



# Trade safely with Russia

Ten important principles



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# 10 principles that can help make your supply relationship successful

Apart from the extensive sanctions, supplies to Russia do not normally require any more preparation and legal review than supplies to any other country, which is generally good news. The legal basics that should be observed in relation to Russian customers are largely the same as those that apply in your home jurisdiction and in supply relationships with other customers. Having said this, there are certain peculiarities in Russian law as well as practical specifics which a supplier should take into account when planning sales to customers located in Russia. The overview below lists 10 principles which we believe are easy to comply with and can help make your supply relationship a lasting and successful one.

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# 01

## Choose the law you feel comfortable with

In cross-border relationships between Russian and foreign companies, the parties are entitled to choose the law that should govern their supply relationship. Certain mandatory provisions of Russian law may apply to the supply agreement even if it is governed by a foreign law. The vast majority of contractual terms can, however, be agreed without limitation as there are very few mandatory rules applicable to supply arrangements.

It is common for a foreign supplier to make supplies to Russia based on agreements governed by the law of its home jurisdiction. In practice, there are a number of laws that are most frequently used, including in particular, German, English, French and Swiss law. Russian law is also used, although in a cross-border relationship the parties would typically tend to choose a foreign law. Foreign suppliers that have established a Russian entity and carry out their sales to Russian customers through that entity are required to have their local supply relationships governed by Russian law. Agreements governed by the United Nations Convention on Contracts for the International Sale of Goods are rarely used.

As a rule of thumb, it is advisable for the parties to choose a law they both feel comfortable with and that can be easily applied by arbitrators in case of a dispute. In other words, it should be a law with settled court practice and for which both parties would be able to appoint experienced arbitrators.



Key Figures

## Russia

GDP (2014)

billion \$ 1,860

GDP growth rate (2015 est)

-4.1 %

### Industries

Among the world's largest and most technologically advanced producers of mining, coal, oil, gas, chemicals, and metals; machine building; defense industries including radar, missile production, shipbuilding; road and rail transportation equipment; communications equipment; agricultural machinery, construction equipment; electric power generating and transmitting equipment; medical and scientific instruments; consumer durables, textiles

Exports annual (2015 est)

growth rate -5.3 %

Imports annual (2014 est)

growth rate -13.7 %

Source: IHS

# 02

## Get the basics right

In cross-border sales, it is common practice for foreign and Russian partners to enter into written supply agreements regulating all details of their relationship before starting any supplies. Nonetheless, it does happen that supply agreements may not be enforceable against the contracting party due to very basic insufficiencies. For example, it is not unusual in Russia to find more than one legal entity using the same corporate name. It is therefore essential to state the full corporate name, legal form and address in order to clearly identify the parties entering into the agreement. In addition, any supply agreement must contain sufficient information about the specification, quantity and quality of the products, the purchase price and payment provisions as well as the specific terms and time of the supply, e.g. by using INCOTERMS or otherwise.





# 03

## Keep it simple

Over the last two decades, there has been a tendency among certain Russian distributors to structure supplies to Russia through complex import schemes, which often involved the use of offshore entities as re-sellers so that products were delivered to non-Russian warehouses and then imported under a separate transaction between the re-seller and the Russian importer. Such structures allowed distributors to play with the valuation of imported goods and repatriate profits from Russia via offshore entities. This tendency gradually changed in favour of compliant import practices. Nevertheless such indirect supply structures still remain widespread in certain sectors.

While valid reasons may exist for structuring supplies indirectly via non-Russian entities, most of such structures are illegal if they involve the evasion of customs duty or import tax or are aimed at the illegal repatriation of profits from Russia.

Such indirect import structures have therefore recently been under the increasing scrutiny of the Russian authorities. There have been numerous investigations initiated by the Russian customs and prosecution authorities, which often lead to the confiscation of the imported goods, for which the importing entity then refuses to pay. Indirect import structures have also recently given rise to large tax disputes.

Generally speaking, it is therefore advisable to use simple and transparent supply arrangements, namely in the form of direct deliveries from the foreign supplier to the Russian customer and, in turn, direct payment from the Russian partner's account to the account of the supplier. Where supply arrangements involve third parties, offshore entities and indirect deliveries, it should be ensured that there is a valid economic rationale that can be referred to as justification in the event of an investigation.

# Russia

## Most important sectors

2014, % of GDP

Services	60%
Industry	36%
Agriculture	4%

## Main import sources

2014, % of total

China	18.7%
Germany	11.7%
USA	6.0%
Belarus	4.5%

## Main export markets

2014, % of total

The Netherlands	11.8%
China	7.6%
Germany	7.5%
Italy	6.2%

### Main expenses of foreign exchange

43%

Capital  
goods

18%

Food

17%

Chemicals

### Main sources of foreign exchange

67%

Oil/gas

13%

Metals

5%

Machinery



# 04

## Make sure you get paid

As a starting point, there is no reason to be concerned about the risk of non-payment merely due to the fact that supplies are made into Russia. The majority of supply relationships between foreign suppliers and Russian customers have been working successfully for many years and in accordance with the agreed supply arrangements. However, a supplier should seek the same level of protection it requires when selling in its home country or to other parts of the world. Generally, this means that supplies should only be made to a creditworthy entity that has sufficient assets for payment claims to be enforceable. Where this cannot be guaranteed, a supplier should require additional security from a sufficiently solvent affiliated company or from a third party guarantor. In this context, the following types of security are available and can be used in supply transactions.

Whatever type of security the parties eventually agree to, it is, in any event, essential to clearly define the payment obligations in the underlying supply agreement to make sure that the secured obligations are defined in sufficiently specific terms. This is particularly important where the supply agreement takes the form of a framework agreement and deliveries and payments are made on the basis of separate orders. As a general rule, Russian as well as foreign courts tend to apply very strict standards in this regard. The provision of collateral security only makes sense if it is ensured that any right to realise such security is enforceable by court action.

It should be noted that enforcement proceedings in Russia can be lengthy and burdensome. Where the Russian customer belongs to an international group or owns assets outside of Russia, it may often be preferable to obtain security abroad in order to avoid the procedure of getting an arbitral award recognised and enforced in Russia.

Last but not least, the new security instruments referred to here have not yet been tested or applied in court and therefore it is difficult to say how they will operate in practice.

### Surety

The most commonly used security instrument is a surety typically granted by another group member (e.g. the parent company or ultimate owner of the customer). A Russian-law surety, however, is accessory in nature, so the validity of the surety depends on the validity of the underlying supply agreement. As mentioned above, it is not uncommon that supplies are structured through complex offshore schemes and with the participation of third parties. It must then be borne in mind that any risk relating to the underlying supply agreement may also affect the enforceability of the surety. This is therefore a further reason to make sure that the underlying supply relationship is transparent and fully compliant with the law.

### Independent guarantee

Historically a Russian-law guarantee being a non-accessory security instrument which does not depend on the underlying obligation could only be issued by a bank or insurance company, and not by other corporate entities. Therefore, in practice some parties used a guarantee issued under foreign, e.g. German or English, law. Starting from 1 June 2015 a non-accessory independent guarantee became available under Russian law for any commercial entity. The payment obligation of the guarantor under an independent guarantee does not depend on the validity of the underlying agreement and the guarantor may not rely on any of the debtor's defences against the creditor.

### Bank guarantee

In practice, the provision of bank guarantees by Russian customers is rare. The reason for this is that the costs associated with obtaining a bank guarantee are often considerable and may make the supply relationship unattractive. Bank guarantees could however be an option in situations where other security instruments are not available.



## Pledge of account

Russian law now allows the pledge of bank accounts. The pledge may extend to all or any part of the funds held in the account (e.g., by stipulating a minimum amount which must be held in the account). The owner of the pledged account may not close the account without the consent of the pledgor and deal with the account in a manner inconsistent with the pledge agreement. To enforce a pledge over a bank account, the pledgor must give notice to the bank maintaining the pledge account along with a copy of the executed pledge agreement.

## Pledge of assets

Depending on the circumstances of the particular case, the parties may consider the use of a pledge of assets. A pledge over the supplied products or other movable property owned by the customer may involve a certain amount of administrative work and can be difficult to enforce, e.g. in cases where the pledged property has been sold to a third party. A pledge can nonetheless be an option considering that recent legislative amendments improved the Russian pledge regulations. For instance, the secured obligations can now be described (i) by a reference to the underlying agreement without a detailed description of the secured obligations; or (ii) as all obligations owed by a pledgee to a pledgor from time to time up to a certain amount. In addition, a pledge over movable assets can be voluntarily registered in a special register maintained by the notaries and the priority of the pledge will be determined in accordance with the order of registration. Out-of-court enforcement remains possible, however it has certain peculiarities which shall be observed at the moment of drafting a pledge agreement.

Depending on the specific circumstances, a parent company of the customer may offer to pledge a certain number of shares in the customer entity rather than having to provide other security.

## Mortgage

A mortgage over immovable property owned by the customer or a third-party can likewise be very attractive and valuable security. The creation of a mortgage is, however, subject to the conclusion of a detailed mortgage agreement that is to be registered with the Russian property register. In addition, a mortgagee will typically wish to carry out a due diligence review of the property prior to accepting a mortgage. As a consequence, it is often not practical to negotiate a mortgage in connection with a supply relationship. In addition, customers are often not ready to mortgage property for the purpose of purchasing goods. In practice, therefore, the use of a mortgage is rare in such cases unless exceptional circumstances exist. This may be the case if the value of the goods to be supplied is exceptionally high, if deferred payment arrangements are accepted by the supplier, or if large equipment is to be supplied and installed in a building or on land which can be mortgaged.

## Other security options

Russian law has recently undergone extensive amendments and now provides for new concepts that have previously not been recognised and which can be referred to in supply agreements, including security deposits, indemnities, representations and escrow arrangements.

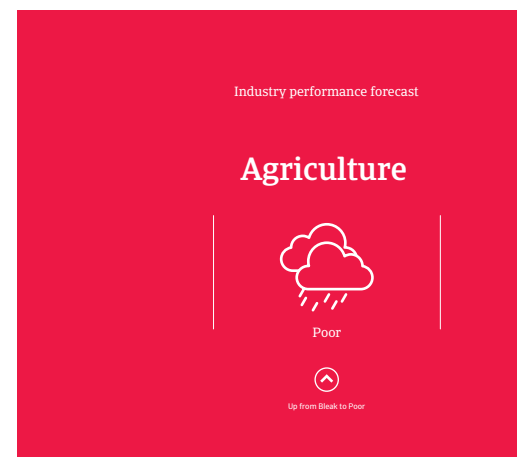


# 05

## Beware of corporate approval requirements

Supply agreements are usually signed by the general director of the Russian company or by another person authorised to do so by virtue of a power of attorney. General directors of Russian companies are entitled by law to enter into agreements with third parties and to bind the company. Following recent legislative amendments, a Russian company may have several general directors acting jointly or independently. To verify the signing authority of a general director, it is common practice to request the company's charter and the shareholders' resolution on the appointment of the general director. If an agreement is signed by a person other than a general director, a copy of a power of attorney confirming the authorities of such person should be requested.

In addition, under specific circumstances, corporate approvals may be required on the Russian side. Essentially, there are two situations that should be borne in mind. Firstly, if the value of the supplied products is high, it may have to be checked if the supply agreement qualifies as a "major transaction" for the Russian customer and therefore requires approval of the board or the shareholders. Secondly, if security is provided by an affiliate of the customer, the Russian regime on so called "interested party transactions" may be applicable. The issuing entity may then require a corporate approval be adopted under a special procedure. Without going into the details of this approval procedure, from the supplier's perspective it is important to determine whether a surety or guarantee could fall within the "interested party regime". It is therefore critical to obtain any relevant information on the relationship and any affiliation between the customer and the entity providing the security.



# 06

## Comply with competition laws

Irrespective of the governing law chosen by the parties, any supply agreement relating to supplies to the Russian territory is subject to mandatory Russian competition rules. The Russian rules applicable to vertical supply relationships are similar to those existing in the European Union. In brief, Russian competition law prohibits contractual provisions concerning vertical supply relationships that (i) interfere with the setting of the resale price, (ii) restrict the customer's capability to sell goods of a competitor, or (iii) otherwise restrict competition in the relevant market.

There exists a safe harbour exemption for vertical agreements between parties that do not hold a market share of 20% in any of their markets.

Where one of the parties holds a market dominating position, which normally means that it has a market share of above 50% (or less in cases of collective dominance and certain other cases), special rules apply, prohibiting, among other things, discrimination of customers, unjustified refusal to supply, any bundling and tying of products, etc.



Industry performance forecast

**Automotive/  
Transport**



Bleak

**Chemicals/  
Pharma**



Fair

**Construction  
Const.Mtrls**



Poor



Up from Poor to Fair

*market monitor – [Click here to download latest version.](#)*



# 07

## Just a supply, or is there anything in addition?

As a rule, the conclusion of a supply agreement is not subject to Russian licensing, registration or other administrative approval requirements. Something else may however apply if an agreement contains elements of other types of agreements for which Russian law provides mandatory requirements. It is therefore necessary to verify that none of the following applies:

- If a supply agreement contains features of a franchise relationship, this may mean that the mandatory provisions concerning franchise agreements apply. In particular, franchise agreements are subject to state registration with Rospatent (Russia's Federal Service for Intellectual Property), which includes the obligatory registration of the agreement, any amendments to the agreement or its termination. Without such registration a franchise agreement is deemed void.
- If a supply agreement also relates to intellectual property rights (e.g. trademarks and/or patents) that are to be transferred to the customer, such transfer may constitute a licensing agreement. In this case, the agreement must be registered with Rospatent in order to be valid and protected by Russian law.

Industry performance forecast

**Consumer  
Durables**



Poor



Up from Bleak to Poor

**Electronics/  
ICT**



Poor



Up from Bleak to Poor

**Financial  
Services**



Poor



Up from Bleak to Poor

**Food**



Poor



Up from Bleak to Poor

**Machines/  
Engineering**



Poor



Up from Bleak to Poor

**Metals**



Poor



Up from Bleak to Poor



# 08

## Comply with sanctions legislation and observe tax and custom regimes and import approvals

The European Union and United States of America have imposed comprehensive sanctions on Russia, which must be complied with when dealing with Russia. These sanctions regulations restrict the import and export of certain types of products and services; contain a freeze of assets of individuals and organisations (which can extend beyond the direct shareholders or board members to those of the companies which indirectly have an ownership in the trade partner); and provide for capital market prohibitions for major Russian financial banks and several other large entities.

As mentioned above, tax and customs issues often arise where supplies are made through complex offshore schemes and not directly from the supplier to the actual customer. As a general rule, the supply relationship should therefore be kept simple and transparent. It is also important to keep on file all documentation relating to the supply relationship, including agreements, order documents, price lists and payment documentation.

In addition, supply arrangements for the import of goods into Russia from abroad often require an analysis from a Russian permanent establishment and VAT perspective, in particular, where supplies are made via an agent and/or via a warehouse located in Russia.

Further, applicable customs legislation, including the application of customs duties and import VAT, import formalities and restrictions, will have to be reviewed prior to entering into the supply agreement.

Due to the recent establishment of the Eurasian Economic Union between Russia, Belarus, Kazakhstan, Armenia and Kyrgyzstan, customs legislation is currently being rapidly amended. At the current stage most of such amendments affect technical regulations and product homologation procedures, labelling requirements etc. It is advisable to clearly provide in the supply agreement which party is responsible for the certification of the supplied goods (if such certification is required) and obtaining other necessary regulatory approvals.

In addition, the import of certain categories of goods to Russia is (i) prohibited/restricted, and/or (ii) subject to import licences or approvals. The supplier should monitor such prohibitions, restrictions and licensing requirements and it should be considered addressing this in the supply contract.



# 09

## Consider the dispute resolution forum in advance

The parties may contractually agree on the dispute resolution forum (either a specific Russian or foreign court or arbitration). Russia is a party to only a very limited number of treaties on the mutual enforcement of court judgments. These treaties extend to CIS countries and various other countries, but not to most Western countries. As a result, decisions of a foreign court cannot normally be enforced in Russia. Vice-versa, Russian court decisions cannot normally be enforced against a foreign supplier.

The situation is much different in relation to arbitral awards, even if rendered by a foreign arbitration tribunal. For any cross-border supply agreement, it is, therefore, a 'must' for the parties to include an arbitration clause in their agreement. Russian and foreign arbitral awards are generally recognised by Russian courts, provided that certain procedural requirements applicable to the presentation of such awards are complied with.



Industry performance forecast

Paper



Fair



Up from Poor to Fair



# 10

## Be insured

As holds true for supplies to other countries, certain risks relating to supplies in Russia remain that cannot be fully excluded, even if all legal aspects are assessed and complied with. It is therefore common for suppliers to consider export insurance of their supplies to a Russian customer.

In case of cross-border supplies to Russia, it is common for suppliers to seek insurance outside of Russia in their home country. Where supplies are made within Russia from a Russian supplier to a Russian customer, such supplies are typically insured by a Russian insurer. This is due to the fact that insurance activities on the Russian market are subject to mandatory licensing, which can only be obtained by Russian entities, but not by foreign insurers acting from abroad. Various international insurance groups have however entered into cooperation agreements with Russian insurance companies, enabling such local insurance companies to sell certain insurance policies on the Russian market with re-insurance backing by the foreign insurance group.

To obtain insurance for export supplies to Russia, a company will typically have to provide the underlying supply agreement and proof that sufficient security has been sought from the Russian customer, e.g. by obtaining a guarantee or surety from the customer's ultimate parent. Insurance policies will normally exclude coverage for risks arising out of circumstances that are under the supplier's control. Such circumstances may include the legal validity of the underlying supply agreement, the validity of the security obtained by the insured and compliance with any corporate approval and regulatory requirements. In other words, observing the 10 rules listed in this overview, amongst others, is not only essential for a supply relationship with a Russian customer, but also forms the basis enabling the supplier to obtain and rely on its insurance coverage.

Industry performance forecast

### Services



Poor

### Steel



Poor

### Textiles



Poor

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This overview is intended to provide general guidance on the legal framework applicable to supply relationships with Russian customers. It is not intended to provide legal advice and cannot replace a thorough analysis of a respective supply arrangement.

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