of a company's nationality. However, one way to achieve this did emerge a few years ago. And this way goes through SARs standing for Special Administrative Regions. So far there are two of them: Island Russky in Primorsky Kray and Island Oktyabrsky in Kaliningrad Oblast.

The Federal Law "On International Companies and International Funds" provides foreign companies with the opportunity to change their nationality to Russian (assuming their personal laws also provide for such opportunity) in case they agree to invest at least RUB 50 mln in Russia within 6 months. Not too high a number for a multinational already active in Russia. In fact, an additional contribution to a subsidiary's charter capital or assets would suffice. Moreover, the subsidiary's spend on fixed assets would equally qualify.

In the course of the re-domiciliation, the company would have to accept one of the Russian legal entities' forms with an addition of the word "International". The status of international company may be used to achieve the status of international holding company (satisfying a number of additional requirements), which is quite beneficial tax-wise. However, this is a different story. Becoming let's say International limited liability company already makes you a Russian company manifestly eligible for the 0% dividend tax rate under standard conditions. Should you wish not to stay registered on an obscure island you are unlikely ever to visit for too long, you can opt out of the status the next day after registration. You just need to re-register to the city where you actually do business. You will lose the word "international" in the name of the company and become a standard Russian LLC.

There are 2 things though to think about. First, the option is only available for the foreign companies, which as of 1 January 2018 (expected to be changed to 1 January 2020 soon) did business "on the territories of several countries" themselves or through a "one group of persons" as defined by Russian anti-trust law. Should not be too hard to comply with for a multinational, but each case must be assessed separately. Having a seat in say Cyprus and a representative office in Russia may or may not suffice, we simply don't know at this stage.

Second, it may well be a one way street. It's easy to become Russian in a SAR, but opting out of Russian corporate citizenship may not be that easy — it would require consent of the Russian Government itself. But then, there is always a way out, isn't there?

Option 4. Substitute

One more option exists. The owner(s) of the foreign company — Russian tax resident could establish a new Russian holding company and transfer the shares of the foreign company as the contribution into the new holding's charter capital. Then — as 365 days pass (it is a prerequisite for the 0% rate) — liquidate the foreign company.

Assets of the latter transferred into the ownership of the new Russian holding would not be taxable. Insofar their value does not exceed the value of the assets previously invested into the foreign company — per a direct provision in the law (after all, this is only a return of the capital invested). As regards the rest — because it is considered dividend, and dividends, as we remember, are subject to 0% rate in the hands of a Russian recipient.

Thus, by way of substitution you can get rid of the foreign holding company having which does not make any sense anymore and at the same time achieve what currently looks bound to be lost, namely the availability of the 0% tax rate. The problem with this scenario is that it is pretty burdensome as any corporate reorganization and can cause problems with side creditors. In particular, you should look up all covenants in loan agreements with banks. Also, the foreign corporate law should be carefully checked for any obstacles that could affect the case depending on particular circumstances. Still, it seems quite a viable way of solving the problem.

To summarize, the answer to the question whether the 0% dividend tax rate will definitely be lost unless Russian legislator revisits the situation and reverses its decision is definitely a firm "NO". However, as always, a decision must be made in time to navigate this change in taxation smoothly. If you are affected by the change, consider your circumstances, consult professionals you trust, and make an educated decision to prevent a 13% bite out of your Russian profits.

Part 4

Business in Russia after COVID-19

Trends and changes on the Russian market

JAANA REKOLAINEN

CEO, FINNISH-RUSSIAN CHAMBER OF COMMERCE (FRCC)

Jaana has held a number of positions in Russian trade for over 30 years.

She joined the Finnish-Russian Chamber of Commerce in 2009 and was appointed CEO in 2016.

The Finnish-Russian Chamber of Commerce (FRCC) is a leading expert organization for Russian trade, employing over 20 experts in Finland and Russia. FRCC counts about 650 member companies active in Finnish-Russian trade.

The Finnish-Russian Chamber of Commerce, together with its partners, publishes a barometer survey on Russian trade twice a year. The surveys examine the prospects and challenges of the Russian market and economy from the perspective of Finnish business leaders, collecting responses from approximately 300 directors of companies operating in trade between Finland and Russia.

In the spring 2021 survey, we asked whether the Russian market would change after COVID-19 and what kinds of changes were expected.

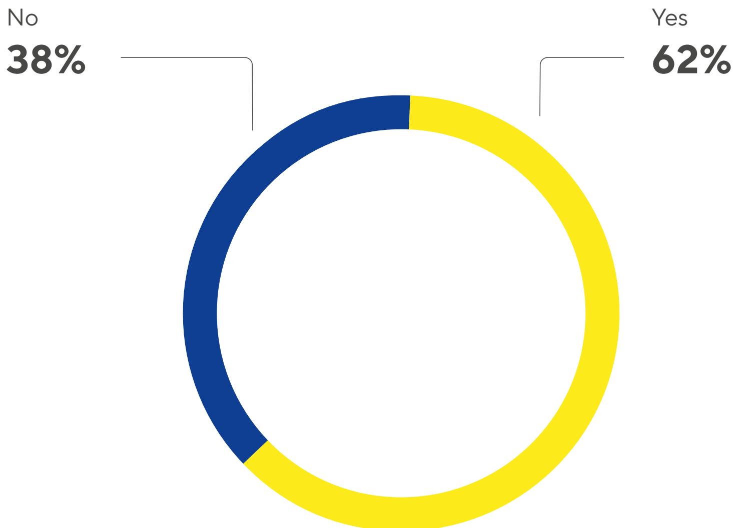
Almost two-thirds of the survey's respondents (62%) believe that the Russian market will change after or as a result of COVID-19. In this article, I will outline six trends identified by the survey. Some can be seen as changes in operating practices, triggered by the exceptional situation, but now seemingly permanent; others are linked to the economic impact of the pandemic. COVID-19 also highlighted certain sub-surface pressures for change, which existed independent of the pandemic, but made demand for change more prominent.

Digitalization and remote access

One direct and irreversible change is the rapid digitalization of sales and marketing. The most recognizable change concerns consumer trade, which has seen sizable growth in online commerce. In Russia, domestic online trade grew by up to 58%, but cross-border trade has also risen sharply. Digital channels, remote connections, and virtual events also quickly became part of B2B trade.

In spring 2020, the companies' abilities to react varied greatly, with rapid changes in operating procedures required for effective response to the situation. In Russia, the development of digitalization is strongly backed by the state. There is no return to the previous situation, and the wider use of remote connections and hybrid or virtual events will remain an integral part of the

Will the Russian market change after or as the result of COVID-19?



business world's operating methods. Many companies cut their travel budgets and will now require more arguments for business trips. For example, some airlines anticipate that business travel will fall by 10-30% in the future — a development that will have knock-on effects on several sectors.

Change in consumer behavior

The economic crisis caused by COVID-19 also significantly affected consumers in Russia. Uncertainty about work and regular income, alongside health concerns, caused consumers to become cautious, reduce consumption, and save part of their income for a rainy day.

Although in Q2/2021 real income increased by 7.7% and real disposable income by 6.8% (year on year), consumer confidence and purchasing power have not yet returned to the pre-pandemic level. Increasing numbers of consumers have to base their purchase decisions on prices.

Market redistribution and demand peak

The exceptional situation has removed some of the Russian and foreign competitors from the market and had differing effects on the competition setting in each sector. The world market is turbulent and, at least for the moment, overheated, and this is also the case in Russia. Following the pandemic, global demand is growing strongly, causing high price pressure on raw materials. Russian exporting companies, for example, in the forestry and mining sectors, have the resources to invest in new developments and modernize existing production processes right now, if they wish so.

Reliability and security of supply are important competitive factors in the post-corona market, as many companies have experienced supply chain disruptions. This is an absolute competitive advantage for European companies on the Russian market following the pandemic. Right now, many of our member companies have improvement of competitiveness and active mapping of potential customers high on their agendas.

The Russian economy has recovered rapidly from the damage caused by the pandemic, and GDP growth in 2021 is expected to reach about 4%. A more important question is how development will look afterward. It seems that, in the long term, Russia has the preconditions for stable but clearly slower growth. One of the reasons is unfavorable demographic development and its consequence of labor shortage — currently exacerbated by the lack of foreign labor. This applies particularly to the construction sector but also to the service sector and retail trade. Labor shortages slow economic growth and increase wage costs.

Improving the business environment, in particular through reinforcing legal certainty and free competition, would accelerate private investment, increase productivity, and enable faster growth.

Russia's closure and protectionism as threats

When the post-pandemic rapid growth is over, the old challenges of the Russian economy will re-emerge. One of the challenges is the lack of competition in some sectors, which is partly maintained artificially by the import substitution policy and protectionist measures. This is not a desirable development from the perspective of Russia's long-term economic growth and diversification needs. Currently, as shown by our experience, foreign companies working in Russia are increasingly facing localization requirements. The localization of production or the partial transfer of production processes to Russia can be a well-founded solution. However, localization is most successful when it takes place on market terms, not due to requirements. Turning inward is not unique to Russia — in fact, all rules-based free global trade is currently affected by the same phenomenon, with the number of trade barriers increasing worldwide in recent years.

There is a risk that geopolitical tensions, exacerbating mistrust and disturbances in supply chains caused by the pandemic, will become further drivers of Russia's process of turning inwards. This would be detrimental not only to foreign companies operating in the country but also to the Russian economy.

Geopolitics in focus

The global pandemic did not sweep political and geopolitical tensions away. From a business perspective, politics and the economy are increasingly intertwined, requiring the attention of business leaders. Increasingly complex and multi-level sanctions make it more difficult for companies to operate and necessitate additional work. The threshold for the use of economic sanctions as a policy instrument has been lowered. The Russian rouble exchange rate is sensitive to international political developments, be they events in Belarus or elections in the USA. Predicting the exchange rate requires an increasingly broad understanding of geopolitics and trade policy.

According to our spring 2021 Russian trade barometer survey, companies take geopolitics into account and must keep it in focus when operating on the Russian market. It is good practice to recognize and identify political risk, helping the company to limit risks to a tolerable level.

ESG, especially the environment, as a rising trend

Environmental issues, especially climate change, have quickly reached a high level of political debate in Russia. A good example of this discussion is a session of the September 2021 Eastern Economic Forum entitled "Will Russia be ready for ESG transformation?" that highlighted, for example, energy efficiency, increased use of alternative energy, and wider use of cutting-edge technology. Anatoly Chubais, Special Envoy of the President of the Russian Federation to international organizations for the achievement of the Sustainable Development Goals, expressed his own strong view, referring to serious economists, and stated that the paradigm of brown growth has proven untenable. According to Chubais, brown growth can no longer exist and has no future — Russia must participate in the energy transfer and introduce environmentally friendly technologies in order to occupy a noticeable place in the world and ensure decent living standards for its citizens.

Similarly, environmental responsibility and ESG have quickly become part of the activities of many Russian companies. Companies must respond to consumer and financier demand for responsible operations. The European Union's "Fit for 55" legislative package and carbon tariffs will also sharpen the need for Russian export companies to invest in clean technologies.

Although Russia has officially shown reluctance towards adopting the "Fit for 55" package, I also see elements here favoring a new, more constructive EU-Russia dialogue, technological partnerships, and the export of knowledge. The first steps of green growth are now being taken in Russia.

Strategies and prospects for European companies in Russia

ALEXEY DOROFEEV

GENERAL DIRECTOR (CEO), GFK RUS

Alexey has vast experience in effective commercial policies and strategy development, as well as account management in the main markets where GfK operates in Russia: FMCG, Durables, Retail, and Services.

Alexey joined GfK from Safilo, European integrated eyeware manufacturer, where in the position of Managing Director he was responsible for the company business in Russia & CIS.

Prior to Safilo he worked as Vice President at Samsung Electronics where he was leading Mobile & Note PC business.

Also Alexey worked at Wimm Bill Dann, Kraft Foods, Procter & Gamble, Depsona.

The study "Strategies and Prospects of European Companies in Russia" was conducted by the AEB in association with the GFK Rus International Institute for Market and Social Research for the fourteenth time since 2011. This study is a valuable source of first-hand information that provides an overview of the attractiveness of Russia's investment climate and focuses on the main challenges and strategies of European companies doing business in Russia. In addition, the rolling nature of the study allows for the comparative analysis of data over the years.

The most recent survey was conducted in April-May 2021 with the participation of 105 companies.

Company profiles

Representatives of companies from various countries took part in the study, including Russia (25%), Germany (19%), France (8%), the Netherlands (5%), Italy (4%), USA (4%), Sweden (3%), UK (3%), and Finland (2%). It is worth noting that many Russian AEB member companies have a share of European capital and/or were founded by citizens of European states.

11% of the participating companies indicated professional services as their main area of activity, 11% indicated FMCG and retail, 10% indicated chemical/pharmaceuticals and financial services (each area), 9% indicated automotive, 8% indicated energy and natural resources, and 6% each indicated engineering/construction and transportation/logistics.

43% of companies reported having 100 or fewer employees located in Russia, while 7% of survey participants were companies with more than 5 thousand employees.

Nearly half of the companies surveyed (46%) said their turnover in 2020 was up from the previous year, which is down from 2019 (61% of companies reported growth in 2019). At the same time, 31% of companies noted a decrease in turnover compared to last year, which is almost twice more than in 2019 (18%).

Entering the market

As in previous years of the study, the main reasons to enter the Russian market were high potential, the positive dynamics of development, and a large market volume (noted by 95%, 93%, and 91% of companies, respectively). These same factors are most relevant reasons for the companies' current presence in the Russian market and the importance of these factors for companies has increased over the past year.

The future prospects of companies and the business environment

Russian macroeconomic indicators point to the deterioration of the economic situation over the past year. However, business leaders are optimistic. There is a significant increase in expectations for the development of the Russian economy in the short term, i.e. over 1-2 years (64% of companies expect growth vs 27% last year) and medium-term expectations are rising (73% expect the economy to grow over the next 3-5 years, up from 66% in 2020). Long-term (6-10 years) economic prospects are estimated highly by the majority of companies at a similar rate to the previous year (79% according to the 2021 survey).

Given the better-than-expected start to 2021, estimates of business development in the short term and readiness to invest are on the rise.

- For example, 42% of survey participants said that their company's business grew better than expected during the first 3 months of 2021. Most expect growth in turnover and profits over the next 3 years: 75% expect growth in turnover and 62% in profits, versus 68% and 51%, respectively, in 2020.
- Just under half (45%) plan to increase their investments this year, a significant increase from a year ago (27% planned to increase investments in 2020). At the same time, European companies do not expect a similar increase in investment in their industry and in Russia as a whole (21% and 25% respectively, which is the same as last year).

Despite optimistic assessments of the prospects of economic development, the current situation in Russia continues to be difficult. AEB member companies have listed the factors that most negatively impact business in Russia, and their impact, according to business estimates, has even grown over the past year.

- 85% of companies said that the volatility of the rouble had a negative impact on their business.
- 75% noted the negative impact of sanctions on Russia.
- 65% say that US policy toward Russia has a negative impact on their company's business.
- 55% mention the Russian sanctions against the EU and the US as a negative factor.
- 52% mentioned relations between Russia and Ukraine.
- 43% said their business declined as a result of the coronavirus epidemic, but the impact of the epidemic on business was down from last year.

The factors mentioned above have not only negatively impacted their business, but also the economy of the Russian Federation as a whole, according to the study participants.

Note that the price of oil as a negative factor has become less relevant.

The financial environment

In terms of funding, the agenda has been largely shaped by the coronavirus. The coronavirus epidemic continues to be the main problem for funding (imposed restrictions are 20%, the economic impact of COVID-19 is 42%). This is followed by high interest rates (18%) and restrictions on lending by banks (14%).

Slightly over half of the companies (55%) applied to the courts to recover debts, and most of these cases were successful. At the same time, 27% of the companies said that they had never had bad debts.

The perception of the business environment

The main changes in the perception of the business environment were associated with an improved culture of interaction with customers and deteriorating assessments on working with legislative bodies.

AEB members assessed interaction with customers positively (with an increase in positive evaluations over the last year), with partners and contractors as neutral-positive, and with tax, customs and legislative bodies as neutral-negative, with an increase in negative evaluations in relation to legislative authorities.

Companies cited the main obstacle to their activities in Russia as regulatory restrictions, and the negative impact of this factor continues to grow (84% cited it as the most significant obstacle to activities in Russia vs 68% in 2020). Other obstacles included epidemiological limitations (36%), lack of qualified staff (29%), and lack of supply chain reliability (20%).

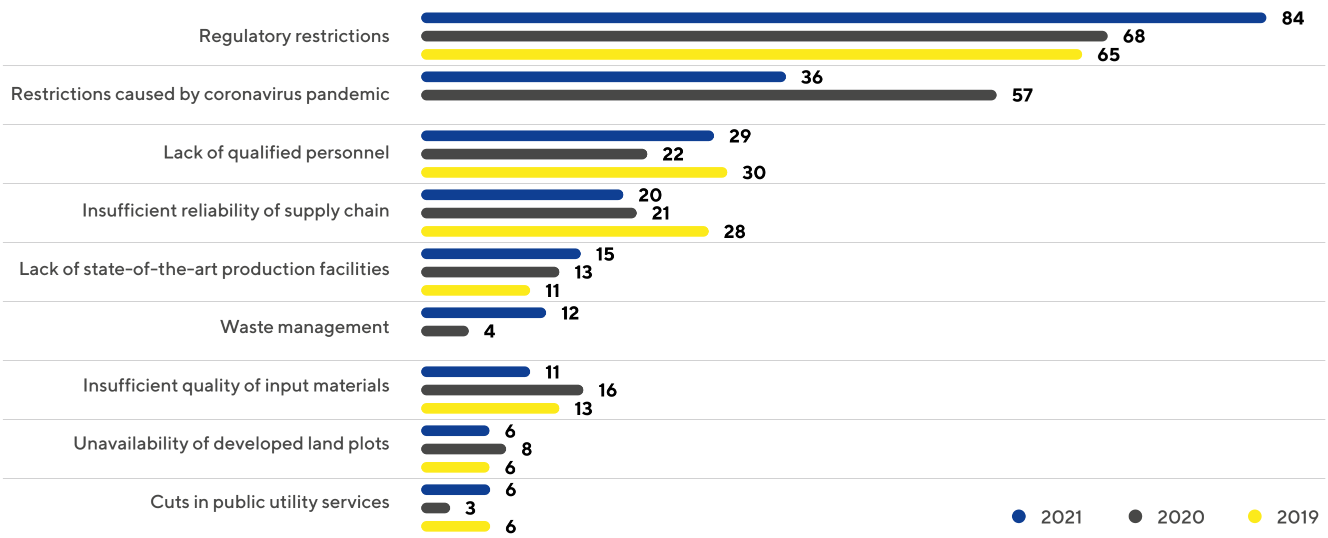
Businesses have increasingly low expectations for improvement in the next business blocks in the following areas:

- legal restrictions on activities (47% do not expect any improvement in this area over the next 2 years vs 39% in 2020);
- taxes and fees (58% do not expect any improvement in this area over the next 2 years vs 42% in 2020);
- higher labor costs (37% do not expect any improvement in this area over the next 2 years vs 24% in 2020).

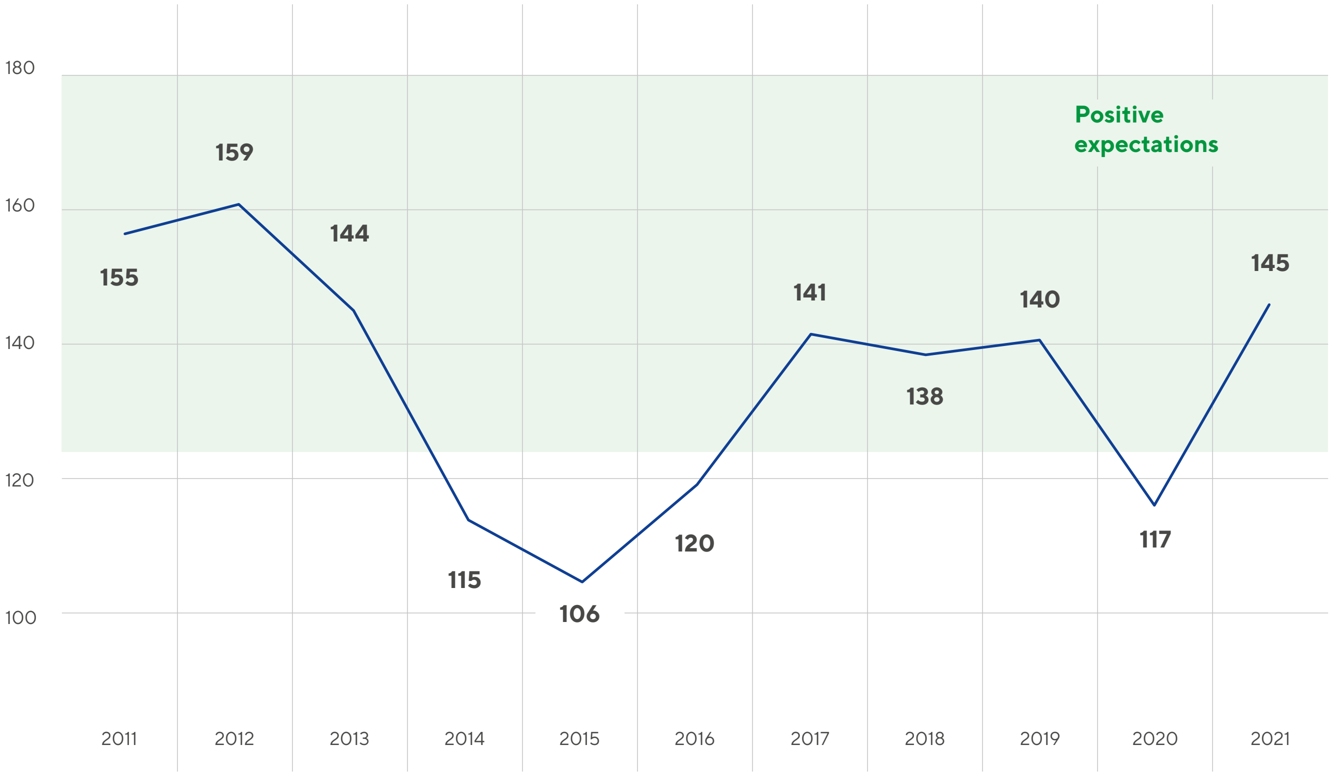
The impact of the coronavirus epidemic on business

During the coronavirus pandemic, almost half of the companies surveyed (43%) saw their business decline. However, one in five of them (20%) has already been able to recover and fully return to pre-crisis levels. Half (47%) of the companies that have not yet managed to fully recover predict their return to the previous level by mid-2022; the rest will need more time.

The most significant barriers to business in Russia (2019-2021), %



AEB-GfK barometer: Business expectations in Russia, index dynamics

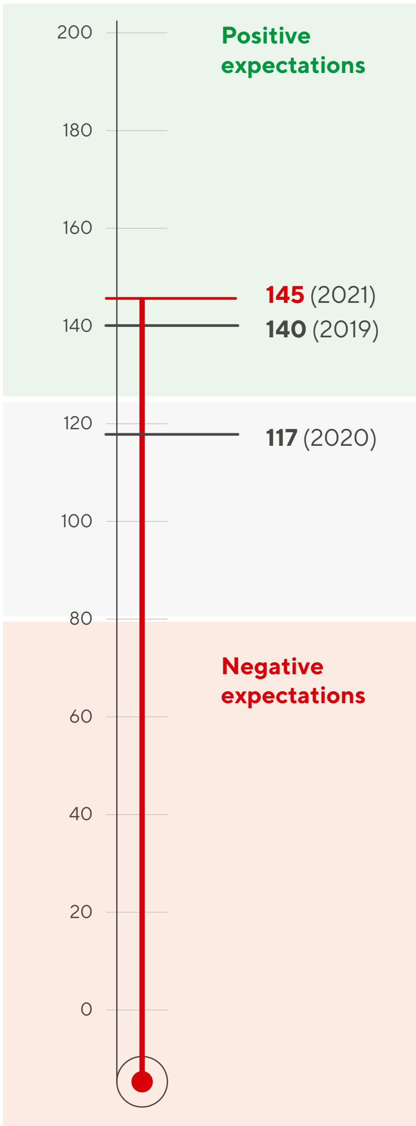


Integrated index

Current business state index	SINGLE INDEXES
118 (2020 - 78)	Current business situation (I=115) ▼
	Current macroeconomic situation (I=116) ▲
	Business development index (I=124) ▲

Business expectations index	SINGLE INDEXES
158 (2020 - 136)	Business expectations(I=131) ▲
	Short-term expectations index (I=153) ▲
	Medium-term expectations index (I=169) ▲
	Long-term expectations index (I=173) ▲
	Expected revenues index (I=168) ▲
	Expected profits index (I=152) ▲

AEB-GfK index, 2021



8% of the companies surveyed used systemic measures of state support and 9% used anti-crisis measures of state support.

Currently, sustainability issues are already a priority for 59% of companies and are among the top 3 key areas of activity. The pandemic has contributed to a growing interest in the subject of sustainability. As a result, over a quarter of companies (28%) have introduced or are developing a sustainability program. Overall, 64% of companies have developed and already adopted a sustainability strategy, 21% are in the process of developing a strategy, and 5% plan to develop one in the near future.

The majority of business representatives (72%) believe that the implementation of initiatives in this area helps improve a company's financial and economic indicators.

The AEB-GfK Composite Index increased by 28 points over last year, currently standing at 145 points out of a possible 200. The growth of the index was largely due to the assessment of business development during the first 3 months of 2021 and short- and medium-term expectations for the future development of business and the economy of the country. The index is in the positive expectation area at the 2019, 2017 and 2013 levels.

Multi-storey timber housing in Russia

ALEXANDER SHANGIN

FOUNDER & CEO OF TAIGATECS.COM

Alexander is the Founder & CEO of taigatecs.com (a leading innovative timber engineering and construction company in Russia & CIS, member of the eastconsult® group).

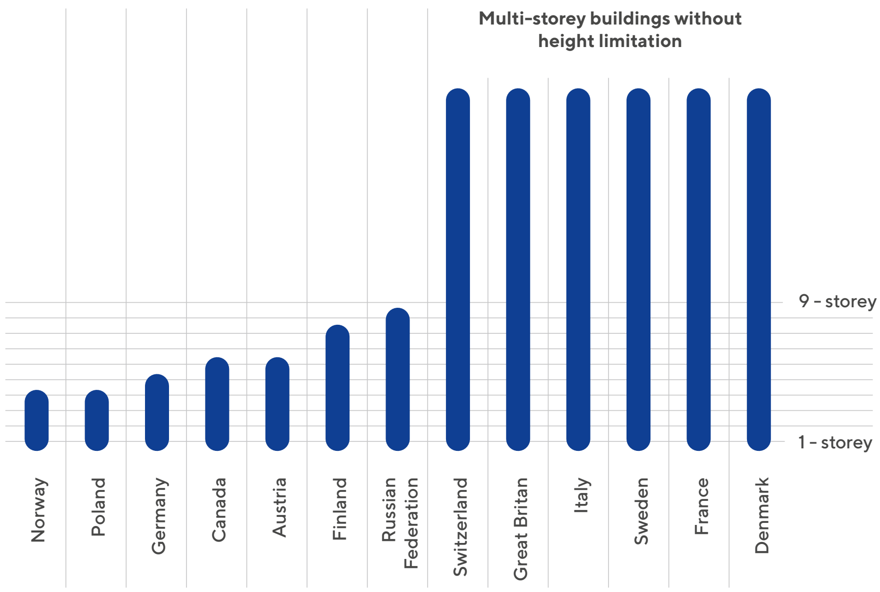
He graduated from Moscow State University of Civil Engineering (Diploma with Honors). He is also a MEng graduate of the Institution of Civil Engineering (London, UK).

Alexander has a 15+ years experience in large CAPEX projects management and a 7+ years experience in the top management of timber industry leaders, holding CTO, CBDO and Global Strategy Management positions.

In April 2020, the Russian government introduced brand-new regulations (SP 451 and SP 452) permitting construction of mass timber residential and public buildings up to 28 m high.

This was a significant jump from the previously permitted buildings of maximum 3 storeys to 8 or 9. Consequently, Russia has formally joined the ranking of countries with regulations allowing the tallest timber dwellings.

Adjusted maximum number of floors in mass timber buildings formally permitted by the Construction Code of various countries

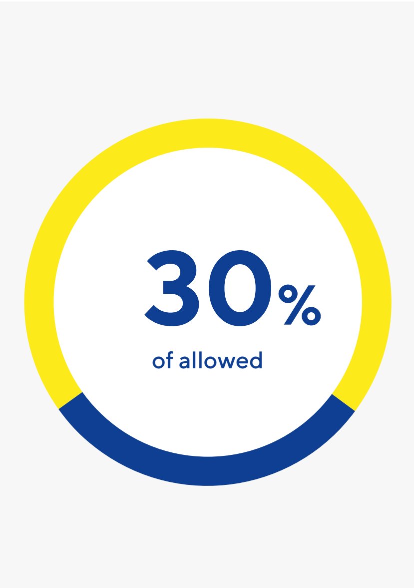


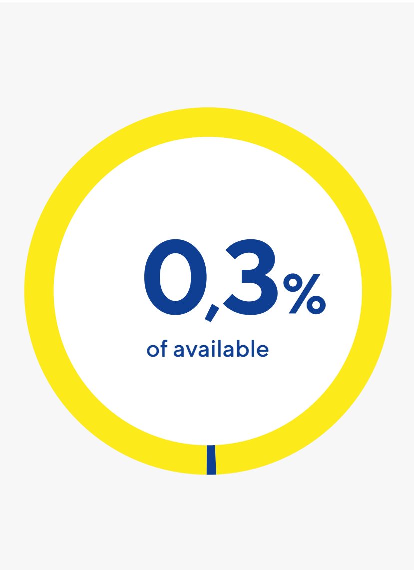
Source: taigatecs.com

Moreover, since April 2020, several new Federal Standards (GOSTs) and other rules on various timber structures have been issued or revised, with more regulatory developments expected to be disclosed later this year. Thus, the term "CLT" (Cross-Laminated Timber) and its Russian interpretation, abbreviated as "DPK" (Drevesina Perekryostno Kleyonaya), has appeared in the local legal and technical vocabulary.

On the one hand, the change demonstrated the Russian law-making is effectively developing at a relatively high pace, as well as its ability to focus on one "of many construction techniques" in a wide spectrum. But on the other hand, we can see that the country still has the greatest surface area of forested land on the planet — and is still harvesting only about 30% of the AAC (Annual Allowable Cut), or just 0.3% of the total resource physically available here.

Share of round timber volumes annually harvested in Russia





Source: taigatecs.com

As such, in a meeting held on September 30, 2020, devoted to the development of and elimination of criminality in the forestry sector, President Putin gave several clear orders. Among these were:

- prohibition of export of round and raw wood as of January 1, 2022;
- elimination of legal barriers to the development of prefabricated timber-based housing.

Hence, the government is committed to giving proper attention to the forestry sector for the coming years, alongside welcoming any related investments.

At present, only 3 industrial producers of CLT panels operate in Russia, all of them are private Russian companies of varying scale, which only recently started up their plants. Many more companies manufacture a range of glulam products, but the majority of these focus on the typical single-family houses and low-rise buildings. Finally, there are 2 LVL producers.

According to the Ministry of Construction, as of August 1, 2021, the total commissioned floor area of residential buildings amounted to 43.9 mln sq. m. (472.5 mln sq. ft) — 30.9% more than the previous year (YTD) — with multi-storey apartment blocks accounting for 19.57 mln sq. m. (210.65 mln sq. ft), a 21.6% increase, and houses for 24.37 mln sq. m. (262.3 mln sq. ft), a 39.5% increase.

Of these volumes, timber-based construction currently makes up only about 20%. While timber construction's share is growing rather rapidly, with a 28% increase recorded in 2020 vs 2019, the vast majority of this is low-rise single-family buildings.

Despite the fact that about 68% of the population are willing to live outside of cities — especially given the remote working opportunities triggered by the COVID-19 pandemic — 64% of families still live in apartment blocks, according to a survey conducted by state housing policy institution DOM.RF and the Russian Public Opinion Research Centre (VTsIOM). The survey also states that no more than 30% of the population can actually afford private houses.

Indeed, the population still tends to move to and concentrate around Russia's large regional and federal centers, driving growth not only in city size but also in average height. The average number of floors of Russian apartment blocks is already 17 or 18 — compared to around 13 storeys pre-2010.

In general, the Russian construction industry and new housing are well supported, due to their importance to many other industries, and have never faced significant restrictions.

In general, the Russian construction industry and new housing are well supported, due to their importance to many other industries, and have never faced significant restrictions.

This situation opens a number of opportunities for business growth — particularly in the areas of timber production and manufacturing, dwelling prefabrication, and timber construction. However, finding the right partner and knowing how to deal with common obstacles is still key to success.

The current market reality is such that a cubic meter of engineered timber in the final bearing structure is significantly more expensive than an equivalent made of reinforced concrete. Depending on the type of building, this can make the fully finished apartment some 5-15% more expensive. And the fact that timber construction has the potential to be carbon neutral is not — as yet — supported by any subsidies or other material benefits for stakeholders.

The majority of Russians continue to hold the following perceptions about timber construction:

» Forests are not renewed properly.
» Timber buildings create serious fire risks — likely remembering school history lessons on the fire which destroyed most of Moscow during Napoleon's 1812 invasion.

In fact, the modern situation is the complete opposite. The majority of the Russian forestry industry consists of large companies exporting up to 90% of products worldwide. As such, in many cases, the market itself requires selling 100% FSC-certified products. Federal law also mandates transparent tracing of deals through logs in the LesEGAIS digital system. Fulfillment of all these requirements is monitored by a range of authorities, from the Federal Tax Service to Customs. Attempts to breach the rules appear to no longer make sense, as the risks are too high.

As for fire hazards, very few people realize that massive timber burns very slowly and predictably, at a rate of approximately 0.7 mm (0.028 inches) per minute. The surface layer of charcoal presents a barrier to oxygen, preventing the fire from spreading to the structure's core and allowing the building to maintain bearing capacity for hours. And during this time, surrounding rooms may not even heat up. Moreover, buildings of 4 storeys and higher must be equipped with an automatic fire extinguishing system.

Also, despite Russia's significant steps towards state-of-the-art timber construction, fire safety regulations still define any type of wood as combustible material (classed K3) and require all structures of any large building to be classified K1 or even K0. This means that the surface of any load-bearing timber structure is to be covered with completely non-combustible and often non-transparent materials — even if the timber is massive and capable of carrying the load for hours in a fire. Moreover, the use of wood in external walls and facades of large or high-rise buildings is formally prohibited.

It is possible to obtain so-called "Special Technical Conditions" status, allowing a specific building to deviate from the regulations with the application of compensatory measures. But this method requires at least several hundred thousand roubles (several thousand dollars) for paperwork and permits, and then provides a derogation valid only for that particular building.

Finally, it is particularly worth mentioning that there are very few Russian timber engineers, and so far, even fewer companies on the market that focus solely on the development of timber engineering knowledge and adoption of international best practices. One of these is taigatecs.com. The companies realizing the first significant timber projects in Russia will draw all the attention of professional circles, government bodies, and the public.

Protection of business reputation, litigations with mass media

EKATERINA KABANOVA

HEAD OF THE CORPORATE DEPARTMENT, BRAND & PARTNER LLC

Ekaterina heads the corporate law practice at Brand & Partner.

She has more than 12 years of experience advising on all aspects of corporate restructuring, joint ventures and mergers & acquisitions, including due diligence and recommendations on legal restructuring; negotiating and mediating with partners.

She also advises multinational corporate clients on Russian employment, competition and civil law matters.

Ekaterina graduated from Peoples' Friendship University of Russia in 2008 and is fluent in German, French and English.

Recently, various publications in the press and social media have resulted in reputational damage lawsuits.

Business reputation or goodwill is a company asset, albeit intangible. Counterparties and clients look to it in order to evaluate company's market reliability and whether it can be trusted. In essence, business reputation is used to describe the ideas and beliefs the public at large has regarding the reliability, decency and professional expertise of a person or a company.

Defamation disputes with the media in cases of protection of reputation are mainly resolved in the framework of article 152 of the Civil Code of the Russian Federation.

Russian antitrust legislation applies to reputation disputes as unfair competition cases only when the parties are competitors.

Currently a lot of noteworthy defamation cases regarding business reputation are being brought before the court, although the majority of claims are still dismissed.

In the summer of 2021 PAO NK Rosneft managed to protect its business reputation on multiple occasions.

In the case against OOO Sobesednik Media (Decision of the Arbitration Court of Moscow in case No. A40-77595/21-51-538, dated 28.09.2021), it succeeded in having the materials of an Internet article found to be untrue and defamatory. The defendant undertook to publish a refutation. The plaintiff in this case sought damages but without success.

In the case against Energy News Today Inc. (USA) who disseminated a misleading article in the Internet, the defendant was ordered to remove the disputed article and publish a rebuttal (Decision of the Arbitration Court of Moscow in case No. A40-123012/2021-134-715, dated 03.08.2021).

Dmitry Rogozin, the head of Roscosmos, also managed to protect his reputation in a dispute with three media outlets as co-defendants (Decision No. 2-3703/20 of the Ostankinsky District Court of Moscow, dated 16.12.2020). The appeal proceedings are currently pending.

Data on defamation cases

>>	Arbitration courts		General jurisdiction courts			
			Disputes between individuals and companies		Litigations with mass media	
	Cases heard	Satisfied in favor of the plaintiff	Cases heard	Satisfied in favor of the plaintiff	Cases heard	Satisfied in favor of the plaintiff
2019	835	263	3140	1195	623	294
2020	940	354	2501	977	365	147

What are the specifics of court proceedings in such cases?

Parties

The parties to a dispute may be individuals or companies. Even if the names of the plaintiffs are not expressly mentioned in the disputed materials, yet they can be identified unambiguously, for example, by the relevant trademark, the court may hold that the business reputation has been harmed.

Reputational damage may also be caused by disparaging the professional reputation of plaintiff's senior manager, which may result in a loss of profits, especially in a highly competitive environment.

Defendants in such disputes are the authors of the disputable materials, as well as the disseminators (the editorial board or founder of the media, the owner of the Internet site, etc.).

The website administrator is typically not liable for the published information provided they are not the person to initiate the publication, chose the recipient of the information or affect its integrity. However since they are in a position to remove information held to be untrue, they may be ordered to do so by the court.

During the proceedings the plaintiff is advised to prove its business reputation, for instance, by providing the court with the fulfilled contracts and recommendation letters from the counterparties. Not all courts presume the plaintiff's good business reputation. A company's inclusion in significant business ratings may also help in proving its goodwill.

When there is no question regarding company's goodwill, its negative impact — defamatory nature — must be proven.

For the court to satisfy the defamation claim the publication must be:

- defamatory in nature (the plaintiff bears the burden of proof);
- false or misleading (the defendant bears the burden of proof);
- disseminated (the plaintiff bears the burden of proof).

An expert (typically, a linguist or a psychologist) is appointed by the court to assess the information based on defamation criteria. An expert must determine what the author meant given the circumstances, which entity the information in question refers to and whether it is speculative or assertive.

Sometimes the court constates the fact of assertive nature of the information without the linguist expertise (like in case of the Arbitration Court of Moscow in case No. A40-165062/20-15-1199, dated 19.04.2021 by claim of the Producers & Suppliers Association of Alimentary goods vs Multimedia Information Center Izvestiya).

Jurisdiction and limitations of action period

Arbitration Court — the parties to the dispute must be entrepreneurs, and the disputed information must be of an economic nature. Otherwise, the case is heard in the general jurisdiction court.

Limitation period is not applicable to such cases, except when information about an individual has been disseminated in the media.

The refusal of the media outlet can be appealed in court within a year from the date of publication of the defamatory material (Part 3, Article 45 of the Mass Media Law).

Legal basis

The provisions of the Constitution of the Russian Federation guarantee every person's right to judicial protection of one's honor and dignity, which includes post-mortem privacy rights.

Under the Constitution a right to express one's opinion in any form not forbidden by law without prejudice to rights and liberties of others is also granted. Veracity of subjective opinion expressed by the defendant cannot be checked.

This requires that courts, as judicial authorities, maintain a balance between freedom of speech and right to protection of honor, dignity and reputation when hearing defamation cases.

To put that in the context, in group action against Glagol Media and Gazeta Noviye Isvestiya (Decision of the Arbitration Court of Moscow in case No. A40-249595/20-5-1765, dated 17.06.2021) the linguist's assessment managed to prove the capability of the narration style to indicate the presence of facts in reality.

The courts hearing such cases pay attention to so-called "saving words". "Possibly", "might be", "it is not unlikely that…", "it is my belief that…" are the collocations that normally help authors escape liability. The information must be presented as a fact and not as a subjective opinion for a court to recognize plaintiff's claim. Facts, unlike opinions, can be verified and if found to be false, may become a valid cause for filing a defamation claim.

It's noteworthy that in the above-mentioned dispute between Dmitry Rogozin and media the court has ruled that even when the facts are not expressly stated, the wording used hints at the author's awareness of such facts and therefore they may be assessed by the court. Hence, disputed statements could not have been qualified as an expression of journalist's opinion or a result of an analysis, but were presented as hard facts.

Veracity

The defendant may not be held liable if they prove that the information is largely true. The defendant must prove the veracity of disputed information in key statements as determined by the court. The literal meaning of words and phrases used must be taken into account.

The mere disparaging nature of expressions is not enough to prove the defamatory nature of the information, since expressing a disparaging statement about a person or an event is protected under the freedom of speech clause of the Constitution and may not in and of itself result in a liability.

Dissemination

The wrongful conduct on part of the defendant must manifest in dissemination of misleading information (sharing the information with at least one person) by way of publication, public speech, via Internet or through any other type of media, regarding the plaintiff, which is false and defamatory in nature (aimed at forming a negative public opinion of plaintiff's business qualities). Fact of dissemination may be established by any evidence that meets the requirements of relevance and admissibility (in practice, these are recordings of television programs, paper copies of printed publications, notarized Internet pages, etc.).

Ways to protect business reputation

Special remedies may be used in a defamation case:

- refutation of the defamatory statement;
- publishing of the rebuttal;
- retraction of the publication in question;
- awarding of compensatory damages caused by the defamatory statement.

In the case with defamatory publication by OOO Sobesednik media the court ordered to publish refutation of the statement already removed.

Public apology is not specified as a legal remedy; however, the judicial practice is tentative.

To pursue the lattermost remedy the causal link between the publication and negative economic impact has to be established, for instance, the counterparty refuses to do business with the plaintiff while expressly stating that the published information has raised doubts regarding plaintiff's goodwill.

In assessing the compensation amount the courts determine the scale of the publication's impact. Press run, media outreach (local or national newspaper), citation index, Internet page view count are typically taken into account. The bigger audience means bigger compensation amount.

If the precise amount of compensation cannot be established, it is be determined by the court taking into account all the circumstances of the case based on the principles of justice, proportionality and striving to eliminate the consequences of the violation.

It's worth pointing out that the media outlet may not be held liable for disseminating false and defamatory information if it copied the publication of a different media outlet verbatim (Article 57 of Mass Media Law) and presents a proof that the publisher was not aware of the falsity of the information.

The mass media, however, will still be ordered to publish a refutation of false statement. In the above-mentioned court cases this remedy has been utilized to full extent.

Since goodwill plays an important role in the business environment, the growing number of satisfied claims is a welcome change. Hopefully, this tendency in Russian judicial practice will help prevent unfair business practices without prejudice to the freedom of expression in our country.

Part 5

Regional Development

How the Novosibirsk region is winning the competition for investors

ALEXANDER ZYRYANOV

GENERAL DIRECTOR OF THE INVESTMENT PROMOTION AGENCY OF THE NOVOSIBIRSK REGION

Alexander Zyryanov has headed the Investment Promotion Agency of the Novosibirsk region, which works to attract investors to the region and provide support to them in their activities, since 2017.

Previously, Alexander worked in the Office of the Mayor of Novosibirsk and held executive positions in the Vector State Research Centre of Virology and Biotechnology, one of the largest research centres of its kind in the world, and in a number of business organizations.

He is a member of 20 commissions, councils and task forces, including groups reporting to the Government of the Novosibirsk region.

Alexander Zyryanov serves on the Boards of Directors of the region's key investment sites: the Industrial and Logistics Park of the Novosibirsk region and the Novosibirsk region Biotechnopark.

The Novosibirsk region is a dynamically developing territory in Siberia. Major international companies such as Nestle, PepsiCo, Henkel, Veka, Mars, and others have already chosen this area for their production site.

By the end of 2020, the Novosibirsk region reached a historic high in terms of investment in fixed assets amounting to more than EUR 3 billion. Almost 60% of this is spent on the construction and reconstruction of buildings and structures.

There are several reasons why investors are choosing the Novosibirsk region and investing in the construction of production facilities.

Geography of success

First, the Novosibirsk region and neighboring territories are a large consumer market. Thirteen million people live within a radius of 700 km from Novosibirsk — twice as many as in the Russian Far East that occupies 40% of the territory of Russia.

Second, Novosibirsk is located at the intersection of the largest rail, road and air routes. The developed transport and logistics infrastructure with access to the bordering Asian markets (Kazakhstan, China, Mongolia) contribute to the optimal cargo distribution system. It also allows companies to reduce the delivery time by a factor of 1.5 (compared to other Siberian regions) and to reduce transport costs by 20-30%.

Professional hub

In addition, Novosibirsk is a talent factory for skilled personnel beyond the Urals. Applicants from all over Siberia, as well as from CIS countries and all over the world, come to study at Novosibirsk's universities. After all, this city is home to some of the world's top educational centers, such as Novosibirsk State University, Novosibirsk State Technical University, and other major universities. The Novosibirsk region is home to research institutes of the Siberian Branch of the Russian Academy of Sciences, as well as Koltsovo, the first biotechnological science town in Russia, and the world-famous Vector Research Center of Virology and Biotechnology. Experts from Vector developed one of Russia's COVID-19 vaccines.

At the same time, the labor cost in Novosibirsk is 9% lower than the average for Siberia and 20% lower than the national average. This allows companies to significantly save on payroll expenses.

Ready-made business sites to make the process quick, easy and profitable

Another important factor defining the investment appeal of the territory is the availability of sites ready for project implementation.

One such site is the Industrial and Logistics Park (ILP) of the Novosibirsk region, the largest industrial park beyond the Urals, covering over 1,000 hectares. It is located 6 km from Tolmachevo International Airport. The Trans-Siberian Railway and the Irtysh federal motorway, which leads towards Omsk and the central regions of Russia, pass through the Park's territory.

The Park's key advantages are its advanced engineering and transport infrastructure, as well as prompt approval procedures. It takes on average 6 to 7 months (from the start of cooperation with investors) to get a construction permit and start operations on-site, including an average of 2 to 3 months to lease a land plot.

A transport and logistics center (TLC) is currently under construction in the ILP. A modern container terminal will become the core of the TLC and serve multiple full-length container trains at a time. The terminal will have an annual capacity of 300 thousand containers. A terminal, warehouse and customs infrastructure, which will provide consignees with a full range of logistics services, will also be created as part of the TLC.

Twenty-five Russian and international companies are implementing their projects in the Industrial and Logistics Park. They include a PepsiCo snack factory, Mars pet food factory, Ozon fulfilment center, and the production of refrigeration equipment by the Italian Arneg Group. Total declared investments in the Park's projects amount to almost EUR 1 billion. To date, EUR 520 million has already been invested.

Two territories with a special economic regime have been created in the single-industry towns of Gorny and Linyovo in the Novosibirsk region. Investors are provided with benefits and preferences in accordance with federal legislation: insurance premiums have been reduced 4-fold, and income, property and land taxes have been zeroed. It is worth noting that the land in the advanced social and economic development areas can be leased without bidding and at a token price (about EUR 5 per hectare per year).

The region also has several specialized platforms.

One of them is the Biotechnopark of the Novosibirsk region, which provides convenient conditions for placing pharmaceutical, biotechnological, and medical projects. There are rental premises for small innovative companies, land plots for larger projects, an exhibition and convention area, and a state-of-the-art laboratory complex.

Biotechnopark currently has 13 residents, including Katren, one of the largest Russian distributors of pharmaceuticals, and Angioline, a manufacturer of medical devices for cardiology (coronary stents and catheters), which occupies 70% of the Russian market in this segment.

The first stage of the Park has been fully developed, and work is underway to form the second stage. A land plot has already been allotted, and work is ongoing with potential residents.

Another site is Academpark, one of the most successful science parks in Russia. Its key areas are instrumentation, IT, nanotechnology, and new materials. It has a business incubator, a prototyping center, a resource sharing center, and office premises. More than 300 companies have already become residents of Academpark.

Biotechnopark of the Novosibirsk region

Academpark

One of them is OCSiAl, the world's largest manufacturer of graphene nanotubes. Nanotubes improve the physical and mechanical properties of almost any material: electrochemical power sources, elastomers, paints and coatings, composition materials, plastics, etc. The company's main production and research facilities, as well as the material and technology prototyping center based on graphene nanotubes, are located in Novosibirsk. The second center of this kind was launched in Shanghai in 2019, and a third one opened in Luxembourg in 2020.

OCSiAl accounts for over 95% of the global graphene nanotube market. Founded in 2010, the company is now active in the markets of 40 countries and employs over 400 people.

Champion of business in the Novosibirsk region

The Investment Promotion Agency of the Novosibirsk region plays a key role in working with investors. It was created by the regional government and has been providing comprehensive support for business development to companies for over 15 years.

So, for example, there is a dedicated department in the Agency that deals with the selection of sites for investors in accordance with the requirements for the land plot, premises and infrastructure. Currently, there are more than 580 accredited investment sites for projects of any format in the Agency's register. Experts are ready to select the best options for localising a project, depending on the specific request. Moreover, the Agency ensures interaction with utility providers, which makes it possible to effectively solve engineering and technical issues.

Not only does the Agency provide assistance in selecting a comprehensive set of support tools that the company may use, it also offers support during the preparation and submission of the documentation package. For what it's worth, the Novosibirsk region has a comprehensive regulatory framework to provide tax exemptions and other privileges to investors. In particular, during the implementation of the project, an investor can zero out the property tax and reduce the income tax from 20 to 5% for a period of up to 7 years. It is possible to have a portion of the costs reimbursed for equipment purchases, lease payments and loan interest. Also, a document allowing the investors to compensate up to 100% of costs associated with the creation of infrastructure was adopted at the regional level.

There is a law on investment protection in the territory of the Novosibirsk region. If you conclude an agreement on the protection and promotion of investments with the region, then you can formalise set tax conditions, as well as technical and licensing controls, and other aspects of project implementation.

The Agency is ready to find technology and financial partners, establish cooperation with other companies in the region, improve interaction with authorities, develop a project with the use of public-private partnership mechanisms and identify options for improving labour productivity in a company.

This allows the investor to focus on running their business, making management decisions, spending less time on administrative affairs and, as a result, to significantly reduce the project implementation time.

The Novosibirsk region has whatsoever is required for successful implementation of a variety of investment projects. This can be confirmed by the experience of large foreign companies that have already chosen our region. We will be glad to welcome your business in the Novosibirsk region and provide you with the warmest investment climate, even when Siberian frosts strike.

Yakutia — the leading economy in the leading Russian microregion

ALEXANDER KONDRASHIN

GENERAL DIRECTOR, "AGENCY FOR INVESTMENT PROMOTION AND EXPORT SUPPORT OF THE REPUBLIC OF SAKHA (YAKUTIA)"

Since July 2018, Alexander has been General Director of the state budgetary institution "Agency for Investment Promotion and Export Support of the Republic of Sakha (Yakutia)".

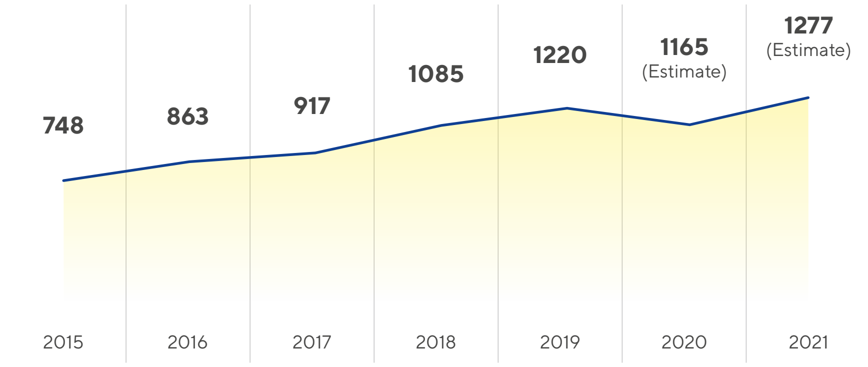
In 2017-2018 he used to be a manager of ANO "Agency of the Far East for Investment Promotion and Export Support" (representative in China, Middle East Department).

Prior to that, he was a corporate management analyst at the Association of Independent Directors.

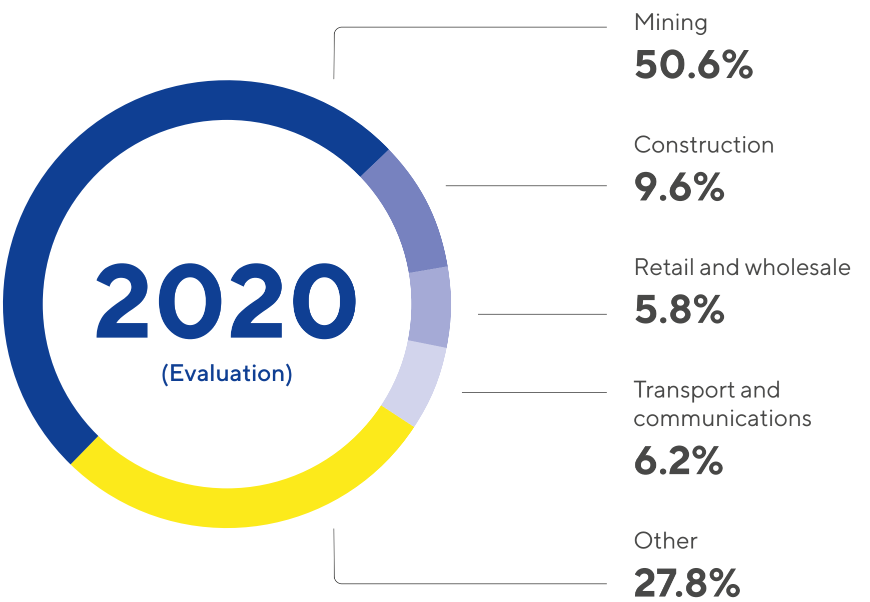
Alexander graduated from Moscow State University majoring in state and municipal governance. In 2021 he finished language internship at China People's University (by the government of China grant program).

The Republic of Sakha (Yakutia) is the largest constituent entity of the Russian Federation in terms of area, occupying almost a fifth of the entire country, with more than two-fifths of its territory beyond the Arctic Circle. It is located in the north-east of Russia and is the largest administrative-territorial unit in the world in terms of area. It is of world importance due to the potential of its mineral resources, transcontinental routes of communication, the richness of the cultures and traditions of its indigenous peoples, and the uniqueness of its nature and environment.

Gross regional product, RUB bn



Gross regional product structure, 2020 (evaluation)



To create a comfortable business environment, for both Russian and foreign companies, advanced development areas are created in Yakutia, within which investors can take advantage of a number of preferences, benefits and tax breaks.

The difference in air temperature throughout the year in Yakutia exceeds 100 degrees Celsius. There is nowhere else in the world with so many people living at such low temperatures in winter, and modern cities are being built to last in permafrost conditions.

Yakutia is one of the top ten regions in Russia in terms of gross regional product per capita. The Republic's economic growth rates are consistently higher than the national average, providing it with leading positions in Russia. We rank seventh in Russia for growth of our gross regional product. The region has skyrocketed from fifty-second place in the Russian national investment climate ranking to tenth.

The Republic is systematically reducing administrative barriers for business. Since 2018, we have been able to significantly reduce the time and number of procedures for obtaining permits. Over three years, we have reduced the average power grid connection time by 29 days, the average time for registering a land plot for cadastral registration by 10 days, and the number of procedures required to obtain a building permit has decreased.

The economy has had an impressive impact on demographics – the region's population increased by more than six thousand in 2020 alone. Urban growth has put new pressure on the social infrastructure, far outstripping the financial resources within the planned social investment programs. To tackle this challenge, the regional government embarked on massive public-private partnership (PPP) programs and is now in second place in Russia by level of PPP development.

A major factor behind these spectacular results is the trust that Yakutia's government has built with its partners – investors, financial institutions, the federal government and its unique territorial ministry, the Ministry for the Development of the Russian Far East (MDRFE), experts that help us structure new projects and drive development of new industries, and business associations which send more and more business our way.

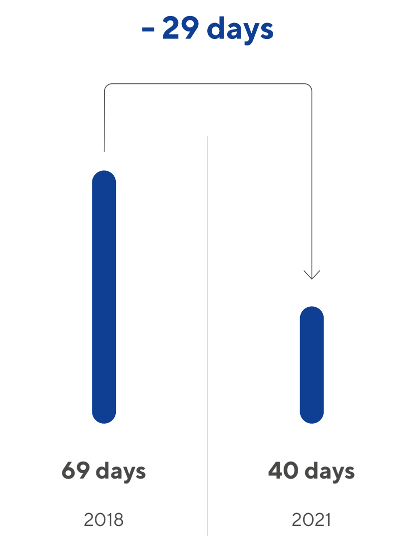
Yakutia is always looking to provide the best possible conditions for investors: our primary preferential mechanism being Advanced Special Economic Zones (ASEZ) administered by the MDRFE. In order to create a comfortable business environment, for both Russian and foreign investors and companies, advanced development areas have been created on the territory of Yakutia, within which investors can take advantage of a number of preferences, benefits, and tax breaks. ASEZ "Yakutia" specializes in the placement of advanced non-resource industries, the development of small and medium-sized businesses. The South Yakutia ASEZ is a tool for the formation of a large industrial center for the deep processing of natural resources in the Far East. Taken together, these vehicles are on track to create over ten thousand jobs and RUB 124 billion of investment.

Mining constitutes more than half of Yakutia's economy, and foreign investors are involved in some of our major projects. For instance, British Petroleum is a party to a joint venture with Rosneft at the Taas-Yryakh oil field exploration project, while the Canadian company Silver Bear Resources mines silver at the Prognoz deposits.

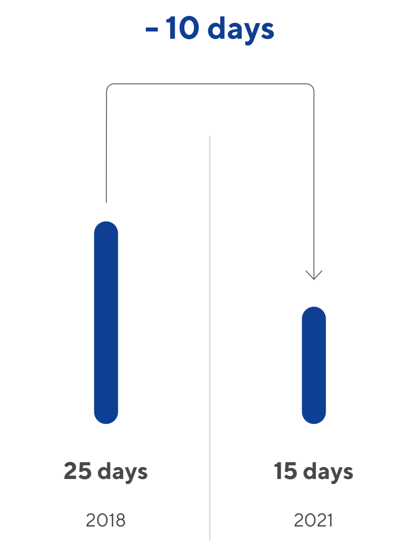
Yakutia is traditionally one of the three leading Russian gold mining regions. Gold production in 2020 grew 8.2% due to Seligdar Gold JSC, Neryungri-Metallic LLC, Polyus Aldan JSC, and ADK LLC. Oil production growth in 2020 reached 112.5% (15,961.8 thousand tons) due to Taas-Yuryakh Neftegazodobycha LLC in the Mirninsky District, Surgutneftegas PJSC at the Talakanskoye field due to the full capacity of the Eastern Siberia Pacific Ocean oil pipeline. Combustible natural gas production increased 2.3 fold by 2019 (6,778.6 million cubic meters) following commissioning of the Chayandinskoye oil and gas condensate field and the Power of Siberia gas pipeline. Silver production decreased 35.3% by 2019, diamond production 4.2 fold, and jewelry production 7.7 fold as a result of a fall in demand for products.

Last year, the Republic's volume of foreign trade turnover amounted to USD 3.4 billion. At the end of 2020, Yakutia ranks 22nd in terms of the export volume of regions to Russia.

Reducing the average time for connecting the electricity power



Reducing the average time for registering a land plot for cadastral registration



Russia's Far East has built a reputation of braving extreme conditions and structuring multilayered federal and regional infrastructure commitments to make projects work thanks to MDRFE support. The new projects currently being structured, such as exploration of the Kyuchyus gold field in Yakutia and Baimskoe copper ore field in Chukotka, seem to come straight out of the pages of a science fiction novel. They include great inventiveness, advanced technology (both projects rely on nuclear energy), and sophisticated federal and regional government commitments, including cutting-edge PPP structuring.

Yakutia has a diversified economy, and one of the fastest growing new industries is tourism. Our region is an attractive location for tourism, primarily ecotourism. We receive more than 200 thousand tourists every year. This number has been growing steadily over 10 years, and we believe we can at least triple it. We put great emphasis on the recently launched year-round ecotourism routes to the Lena Pillars Nature Park, a UNESCO heritage site, one of our strongest tourism attractions.

Our investors have assessed the need for a new four-star hotel with 180 rooms, which Cosmos group will soon build in the center of Yakutsk. A four-star hotel with 120 rooms is also planned for construction by Green Flow very close to the Lena Pillars Nature Park to provide our guests with an unforgettable experience of staying close to one of the most recognizable landmarks in the world.

The concept behind our Lena tourism cluster is to provide tourists with a comfortable and inspirational stay, for which the new investment projects fit perfectly. The Green Flow brand is part of the Healing Hotels of the World association that emphasizes the idea of traveling in peace with nature.

Aaryma Tours has recently opened a cozy small guesthouse very close to the Lena Pillars Nature Park and is welcoming new guests, so if you ever come to Yakutia on business, you can visit its major tourist destination.

Yakutia is one of the largest cultural centers in the north-east of Russia. Yakutia attracts not only nature lovers, but also tourists who enjoy different events. National holidays like "Ysyakh — Yakut New Year" in June and the "Winter Begins in Yakutia" festival in December traditionally attract lots of tourists from all over Russia and the world.

Yakutia also has the engines to power its growth in the future, such as is an IT cluster and a creative economy. The government's commitment to developing these industries in Yakutia is absolute.

We are home to a unicorn company, Sinet, that recently reached billion-dollar valuation and developed the popular ride-hailing app InDriver. Yakutia is a top-10 IT service exporter in Russia, and we have a fully developed mature startup support system, including an IT-park with 119 residents, a Venture fund, and a startup acceleration program. In total, 44 projects have already passed through the acceleration program, which also includes socially significant projects. For example, the program's participants developed products for the rehabilitation of the musculoskeletal system in children with cerebral palsy, search and rescue beacons, and technologies for finding people lost in the forest, as well as hybrid books for children with dyslexia.

Yakutia hosts a major creative economy phenomenon. We are third behind Moscow and Saint-Petersburg for movie production, and we have won national and international prizes for our art. The Yakutia Development Corporation has initiated a Creative Cluster project to provide our creative economy with more resources, which is currently underway.

InvestYakutia is a specialist organization working with investors on a single-window basis that provides the full range of services to support new projects. The Agency has developed an extensive network of contractors and partners and works closely with the Ministry for the Development of the Russian Far East and its structures, VEB.RF, the Agency for Strategic Initiatives, the National PPP Center, various financial organizations, including international ones such as JBIC.

Yakutia is a region that proactively helps investors. Our entire government works towards this goal and the results can be measured by many projects implemented in the Republic.

We are always looking for new partners to collaborate on new projects, to create a new agenda for cooperation with European business in all parts of our economy, and we are planning for an investment promotion event with the AEB in December. We look forward to presenting new investment opportunities for Yakutia and hosting a business mission with members of the Association.

See you in Yakutia!

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