Distribution Q&A: Russian Federation

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Russian Federation-specific information concerning the key local and commercial issues that arise when appointing a distributor.

This Q&A provides country-specific commentary on *Practice note, Distribution: Cross-border overview*, and forms part of *Cross-border commercial transactions*.

Regulation and legal formalities

1. Is distribution specifically regulated by national law? Are there any special rules or definitions applicable to:

- Exclusive distribution?
- Sole distribution?
- Non-exclusive distribution?
- Selective distribution?
- Is any legislation pending, which is likely to affect distributions?
- Are there any formalities that a supplier must comply with when setting up a distribution network, for example, any registration or disclosure requirements?

At present, distribution agreements in Russia (distribution) are not specifically regulated by Russian law. Distribution is not listed as a type of contractual form in the Civil Code of the Russian Federation (Civil Code), despite being widely applied in everyday commercial practice on the sale (distribution) of goods to customers (clients).

In general, distribution can be defined as an agreement under which one party, conducting a business activity concerning the sale of goods (the distributor), undertakes to:

- Purchase goods from another party (typically, a producer or a supplier, referred to in this chapter as supplier).
- Promote their sale in a defined territory. The supplier undertakes not to supply these goods in the agreed territory to other distributors or customers (clients).

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Other types of contractual agreement that may seem similar to distribution are supply agreements, agency agreements and concession agreements. Russian courts have at times held that distribution agreements are by nature supply agreements, which (among other things) include the provision of services on the finding of customers (clients). There have also been cases where distribution agreements have been considered to be agency agreements. In one particular case, the court held that a distribution was a mixed agreement because it had elements of both supply and agency agreements. Some courts have even considered distribution agreements to be concession agreements.

It cannot be completely ruled out that Russian legislation concerning distribution arrangements may change in the future. However, at the moment the ongoing substantial reform of the Russian civil legislation, including various federal laws updating provisions on specific types of contracts in part 2 of the Russian Civil Code (for example, *Federal Law No. 35-FZ of 12.03.2014, Federal Law No. 363-FZ of 21.12.2013* and so on), as well as the draft *Federal Law No. 47538-6* "On Introducing Amendments to Parts One, Two, Three and Four of the Civil Code of the Russian Federation", do not contain any changes in relation to the concept of distribution, despite the fact that this arrangement is widely used in commercial transactions. In addition, there is no available information suggesting that any other legislative changes would introduce the notion of distribution agreement into Russian civil law.

In the meantime, parties involved in international distribution are encouraged to use model distribution agreements together with recommendations adopted by the International Chamber of Commerce. Although these rules were originally designated for use in international contracts, they can potentially be used in domestic contracts too.

Given the absence of domestic regulation, there are currently no special formalities (for example, registration or disclosure requirements) that the supplier must comply with when setting up a distribution network, other than certain competition law requirements with which parties must conform (see *Question 3*).

Note that Russia's Federal Antimonopoly Service pays particular attention to companies' marketing strategies, which should set out:

- Criteria for potential distributors to enter a company's official distribution chain.
- The company's assessment procedure for accepting a new distributor.

The Federal Antimonopoly Service stresses that the criteria and assessment procedures set by companies for potential distributors must be clear and practically achievable.

2. Are there any laws, regulations or case law which apply to agency relationships that might be interpreted in such a way as to apply to a distributor relationship as well?

In the majority of cases, the distributor acts as intermediary between the supplier and the customer only in an economic sense. In a legal sense it remains independent, because it acts in its own interest and at its own expense and creates legal consequences for itself. For these reasons, Russian law provisions governing agency relationships do not apply to distribution.

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However, when the distributor combines the functions of the distributor and trade agent (for example, where the distributor acts as intermediary between the supplier and its customers, by transferring its functions to the supplier for a commission), Russian law provisions governing agency relationships may become applicable. In addition, note that Russian courts have on occasion construed specific distribution agreements as being a form of agency agreement (see *Question 1*).

Competition law

3. Are there any national laws or regulations that would affect the following business practices:

- Grant of exclusive territory?
- Tied selling?
- Territorial restrictions?
- Customer restrictions?
- Resale price maintenance?
- Minimum purchase targets?
- Imposition by the supplier of restrictions on the sources of supply to distributors?
- Refusal to deal?

General prohibitions

Under Russian law, all agreements between parties must (among other things) comply with Russian anti-trust requirements, incorporated in Federal Law No. 135-FZ "On the Protection of Competition" of 26 July 2006 (Russian Competition Law), as amended from time to time. The Russian Competition Law prohibits certain types of agreements and co-ordinated actions that have or may have the effect of restricting competition on the relevant market, and also defines cases where certain agreements or co-ordinated actions may be considered admissible or exempt from these requirements.

The Russian Competition Law expressly prohibits "vertical agreements" entered into between economic entities, which lead or may lead to:

- Price fixing.
- Refusal to sell competitive goods.

A question then arises as to whether the above prohibitions apply to distribution within the meaning of the Russian Competition Law.

According to Explanations N2 of the Presidium of the Federal Antimonopoly Service (adopted by Minutes of the Presidium of the Federal Antimonopoly Service on 17 February 2016) "vertical agreements" are agreements made

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between parties of different levels of technological cycle and containing provisions according to which such parties will purchase, sell or resell certain goods or services. Agreements between a producer and a buyer intending to resell goods (distributor) are considered to be "vertical agreements" also in cases when the parties to the agreement sell the goods within the same market (or markets) given that in that market the distributor sells the goods purchased from that producer, and the distributor does not produce substitute goods. This is also the case when the distributor sale substitute goods produces by different producers.

Subject to the specific prohibitions and exemptions discussed below, distribution agreements may theoretically contain certain restrictive provisions in terms of price, territory, types of goods, identities of suppliers and/or customers and so on.

Specific prohibitions and exemptions

The Russian Competition Law contains prohibitions in relation to vertical agreements that are particularly relevant to distribution. It prohibits:

- Agreements that lead or may lead to the fixing of resale prices in relation to the sale of goods to customers (clients). Note, however, that the fixing of a maximum resale price is not prohibited (that is, only the fixing of a set or minimum resale price is prohibited).
- Agreements that impose on the distributor an obligation not to sell goods produced by the supplier's competitors. Again, note that this excludes cases where the goods are sold or distributed under a specific trade mark or brand of the supplier. In this case, the supplier has the right to require that the distributor refrain from purchasing goods from the supplier's competitors. A licence agreement should normally be entered into between the supplier and the distributor, if relevant.

The Russian Competition Law also specifically prohibits agreements that lead or may lead to the restriction of competition, including, among other things:

- Imposing conditions that are not in the interests and/or to the benefit of one of the parties.
- Economically, technologically or otherwise unjustified fixing of different prices in relation to the same kind of goods.
- Creating obstacles to access or exit the relevant goods market.
- Establishing specific membership requirements in professional and other unions.

Admissible agreements

According to the recent changes to the Russian Competition Law made on 3 July 2016 "vertical agreements" are considered admissible in the following cases:

- If such "vertical agreements" are made in a written form and constitute a commercial concession.
- If the market share of each economic entity being a party to the "vertical agreement" does not exceed 20%.

Please note that the cases mentioned above do not apply to financial entities.

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Furthermore, agreements that lead or may lead to the restriction of competition (see above Question 3, *Specific prohibitions and exemptions*) are also considered to be admissible if both of the following conditions are met:

- The agreement is entered into by economic entities which have no dominant position as defined by the Russian Competition Law.
- Aggregate goods proceeds of such economic entities for the last calendar year do not exceed RUB400 million.

Parties are encouraged to provide proof to the Federal Antimonopoly Service that their agreements may be considered admissible (at the discretion of the Federal Antimonopoly Service) if the required conditions are fully satisfied.

Agreements may be considered admissible by the Federal Antimonopoly Service if they are directed at one or more of the following:

- Improvement of production.
- Sale of goods.
- Stimulation of technical or economic progress.
- An increase in competitiveness of goods produced in Russia on the international market.
- In general, ensuring receipt by the customers (clients) of advantages and benefits that are comparable to the benefits and advantages obtained by the relevant economic entities as a result of these agreements and/or co-ordinated activities.

Government exclusions

The Russian government, at the request of the Federal Antimonopoly Service, can make other types of agreement admissible for a defined period. The government must specify:

- The type of agreement.
- Conditions which are not considered as admissible in relation to such agreements.
- Conditions to ensure competition which shall be obligatory specified in such agreements.

The government can impose other conditions on the agreement.

On 16 July 2009 the Russian government adopted general exclusions in relation to agreements between suppliers and buyers (Government Exclusions), which are valid for ten years following their issue (*Regulations No. 583 of the Government of the Russian Federation "On the Admissibility of Agreements between Economic Entities"*). New legislation issued in 2014 has amended the Government Exclusions (*Regulation No. 385 of the Government of the Russian Federation of 29 April 2014 amending Regulation No. 583*). The Government Exclusions are intended to cover distribution.

In accordance with the Government Exclusions, the Federal Antimonopoly Service generally considers distribution admissible if all of the following conditions are met:

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- The supplier, whose market share is less than 35%, sells the goods to more than one buyer (distributor), or the supplier (regardless of its market share) sells the goods to only one buyer (distributor), whose market share is less than 35%.
- The supplier and the buyer (distributor) do not compete, or they compete in the market in which the buyer (distributor) purchases the goods for their subsequent resale.
- The buyer does not produce goods that are replaceable in relation to the goods purchased under the relevant distribution agreement.

Distribution containing any of the following conditions is inadmissible:

- **Resale prices:** conditions limiting the buyer's (distributor's) capacity to independently set resale prices. In particular, this includes establishing minimum or fixed resale prices (the maximum price can be fixed).
- **Market division by territory/customers:** conditions providing for the buyer's (distributor's) refusal to sell goods in a defined territory and/or to a defined category of customers (clients).
- **Replaceable goods:** conditions prohibiting the buyer (distributor) from producing, purchasing and/or selling goods that are replaceable (substitutable) in relation to the goods being purchased.
- **Quantitative restrictions:** conditions obliging the buyer (distributor) to purchase from the supplier more than 50% of the total quantity of goods (taking into account replaceable goods) that the distributor buys during a year.
- **Sale of spare parts or components:** conditions restricting the seller to sell spare parts or components to the goods produced by the buyer.

Note that the Government Exclusions contain certain exemptions to inadmissible conditions; the application of these exemptions should be checked on a case-by-case basis.

Other exclusions

The competition law requirements discussed above are, as a general rule, not applicable to agreements and/or co-ordinated activities between the parties that belong to the same group of persons within the meaning of the Russian Competition Law, that is, where one of the contracting parties is under the control of the other party, or where both contracting parties are under the common control of one party.

Finally, the above requirements do not apply to agreements on the provision and/or disposal of the right to use intellectual property or the means of differentiating a legal entity, goods, works or services.

Liability for breach

The Federal Antimonopoly Service has broad powers to discover, prevent and terminate breaches of Russian competition law, including (without limitation) those in relation to prohibited contractual arrangements and/or co-ordinated activities by organisations, state authorities, their officials and other individuals.

It can, among other things, check, investigate, request and access any documents and information required to establish potential infringements of the law. It can hold liable those responsible and bring law suits before courts of competent jurisdiction.

The breach of Russian Competition Law can potentially lead to administrative and/or criminal liability:

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- Administrative liability: imposed on the responsible persons (legal entities and individuals). Penalties are administrative fines up to RUB1 million for legal entities and/or up to 0.15% of the relevant party's proceeds from the sale of a relevant product (or provision of relevant services), or disqualification from duties (in relation to officers) for up to three years (*The Code of the Russian Federation on Administrative Offences, introduced by Federal Law No. 195-FZ, 30 December 2001*).

In exceptional cases the responsible party may be released from administrative liability (that is, where that party voluntarily approaches the Federal Antimonopoly Service (the relevant territorial branch) with information on entering into a prohibited agreement and/or on being involved in co-ordinated activities).

- **Criminal liability:** imposed on the responsible individuals (companies' officers) in particularly serious cases. Penalties include (*The Criminal Code of the Russian Federation, introduced by Federal Law No. 63-FZ, 13 June 1996*):
  - if there was violence or threat of violence, imprisonment for up to seven years, which can be accompanied by a prohibition from holding certain positions or from conducting certain activities for up to three years;
  - mandatory works for up to five years (these are works to be performed by the convicted individual within a certain period of time; some percentage of the individual's salary (up to 20%) is retained by the state), which can be accompanied by a prohibition from holding certain positions or from conducting certain activities for up to three years; and
  - imprisonment for up to six years, which can be accompanied by a fine up to RUB1 million or the amount of salary or other income of the responsible individual for a period up to five years, and a prohibition from holding certain positions or from conducting certain activities for up to three years.

In exceptional cases the responsible person may be released from criminal liability if they have facilitated the detection of the crime, paid compensatory damages and has otherwise reimbursed losses suffered by an injured party as a result of the criminal activities.

4. Is there specific competition or anti-trust law regulation of exclusive and selective distribution? Describe briefly.

The Russian Competition Law does not expressly regulate "exclusive" and "selective" distribution. Such schemes are permissible subject to competition law requirements (see *Question 3*).

5. Are there any national provisions relating to the imposition of minimum or maximum prices?

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The Russian Competition Law prohibits the establishment of minimum or fixed resale prices in distribution agreements (see *Question 3*). However, the maximum resale price can be set.

6. Can a supplier impose minimum purchase obligations or targets on a distributor?

The Russian Competition Law specifically prohibits agreements, which lead or may lead to the restriction of competition, including in particular, conditions that are not in the interests and/or to the benefit of one of the parties (see Question 3, *Specific prohibitions and exemptions*). The question may arise as to whether the imposition of minimum purchase obligations or targets on a distributor could be interpreted as impairing the interests of one of the parties (namely, the distributor). There is currently no established case law in this regard.

The parties are encouraged to submit their agreements to the Federal Antimonopoly Service to check whether they are admissible.

Note that under the Government Exclusions, a supplier must not require that a buyer (distributor) buy more than 50% of the total quantity of goods (taking into account replaceable goods) that the relevant buyer (distributor) buys during a year (see *Question 3*). This does not, however, cover:

- Agreements entered into before 31 July 2009.
- Agreements entered into for less than three years.
- Agreements under which the supplier provides premises and/or land to the buyer (distributor) for the sale of goods. Such agreements may potentially include an obligation requiring that the buyer buy a certain quantity of goods from the supplier.

7. Can a supplier impose exclusive purchase obligations on a distributor?

The Russian Competition Law prohibits agreements that impose an obligation on the distributor not to sell goods produced by the supplier's competitors, with the exception of admissible agreements and agreements where the goods are sold under a specific trade mark (see Question 3, *Admissible agreements*).

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In addition, a supplier must not prohibit a buyer (distributor) from producing, purchasing and/or selling goods that are replaceable (substitutable) in relation to the goods being purchased. These conditions would be considered inadmissible under the Russian Competition Law (see Question 3, *Government exclusions*).

8. Are there any laws or regulations relating to restrictive covenants or covenants not to compete during the distribution agreement? To what extent is it possible to continue the restrictions after the agreement has expired? In particular, to what extent does the geographical extent and or the length of time of the restriction affect its enforceability?

There are no laws or regulations relating to restrictive covenants or covenants not to compete during the distribution agreement, nor are there any relating to possible continuation of the restrictions after the agreement has expired.

However, there is a risk that such covenants, if included in the distribution agreement, may be unenforceable under Russian law for restricting competition and be penalised (see Question 3, *Liability for breach*). There is currently no established case law in this regard. The parties are, however, encouraged to submit their agreements to the Federal Antimonopoly Service to check whether they may be considered admissible (see Question 3, *Admissible agreements*).

9. Is the supplier free to impose on the distributor an obligation to buy and keep a full stock of each of the products comprised in the range of products which are the subject of the distribution agreement?

There are currently no rules in relation to this issue. In general, it should be possible provided that there is compliance with the competition law.

10. Where a distribution network involves trading online how is this regulated?

There is currently no regulation relating to distribution networks that involve online trading. General rules on online trading would therefore apply.

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In addition, there is no specific law regulating online trading, rather, the relevant provisions are spread across various pieces of legislation, as follows:

- General provisions on the supply of goods (Civil Code of the Russian Federation, Part 2, Chapter 30).
- Federal Law No. 63-FZ "On Electronic Signature" of 06 April 2011.
- Federal Law No. 184-FZ "On Technical Regulation" of 27 December 2002.

In the event that individual consumers are covered by online trading, Law No. 2300-1 "On Protection of Consumer Rights" of 07 February 1992 would apply, as well as the Rules on Distance Sale of Goods (Regulations No.612 of the Government of the Russian Federation of 27 September 2007), as well as other regulations.

Intellectual property

11. Does a distributor enjoy an implied licence to use the supplier's intellectual property rights in performance of its obligations under the distribution agreement?

The distributor does not enjoy an implied licence to use the supplier's intellectual property rights in performance of its obligations under the distribution agreement. A separate (licence) agreement must be entered into.

12. Is registration of intellectual property licences possible? Does this give any added protection?

Intellectual property licences must be registered with the registration authority (the Federal Institute of Industrial Property) when the underlying intellectual property is subject to state registration (for example, trademarks, patents and so on) (*Articles 1232 and 1235, Civil Code (Part IV)*). Failure to register a licence renders it invalid. The registration authority must ensure that the intellectual property licence complies with formal Russian law requirements.

13. If the supplier is based abroad, does the distributor need to be registered as owner or user of the trade mark to be able to import goods bearing the trade mark?

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There is no formal requirement for the distributor to be registered as owner or user of the trade mark in order to be able to import goods bearing this trade mark from abroad.

14. Does the distributor become entitled to any rights in a trade mark (or any other intellectual property right) by virtue of selling the trade-marked products in its territory?

The distributor does not generally become entitled to any rights in a trade mark (or any other intellectual property right) solely by virtue of selling the trade-marked products in its territory, unless otherwise provided under a relevant licence (or other) agreement between the supplier and the distributor in relation to the use of the supplier's intellectual property.

15. Are there any competition laws or anti-trust implications of licensing intellectual property rights?

In general, there are no direct competition law implications of licensing intellectual property rights. The following should be considered, however:

- A violation of intellectual property rights may potentially amount to unfair competition, which is prohibited under the Russian Competition Law.
- Unfair competition covers any activities of the economic entity (group of persons) that:
  - are directed at gaining advantages in its business;
  - are contrary to Russian law, good business practices, requirements concerning integrity, reasonableness and fairness; and
  - incur (or may incur) losses to other economic entities (competitors) and/or damage to their goodwill.

The prohibition of unfair competition applies (among other things) to the sale of goods that involve the illegal use of intellectual property rights (for example, to differentiate legal entities, goods, works or services). An interested party can protect its rights under Russian competition law.

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16. Can the supplier impose restrictions on the use of the supplier's confidential information by a distributor either during or after the expiration of the distribution agreement?

The supplier can impose restrictions on the use of the supplier's confidential information by a distributor, both during the term of the distribution agreement and after the expiration of that agreement.

The confidentiality clause may be inserted directly in the distribution agreement. Alternatively, the parties may enter into a separate confidentiality agreement, which may provide for a term during which the distributor will keep the supplier's information confidential.

Employment law

17. Is there a risk that distributors may be treated as employees of the supplier?

The risk that individual distributors may be treated as employees of the supplier is rather theoretical. The interested party would be required to prove in court that the relevant agreement constituted an employment relationship (that is, that the agreement contained all the elements of an employment relationship), which is quite difficult to prove in practice.

In addition, the supplier could provide evidence that the individual distributor was acting in the capacity of a distributor by performing purely distributor functions. This may, for instance, include evidence that the distributor performed acts accepting works or services, transferring goods to Russian customers (clients) and so on.

Given the above, the authors are of the view that in situations where the relationship between the supplier and the distributor is duly documented, the risk that the distributor will be treated as an employee of the supplier is very low.

However, the agreement between the supplier and the distributor may be reclassified by the courts to constitute an employment agreement if the distribution agreement:

- Sets fixed hours for the performance of the distributor's duties.
- Requires the distributor to observe the supplier's internal corporate policies and rules.

Requires that the supplier ensure certain working conditions for the distributor, as required under Russian employment law.

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18. Could employment liabilities of an outgoing distributor be transferred to a new distributor or to the supplier itself?

In general, Russian employment law does not apply to distribution, which is generally governed by civil legislation. Russian employment law may become applicable only when the distribution agreement between the supplier and individual distributor is reclassified by the court as constituting an employment agreement (see *Question 17*).

However, even if the distribution agreement is considered to be an employment agreement, rights and obligations under such an agreement cannot be transferred from one individual or entity to another. Russian law does not recognise the concept of transferring employment rights and obligations.

Tax

19. Will a foreign supplier who appoints a distributor directly in the national territory be regarded as carrying on business for tax purposes in that territory?

As a general rule, a foreign supplier appointing a distributor in Russia will not be considered as having permanent representation (a permanent establishment) in terms of tax law, that is, as carrying on business in Russia for tax purposes, if the supplier enters into transactions with the distributor in its own name and does not have any representation in Russia. As a result, the foreign supplier will not have to pay taxes in Russia.

However, the situation may change if the foreign supplier has legal representation in Russia, for example, in the form of a branch office that concludes transactions in its own name or an individual representative who enters into transactions in the name of the supplier but has the right to negotiate and approve essential terms of such transactions directly with customers. In such cases, the supplier will be treated as having a permanent establishment in Russia and the permanent establishment will be a wholly taxable business instrument.

Note that agreements on the avoidance of double taxation may set other criteria for determining whether a foreign company has permanent representation in Russia.

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20. Are any withholding or other taxes levied in the territory on remittance monies? When and by whom are they payable?

A foreign supplier does not pay taxes in Russia (see *Question 19*) and no withholding tax is levied in Russia on remittance monies. However, if the supplier is found to have permanent representation in Russia, it will have to pay all applicable taxes in Russia, including, among other things, corporate profit tax and corporate property tax.

Currently, the profit tax rate is 20% of the revenue of the permanent establishment less its documented deductible expenses, taking into account the establishment's functions, assets used and commercial risks taken. Profit tax must be paid directly by the permanent establishment. The reporting period for corporate profit tax can be quarterly, half-yearly or every nine months, and the tax period is one year. Tax returns must be submitted to the tax authority on or before the 28th of the month following each accounting period, and on or before the 28 March of the year following the relevant tax period.

The corporate property tax rate is established regionally, but it cannot be higher than 2.2% of the average annual book value of the taxable fixed assets. The reporting period for corporate property tax can be quarterly, half-yearly or every nine months, and the tax period is one year. Tax calculations on the corporate property tax must be filed on or before 30 calendar days after the expiry of each reporting period, and tax returns must submitted on or before the 30 March of the year following the tax period.

21. Will there be any difficulties in a domestic distributor making payment to a foreign supplier, either in local currency or in the currency of the supplier's country? Are there any exchange controls in operation?

The distribution agreement may provide for payment either in Russian roubles, or in a foreign currency. For the payment to be made in roubles, the foreign supplier must have a bank account opened in Russian roubles.

If payments are to be made in a foreign currency, the Russian rules on foreign exchange regulation and control require the Russian distributor to have a "transaction passport" with its bank. As evidence that the payment is lawful, local banks may require a copy of the signed distribution agreement (*Federal Law No. 173-FZ "On Foreign Exchange Regulation and Control", 10 December 2003*). The distributor must also provide to the bank documents that confirm the transaction and acceptance of goods received from the supplier. The Instructions of the Bank of Russia No. 3016-U of 14 June 2013, have changed certain aspects of the procedure to obtain the transaction passport (for example, the specification of the documents to submit when requesting the passport).

A transaction passport is not required if the total amount payable under the agreement does not exceed US$50,000 at the exchange rate of the Central Bank of Russia as of the date of signing the agreement, or as of the date of introducing the latest amendments to the agreement, if the agreement has been amended.

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Product liability

22. To what extent is it possible to exclude liability as between the distributor and supplier for the supply of defective goods or services? To what extent can a distributor be indemnified against product liability claims?

As a distribution agreement is not specifically regulated by Russian law, it is likely that Russian civil law provisions governing supply agreements will be applicable by analogy in relation to liability between the supplier and the distributor for the supply of defective goods or services.

Under Russian law, when defects were not known to the buyer in a supply agreement, the buyer has the right to request that the supplier do any of the following:

- Decrease the purchase price of the defective goods.
- Rectify defects within a reasonable timeframe.
- Reimburse expenses on the rectification of defects.

However, the above list is not exhaustive. The parties may agree in the contract on other types of requests that the buyer submit to the supplier. Freedom of contract is illustrated by Resolution No.16 of the Plenum of the Supreme Arbitration Court of Russia of 14 March 2014 "On the Freedom of Contract and its Restrictions". The Resolution is currently in force.

When defects are of a material nature (that is, defects that cannot be rectified, or cannot be rectified without significant expense, or appear again after their rectification and so on), the buyer has the right to either:

- Refuse performance of the agreement and request the supplier to return the purchase price paid for the goods.
- Request replacement of the defective goods.

However, these rules do not apply if the supplier, having received notification from the buyer concerning defective goods, replaces them with goods of suitable quality.

In view of the above, it is unlikely that an exclusion of liability by agreement between the supplier and the distributor for the supply of defective goods or services would be enforceable under Russian law.

In 2015 the Civil Code was supplemented by indemnity provisions (*Article 406.1, Civil Code*) allowing parties to include into their agreements a list of cases when one party will reimburse material losses of another party. The parties must specify in their agreement the volume of such reimbursement or an order to determine it. However, this does not apply to cases when the loss arises out of a breach of its obligations by one of the parties.

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Therefore, it is necessary to distinguish the concept of reimbursement of material losses (*Article 406.1, Civil Code*) and reimbursement of damages (*Article 15, Civil Code*). The Civil Code does not contain provisions related to indemnification against damages. However, the distributor can be indemnified against product liability claims of customers to the extent provided under the relevant distribution agreement between the supplier and the distributor (product liability clauses). In addition, the parties may consider insuring risks associated with possible product liability claims by their customers.

According to Article 15 of the Civil Code damages include actual damage and loss of profit. Therefore, it is advisable to specify precisely in the distribution agreement the extent of indemnity.

We note that in some cases the supplier will still need to pay the agent for the loss of profit event if the distribution agreement contains an exclusion of liability clause. These are the cases when the supplier intentionally breaches the agreement since an agreement made in advance to exclude or restrict liability for intentional breach of obligations is void (*Clause 4, Article 401, Civil Code*).

The distribution agreement

23. Are any particular formalities required in relation to distribution agreements?

As distribution agreements are currently not specifically regulated under Russian law, there are no particular formalities required for an agreement to be legally valid and enforceable, as long as it complies with general Russian law requirements (with respect to form and substance) and Russian competition law requirements (see *Question 3*).

In relation to form, the distribution agreement must be in writing.

In relation to substance, the distribution agreement must contain all material terms. These terms specifically include:

- A definition of the territory in which the distributor conducts its activities.
- A term of validity.
- A definition of the relevant goods.

The distribution agreement must also contain terms and conditions concerning supply (see *Question 24*).

Usually, either local legal entities or individuals acts as distributors. If a foreign legal entity regularly acts in Russia, it must register its representative or branch office or subsidiary in Russia for taxation purposes. In such a case, the foreign legal entity (or its Russian subsidiary) is considered a taxpayer according to Article 246 of the Tax Code. There are no requirements as to a percentage of local ownership. When a local registration is required and a foreign company fails to meet this requirement, the Russian tax authorities may impose a fine equal to 20% of the income tax unpaid by the foreign company (*clause 1, Article 122, Tax Code*).

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No local registration is needed for a simple signing of contracts on behalf of the foreign parent company (*clause 4, Article 306, Tax Code*).

The supplier does not need to provide any other formal authorisation to the distributor in spite of the distribution agreement being made in writing.

It shall be noted that some distribution activities may require a license under Federal Law No. 99-FZ "On licensing of some activities". This list of licensed activities includes 51 items, including pharmaceutical business and so on. There are no other formalities which could affect the validity and enforceability of the agency agreement under Russian law.

24. Is it possible to incorporate the supplier's standard conditions of sale into the distribution agreement? What do such standard conditions normally cover?

In Russian trade practice, three types of distribution are generally used:

- The agreement may include elements of a supply agreement. In this case, supplies are procured on the basis of the distribution agreement, which incorporates all material terms of a supply agreement (that is, the parties do not have to enter into separate supply agreements).
- The agreement may contain provisions on future supplies. In this case, the distribution agreement is preliminary in nature and contains all the material terms of a supply agreement (that is, a definition of goods and their quantity, as well as the terms of supply). The parties then enter into separate individual supply agreements.
- The agreement may define general terms and conditions (for example, prices, payment conditions, guarantees and so on). In this case, the parties enter into separate supply agreements and apply the general terms and conditions of the distribution agreement to those supply agreements.

All of these options are suited to incorporation of the supplier's standard conditions of sale into the distribution agreement.

Note that there is no general concept of standard conditions of sale in Russia that could automatically be applied to a contract and unilaterally amended by the supplier. However, the supplier's standard conditions of sale may be incorporated into the distribution agreement as an attachment. In this case, the standard conditions of sale can be amended only by mutual agreement of the parties.

Distribution agreements in Russia normally cover the same issues as the standard form contract provided by the International Chamber of Commerce, namely:

- Territory and goods.
- Due care and fidelity.
- Distributor's functions.

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- Non-compete clause.
- Sales' organisation.
- Marketing and advertising.
- Prices and conditions of sale.
- Volume of sales and minimum sale targets.
- Sub-distribution and agents (distribution network).
- Supplier's right to information.
- Resale prices.
- Sales outside the defined territory.
- Supplier's trade marks (means of differentiation).
- Stock and spare parts, and technical maintenance after sale.
- Distributor's rights of exclusivity.
- Direct sales.
- Distributor's right to information.
- Length of the agreement.
- Early termination of the agreement.
- Reimbursement of losses for early termination of the agreement.
- Return of documents and stock.
- Arbitration and applicable law.

Other auxiliary provisions (invalidity, variation, assignment and so on).

25. Does national law impose any obligations on the supplier or the distributor? Are there any obligations of either party which are typical due to local custom?

Russian law provisions governing supply agreements are most likely applicable in relation to obligations between the supplier and the distributor.

In general, the supplier discharges its obligations on the supply of the agreed goods of a certain quality to the distributor. In addition, the distribution agreement may specifically impose the following obligations on the supplier:

- Respecting the distributor's exclusive rights in relation to the distribution of the goods.
- Assisting the distributor (for example, providing all technical and commercial information necessary to the distributor to promote distribution of the goods).

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- Training of the distributor's employees (alternatively, the supplier may provide its personnel to the distributor).
- Paying a fee (reimbursing losses) to the distributor on termination.

The main distributors' obligation is to purchase and re-sell the supplier's products. The distribution agreement may also oblige the distributor to promote the supplier's products. There are no other specific obligations which are typical for the distribution agreements under Russian law.

26. Are any terms implied by law as to the supplier's title to the goods? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

Under Russian law, as a general rule, a supplier's title to goods passes to a buyer on delivery of the goods (that is, to the buyer or a third person designated by the buyer). As an alternative, the agreement may provide that title to the goods passes to the buyer on payment of the purchase price for the goods.

These rules, which are generally applicable to supply agreements, similarly apply to distribution. In other words, the distributor becomes the owner of the goods sold to it by the supplier. On the purchase of the goods from the supplier, the distributor acts as independent seller of the goods to its customers (clients).

27. What term is commonly agreed for a distributorship? Does national law regulate the length of notice periods?

The parties to the distribution agreement are free to determine the term of the distributorship. There are no restrictions under Russian law as notice period lengths are not regulated.

28. What events will be regarded in law as justifying termination of the distribution agreement? Do any statutory obligations arise on termination? What provision is usually made in the agreement for termination?

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As a distribution agreement is not specifically regulated under Russian law, general civil law provisions concerning termination of agreements apply.

In particular, termination of the agreement is generally possible:

- By mutual agreement between the parties, as well as at the request of one of the parties on the basis of a court decision.
- In the case of material breach of the agreement.
- In other cases, expressly provided for under the relevant agreement or Russian law.

Applying the law on supply by analogy, it is possible for the distribution agreement to provide for other grounds of termination at the initiative of one party by notice in writing to the other party (that is, without the court decision).

In accordance with Russian law provisions governing supply agreements, unilateral termination of the supply agreement is possible in the case of material breach of the agreement by either of the parties. A breach is presumed to be material in the following cases only (the parties cannot extend the list of grounds):

- By the supplier:
  - on the supply of goods with defects that cannot be rectified within a reasonable term; and
  - on the repeated violation of supply terms.
- By the buyer:
  - on the repeated violation of payment terms; and
  - on the repeated non-acceptance of goods.

If a material breach occurs, the agreement is considered terminated from the moment of receipt by the other party of the written notice of unilateral refusal, unless the notice provides for some other consequence as previously agreed by the parties.

The Civil Code does not provide any statutory compensation for termination of agreements. Furthermore, the law does not regulate issues related to cancellation of orders where delivery would take place after termination. However, the parties may include such provisions in the distribution agreement.

29. What rights does the distributor have to compensation on termination of the distribution agreement or discontinuation of supply of the products? How is compensation for termination / discontinuation of supply calculated?

Russian law does not regulate the distributor's rights to compensation on termination of the distribution agreement. However, compensation for termination may be agreed between the parties.

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In addition, under the general provisions on supplier contracts a distributor is entitled to claim a specified amount if, within a reasonable time upon termination following the breach by the supplier, the distributor buys the goods from another seller at a higher price, to make up for the goods as provided by the terminated agreement. The amount of the claim is the difference between the price the distributor paid and the price under the original contract with the supplier

Even if the distributor does not enter into a new contract to make up for the terminated contract, and provided that the relevant goods can be showed to have a current price (the price charged under similar circumstances for similar goods at the place where the goods were to be handed over), the distributor may claim the difference between the contractual price under the terminated contract, and the so-called current price as of the termination of the contract. However, this may prove a harder task for the distributor, since it will have to provide convincing evidence supporting its claims (such as evidence to confirm the current price, the distributor's attempts to enter into a new contract and so on).

Russian law does not regulate the issue of a discontinuation of supply without formal termination of the agreement, but does not prohibit it either. Therefore, the parties are free to foresee such a compensation in their agreements.

30. Where the distributor holds stock or money or other property belonging to the supplier, can the supplier assert its rights of ownership against third parties:

- In the event of insolvency of the distributor?
- In the event that the distributor has dishonestly disposed of them to third parties?

If the distributor holds goods of the supplier and the distribution agreement stipulates that the right of ownership passes from the supplier to the distributor on payment of the purchase price for the goods, one of the following outcomes applies if the distributor is insolvent:

- If the distributor has not resold the goods before its insolvency, the goods remain the property of the supplier and will not form part of the distributor's bankruptcy assets.
- If the goods were resold by the distributor before its insolvency, those goods cannot be demanded from the subsequent buyer. However, the supplier can be included on the distributor's list of creditors, that is, the purchase price for the goods can be claimed in the course of insolvency proceedings.

If, under the distribution agreement, the right of ownership passes from the supplier to the distributor on delivery of the goods, and the goods were not paid for before the distributor's insolvency, the purchase price can be claimed in the course of insolvency proceedings.

Under general rules, the owner has the right to recover its property from illegal possession by a third party, subject to the following:

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- If the property was acquired for free from a person who did not have the right to dispose of it, the owner has the right to recover this property in all cases.
- If the property is acquired for consideration by a *bona fide* acquirer, the owner has the right to recover it only:
  - when the property is lost (by the owner or by a person to whom it was transferred);
  - when the property was stolen; or
  - when the property was otherwise withdrawn from their possession without their free will.

Note that the above rules do not apply to cash and securities, which under no circumstances can be recovered, even from a *bona fide* acquirer.

31. What limitations and exclusions of liability might be appropriate?

The Civil Code does not contain provisions related to limitations and exclusion of liability. However, the parties can determine such limitations and exclusion in their agreement. Please note that in case of an intentional breach of the agreement such limitations and exclusions are deemed to be void (see *Question 22*).

32. Could any terms be implied under local law which regulate the supplier's ability to increase prices to the distributor during the term of the agreement?

There are no specific regulation in Russian law concerning ability to increase prices.

33. Are bank or parent company guarantees, letters of credit or other forms of security common practice in your jurisdiction?

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Usually, no guarantees and other forms of security are used. However, the parties may choose any appropriate form to secure their interests. Parent company guarantees and surety agreements are most common.

34. Would it be permissible to include a clause (referred to as a retention of title clause in common law jurisdictions) to ensure the supplier retains ownership (title) of the products until payment has been received from the buyer?

The agreement may provide that title to the goods passes to the buyer on payment of the purchase price for the goods.

35. Are there any local laws, rules or practices in relation to set-off?

The Civil Code grants the parties a right to set-off their claims (*Article 410, Civil Code*). Therefore, a provision to prohibit set-off is not enforceable under Russian law.

36. Will any customs duties be payable under the agreement for any products that are received by a distributor in your jurisdiction? Would the supplier or the distributor typically be responsible for paying any customs duties?

If the distributor receives products and such products cross the border of Russia, some customs duties may need be paid. What customs duties must be paid and their rate will depend on the kind of products and country of origin.

Usually, the distributor pays the customs duties.

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37. Are there any compliance obligations on either party under your local laws?

Compliance clauses are not common in agreements made under Russian law.

38. Should the distributor be solely responsible for compliance with import licensing laws?

The distributor will act as a customs applicant and must therefore pay customs duties. However, the supplier may pay customs duties for the distributor.

39. Is the supplier, distributor or both parties responsible for ensuring products can be sold in the defined territory: (i) before the start of the start of the agreement; and (ii) during the term of the agreement?

Russian law does not regulate the issue of ensuring that products can be sold in the defined territory. The parties may cover such issues in the distribution agreement.

40. Would it be common practice in your jurisdiction for a supplier to include a clause / clauses stating that it makes no warranty or representation: (i) as to the validity or enforceability of trademarks; or (ii) as to whether the trademarks infringe any third party intellectual property rights?

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Such warranties and representation clauses are not commonly used in agreements governed by Russian law. That is because the concept of warranties and representation is quite new for Russia (it was introduced into Russian law only in 2015).

41. In your jurisdiction, to what extent can a distributor incur personal liability to a customer?

The distributor can be personally liable to a customer in case of product defects (*Article 18, Law on Protection of Rights of Customers*).

The distributor can obtain insurance to cover such personal liability, but this is not widespread practice in Russia.

42. Does the law in your jurisdiction dictate which governing law and jurisdiction will apply to the distribution agreement?

The parties can choose the governing law and jurisdiction that will apply to the distribution agreement (*clause 1, Article 1210, Civil Code*).

If the parties do not specify a governing law in the distribution agreement, there may be a dispute in this regard between the parties, since Russian law does not specify governing law for distribution agreements.

43. Does the agreement need to be in a language other than English for it to be valid and enforceable?

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The distribution agreement can be made in any language. It is common practice to make bilingual agreements where one of the languages is agreed to prevail.

44. How does this agreement need to be executed to ensure that it is valid and enforceable? Does it need to be registered with any authority in your jurisdiction?

Execution formalities
There are no formal requirements to notarise or apostille distribution agreements.

Registration formalities
There are no formal requirements to register distribution agreements with any authority or state body.

45.Are there any clauses in the distribution agreement that would not be legally enforceable or not standard practice in your jurisdiction?

It is not standard practice to use compliance clauses in agreements governed by Russian law (see *Question 37*).

Furthermore, indemnity and restriction of liability clauses might in some cases be unenforceable (see *Question 22* and *Question 31*).

46. Are there any other clauses that would be usual to see in a distribution agreement and/or that are standard practice in your jurisdiction?

The parties usually state in the distribution agreement whether the distributor may enter into sub-distribution or agency agreements.

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Brexit

47. From the point of view of your jurisdiction, what points do you anticipate might arise in relation to a distribution agreement which either: (i) contains an express choice of English law as the governing law; or (ii) has a UK-incorporated supplier or distributor as a party and is governed by the laws of your jurisdiction, if, during the life of the agreement, the UK were to cease to be a member of the European Union?

At the moment, we do not know the details of Brexit, its terms, results and consequences with respect to business. There might be some issues affecting distribution agreements in case of Brexit, since it might involve substantial change in the UK's legislation.

Therefore, if the distribution agreement is governed by English law, we suggest inserting into the agreement wording allowing parties to re-negotiate the agreement in good faith. We believe it might be also reasonable to foresee a right of any party to terminate the agreement unilaterally in case of substantial changes in the governing law.

If the agreement is governed by Russian law, some issues might still arise in case of Brexit since changes in UK legislation might involve revision of UK-based principal's or agent's status (however, we do not await any substantial changes in this regard). Therefore, our recommendations related to re-negotiation and unilateral termination of the agreement might be still appropriate.

We do not anticipate that the issue of whether the UK will remain a member of the EEA or not will influence distribution agreements, since Russia is not a member of the EEA.

48. In relation to any points identified in *Question 47*, would you recommend that any adjustment should be made now to the standard document if it were to be used as an agreement governed by the law of your jurisdiction, in order to address those points in advance?

We would recommend adjusting the distribution agreement to give the parties a right to re-negotiate and unilaterally terminate the agreement (see *Question 47*).

END OF DOCUMENT

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