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Blockchain

Russia: Law & Practice

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DLA Piper Rus Limited

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CONTENTS

1. Blockchain Market and Business Model Overview	p.3	5. Capital Markets and Fundraising	p.12
1.1 Evolution of the Blockchain Market	p.3	5.1 Initial Coin Offerings	p.12
1.2 Business Models	p.3	5.2 Initial Exchange Offerings	p.14
1.3 Decentralised Finance Environment	p.4	5.3 Investment Funds	p.15
2. Regulation in General	p.4	5.4 Broker-Dealers and Other Financial Intermediaries	p.16
2.1 Regulatory Overview	p.4	6. Smart Contracts	p.16
2.2 International Standards	p.5	6.1 Enforceability	p.16
2.3 Regulatory Bodies	p.6	6.2 Developer Liability	p.16
2.4 Self-regulatory Organisations	p.6	7. Lending, Custody and Secured Transactions	p.16
2.5 Judicial Decisions and Litigation	p.6	7.1 Decentralised Finance Platforms	p.16
2.6 Enforcement Actions	p.7	7.2 Security	p.17
2.7 Regulatory Sandbox	p.8	7.3 Custody	p.17
2.8 Tax Regime	p.8	8. Data Privacy and Protection	p.18
2.9 Other Government Initiatives	p.9	8.1 Data Privacy	p.18
3. Cryptocurrencies and Other Digital Assets	p.9	8.2 Data Protection	p.18
3.1 Ownership	p.9	9. Mining and Staking	p.18
3.2 Categorisation	p.10	9.1 Mining	p.18
3.3 Stablecoins	p.10	9.2 Staking	p.19
3.4 Use of Digital Assets	p.10		
3.5 Non-fungible Tokens	p.11		
4. Exchanges, Markets and Wallet Providers	p.11		
4.1 Types of Markets	p.11		
4.2 On-Ramps and Off-Ramps	p.11		
4.3 KYC/AML	p.11		
4.4 Regulation of Markets	p.11		
4.5 Re-hypothecation of Assets	p.11		
4.6 Wallet Providers	p.12		

1. BLOCKCHAIN MARKET AND BUSINESS MODEL OVERVIEW

1.1 Evolution of the Blockchain Market

Until October 2019, assets and rights established and exercised in the blockchain market were not provided for under Russian law. This created tremendous uncertainty, which was partially resolved by amendments to the Russian Civil Code that came into force on 1 October 2019 and established a new category of property rights known as “digital rights.” While blockchain is not specifically mentioned in the law, digital rights are essentially those types of assets and rights established and maintained through systems such as blockchain.

Following the amendments to the Civil Code, blockchain has been used for the crowdfunding and tokenisation of various assets. In perhaps the most well-known case, Norilsk Nickel, a Russian nickel and palladium mining and smelting company, in co-operation with the Central Bank of Russia, has successfully tested its own blockchain for digitalising assets. The project was implemented in the Central Bank of Russia’s regulatory sandbox.

The amendments set a foundation but were only the first step towards comprehensive regulation of digital rights and distributed ledgers. On 1 January 2021, the new Federal Law No 259-ФЗ “On Digital Financial Assets, Digital Currency and on the Introduction of Amendments to Certain Legislative Acts of the Russian Federation” dated 31 July 2020 (the Digital Financial Assets Law), came into effect. However, contrary to expectations, the law in question didn’t result in mass adoption of blockchain technology in Russia. This was partially due to the fact that the law only allows tokenisation of financial rights, and is silent about tokenisation of rights to other assets (eg, rights to real estate or to art objects).

These other non-financial rights would fall under what are known as utility digital rights.

Utility Digital Rights and Digital Financial Assets

Most importantly, however, recent developments in Russian law have taken steps toward providing definition to different types of digital assets. Now, there are two categories of digital rights and cryptocurrencies which are formally defined and recognised as a separate type of property.

The types of digital assets are utility digital rights (UDRs) and digital financial assets (DFAs). They are described in more detail below in **2. Regulation in General** and **3. Cryptocurrencies and Other Digital Assets**, but in essence, UDRs are digital rights which involve the exercise of rights to deliver products, services or IP rights (including use rights) while DFAs involve rights to monetary claims and rights associated with securities.

This additional detail is a big step forward in the development of the Russian blockchain market.

1.2 Business Models

As the new law is not comprehensive, blockchain technology is not widely used in Russia. In addition, the infrastructure for blockchain is not fully developed. Implementation of blockchain in business processes is still expensive, cumbersome and time-consuming. More importantly, most businesses do not see a value addition from blockchain technology. Putting this into perspective, Russian organisations have yet to fully embrace digital documentation and contracting, although the law is firmly established in support of it. That being said, a number of businesses (primarily banks and large, forward-thinking corporations) are experimenting with blockchain.

Examples of this experimentation include:

- Alfa-Bank and S7 Airlines structuring a letter of credit using blockchain and smart contracts on Ethereum;
- Rosevobank using blockchain for remote customer identification;
- the Russian service Deponent using blockchain developed on the Waves platform for verifying authors for copyright;
- Raiffeisenbank using a distributed ledger for issuing mortgage bonds (notably, this solution was developed on the Masterchain platform, which was developed with the participation of the Central Bank of Russia);
- Raiffeisenbank issuing an international (Russia and Belarus) bank guarantee in co-operation with Gazpromneft using blockchain;
- MTS, a Russian telecommunication company, and Sberbank CIS testing the issuing of bonds using blockchain;
- in the oil industry, Gazpromneft-Aero and S7 airlines testing so-called aviation fuel smart contracts, to streamline settlements of payments for fuel;
- in consumer-focused projects, Golos.io, a social network where authors are remunerated with an internal cryptocurrency;
- blockchain technology being used in Moscow and the Nizhegorodsky Region during nationwide voting in connection with amendments to the Russian Constitution in 2020; and
- in August 2020, Expobank providing a loan secured by a pledge of cryptocurrency.

The most important consideration in the development of business models using blockchain is that the market is still waiting for a more detailed legal and regulatory structure.

1.3 Decentralised Finance Environment

It would be fair to say that decentralised finance (DeFi) is at a nascent stage of its development. Currently, there are no laws which specifically

regulate decentralised finance in Russia. Albeit certain aspects of DeFi are captured by the newly adopted Digital Financial Assets Law.

Russian residents predominantly use foreign DeFi providers. For example, when considering popular decentralised prediction markets, these would be Stox, Augur, and Gnosis. As to wallet aggregators, the use of MetaMask is quite widespread. Among lending platforms, one could name Maker, Compound, and Venus.

Generally, Russian business has not shown particular interest in DeFi, this industry is more attractive to individual investors. Since most DeFi providers are registered abroad, they very often fall outside the scope of Russian regulation.

2. REGULATION IN GENERAL

2.1 Regulatory Overview

As noted in **1.1 Evolution of the Blockchain Market**, Russian law on blockchain technology and cryptocurrencies has been sparse. The October 2019 introduction of the concept of digital assets to the Civil Code created a very basic legal framework for digital assets, blockchain and smart contracts. Also in 2019, the Crowdfunding Law was passed (effective as of 1 January 2020) establishing UDRs, essentially allowing for tokenisation associated with assets, IP rights and services.

In 2020, the Digital Financial Assets Law created a legal framework for tokenisation of certain financial assets.

Ultimately, the foundation of the legal framework is established in the Civil Code, the Crowdfunding Law and the Digital Financial Assets Law. To be sure, there are many other relevant rules and

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regulations applying to digital assets, but these three constitute the main legal basis.

Digital rights are rights determined in accordance with the rules of an information system that meets the criteria established by law.

Crowdfunding Law

The Crowdfunding Law establishes UDRs as digital rights involving:

- the right to demand the transfer of things (other than types of property which are subject to state registration, or transactions which are subject to state registration or notary certification);
- the right to demand the transfer of an exclusive right to the results of intellectual activities and (or) the use of intellectual property; and
- the right to demand performance of works or the provision of services.

Digital Financial Assets Law

The Digital Financial Assets Law defines DFAs as a type of digital right, certifying, in particular:

- monetary claims;
- the right to exercise rights in relation to registrable securities; and
- the right to participate in the capital of a non-public joint-stock company.

The Digital Financial Assets Law also provides a definition of “digital currency” which is certain digital data that is offered and/or can be accepted as a means of payment and/or an investment. It is explicitly stated that the monetary unit of Russia (the Russian rouble) or of a foreign country, an international monetary unit or a payment unit are not digital currency. The main difference between a digital currency and a digital finance asset is that there is no obligor liable to the holder of digital currency (save for the operator and/or nodes of the information system required to

ensure its functioning). Hence, most cryptocurrencies (such as Bitcoin, Ether, Dogecoin, etc) are digital currency in light of the Digital Financial Assets Law.

One of the most important provisions in the new law states that Russian legal entities, Russian residents (those who spend more than 183 days a year in Russia), and branches and representative offices of foreign legal entities in Russia are not entitled to use digital currency as legal tender. In addition, dissemination of information about using digital currency as a legal tender is prohibited.

Smart Contracts

Another concept worth noting is smart contracts. General contract law allows parties to use digital technology and to choose how the contracts will be formed and implemented, but the changes to the Civil Code also provide specifics for a smart contract approach for digital assets. According to the law, the terms and conditions of a transaction may enable the parties to perform their obligations thereunder through the use of information technology, as defined by the terms and conditions of the transaction. In other words, the parties are allowed to use smart contracts to perform their obligations.

2.2 International Standards

Russia has implemented both domestic and international anti-money laundering standards for all transactions, including in the blockchain sector.

Russian anti-money laundering legislation includes a specific anti-money laundering law, the Federal Law “On Countering the Legalisation of Illegal Earnings (Money Laundering) and the Financing of Terrorism”. Russia is also member of the Financial Action Task Force (FATF) and follows FATF standards. In addition, starting from 2019, Russia has been filing localised banking

statistics to the Bank of International Settlements (BIS).

While transactions involving digital rights and cryptocurrencies are subject to general rules; formally, cryptocurrency transactions are not yet specifically regulated. There is great concern from regulators, tax authorities and law enforcement that cryptocurrency transactions are not transparent and may be used for illegal purposes. In 2014, RosFinMonitoring, the Russian regulator for anti-money laundering, issued a warning that the use of cryptocurrencies in a transaction could serve as legal grounds for considering that transaction to be aimed at laundering money and financing terrorism.

2.3 Regulatory Bodies

There are no regulatory agencies with specific authority to regulate blockchain, but general authority will be applied. For example, the Central Bank of Russia and the Ministry of Finance are actively involved in the work on the development of digital rights legislation. The Central Bank of Russia has already started to create subordinate legislation regulating the circulation of DFAs. For example, as discussed in **5.1 Initial Coin Offerings**, it has put restrictions on investors acquiring DFAs.

Other interested agencies include:

- with regard to encryption technology, the State Security Service;
- Roskcomnadzor, the agency regulating digital communications and data privacy;
- the State Tax Service; and
- with regard to unfair trading practices, the Federal Anti-Monopoly Service.

2.4 Self-regulatory Organisations

There are no formal self-regulatory organisations performing regulatory or quasi-regulatory roles with respect to blockchain. There are some

industry organisations aiming at developing standards for distributed ledgers, such as the FinTech Association and the Russian Association of Cryptoindustry and Blockchain (RACIB).

2.5 Judicial Decisions and Litigation

There are only a few court decisions concerning the legal regime for blockchain or the status of cryptocurrency. The main issue in these cases involves whether cryptocurrency constitutes an asset or property under law. Most of the cases relate to bankruptcies, when the court has considered whether cryptocurrency could be included as an asset in the bankruptcy estate. Other cases involve whether cryptocurrency constitutes a taxable asset.

The central issues in these cases have largely been resolved by the amendments to the Civil Code in recognising digital rights.

In perhaps the most notable case, a financial administrator proposed that the debtor's cryptocurrency be included in the debtor's estate, arguing that cryptocurrency has a high pecuniary value and so the exclusion of the cryptocurrency from the estate would infringe upon creditors' rights (see case No A40-124668/17-71-160).

The appellate court required the debtor to provide the financial administrator with the relevant access key (password) for the cryptocurrency holdings. The court ruled that cryptocurrency should be regulated as an object of civil rights on the grounds of a broad interpretation of the Civil Code of Russia and, hence, should be considered a pecuniary asset (in other words, a type of property). The appellate court also stressed that – since the debtor himself was able to freely use, possess and dispose of the cryptocurrency – his status should be similar to the owner thereof.

Financial administrators now actively try to include cryptocurrency in a bankruptcy estate.

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In another case, a financial administrator of an individual debtor filed a motion with the court to receive documents required to evaluate the debtor's financial position as well as information on transactions in digital assets such as bitcoins and litecoins. The court granted the motion and obliged the debtor to provide the financial administrator with the requested documents (see case No A13-15648/2015).

It is worth mentioning a case considered by the Russian High Court in September 2020 (see case No A40-164942/19). In this case, investors sued a company that raised funds through an initial coin offering (ICO). The plaintiffs tried to get a return on their investment through the courts because the project was unsuccessful. Courts of all instances took the position that the plaintiffs' claims were not substantiated. Surprisingly, in this case the court concluded that operations with cryptocurrencies are not protected by Russian law and that cryptocurrency is not property under law. Although after the Digital Financial Assets Law, most of the conclusions drawn from the above-mentioned rulings have become obsolete, this case shows that courts are very reluctant to protect ICO investors.

2.6 Enforcement Actions

The legal status of digital rights and digital currency (which is in fact a synonym of cryptocurrency) were only established under law in October 2019 and July 2020 respectively. As a result of this, the precedents for enforcement action are all from before this time and the complexion of enforcement could be different now. The main issue regarding enforcement has been the legal status and nature of various digital rights. The most hotly contested has been related to cryptocurrencies. As described below, where a cryptocurrency is considered to be a "currency surrogate", as held by the Central Bank of Russia, there is an opinion that the cryptocurrency is illegal under law. Where it is considered to be

a property right, it is considered legal and subject to taxation or other regulatory measures for property rights. The Civil Code has now established digital rights under law, and the Digital Financial Assets Law has introduced a general ban on the use of cryptocurrency as legal tender.

It is also worth noting that attitudes on enforcement will depend upon the context of the enforcement. For example, the Central Bank of Russia is concerned with currencies, so it will look at digital rights in that context. The State Tax Service is concerned with applying tax rules, so it is focused accordingly. Ultimately, the conclusion of the legal nature of specific digital rights or cryptocurrency will often depend upon their context.

The Russian Constitution, the Federal Law "On the Central Bank of Russia" and the Civil Code state that the rouble is the exclusive form of legal tender in Russia and the creation or introduction of new currencies or currency surrogates is prohibited. Based on these provisions, the Central Bank of Russia holds the view that circulation of cryptocurrencies is illegal. In 2014, the Central Bank of Russia compared cryptocurrencies with monetary surrogates, which are prohibited, and noted the risk of penalties for issuers and owners of cryptocurrencies. Now this point of view is also supported by the Digital Financial Assets Law.

On the other hand, in 2016, the State Tax Service expressed a view that cryptocurrency is a type of property and that there was no formal ban on Russian citizens performing any transactions in cryptocurrency. In 2017, the Ministry of Finance shared the view that cryptocurrency was a type of property; however, only qualified investors should be allowed to purchase and sell cryptocurrency.

In October 2020, Roscomnadzor – the Federal Service for Supervision of Communications, Information Technology and Mass Media – blocked the websites of Binance and MINE.exchange for dissemination of information about the purchase of bitcoin.

It appears that there are plans to introduce fines for the illegal creation or circulation of cryptocurrencies in Russia with administrative and criminal liability. In November 2020, the Ministry of Finance suggested amendments to the Digital Financial Assets Law establishing criminal liability for the failure to include cryptocurrencies in a tax return.

2.7 Regulatory Sandbox

While the Central Bank of Russia has been consistently sceptical (if not hostile) to cryptocurrency, it is supportive of blockchain.

The Central Bank of Russia has established a regulatory sandbox for piloting various projects in the fintech industry, despite the ambiguity of the applicable regulatory standards. For example, the Norilsk Nickel project, discussed in **1.2 Business Models**, relating to the building of a platform for issuing stablecoins was implemented in the regulatory sandbox, but until passage of additional legislation, the legal status of stablecoins remains unclear.

2.8 Tax Regime

There is no specific tax regime regarding the use of blockchain and cryptocurrencies. With clarification of the legal status of digital assets, an update of applicable tax rules is anticipated. For the time being, general taxation rules are applied, with the presumption that digital rights (in particular, as they relate to cryptocurrencies) are property rights.

The interpretations of the tax status of different digital assets that are discussed below were all

issued prior to the passage of the new rules in October 2019, through which the legal status of digital rights was established. While this information is indicative of the issues faced by the tax authorities, there is a likelihood that some of the positions might be different if articulated today.

The Ministry of Finance has issued several explanatory letters regarding aspects of the taxation of digital assets in Russia. The general approach is that any cryptocurrency income associated with digital rights (especially cryptocurrency) is subject to taxation.

For example, cryptocurrency income received by an organisation was determined to be subject to Russian corporate income tax (see Ministry of Finance letters No 03-03-06/1/61152 dated 28 August 2018, No 03-03-06/1/58171 dated 16 August 2018 and No 03-03-06/1/40729 dated 14 June 2018).

As for the taxation of individuals, the position of the Ministry of Finance is that individuals cannot apply the preferential tax treatment that is available when receiving some types of property to cryptocurrency income, since cryptocurrency is not the type of property for which the preferential tax treatment is applied. However, in accordance with the basic principles of taxation, individuals have a right to reduce their taxable cryptocurrency income by the amount of expenses incurred in association with that cryptocurrency income (see Ministry of Finance letters No 03-04-07/80764 dated 8 November 2018, No 03-04-05/63144 dated 4 September 2018, No. 03-04-05/46553 dated 5 July 2018).

We note that even official letters of the Russian Ministry of Finance are of an advisory nature and are not law. For now, there is no prevailing court or law enforcement practice regarding the taxation of digital assets in Russia.

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Enforcement of tax rules is particularly complicated with regard to digital assets, as the Federal Tax Service of Russia often does not have the technical ability to trace crypto transactions and link them to a specific taxpayer. Russian financial and tax authorities still need to develop the legal mechanisms necessary for the taxation of digital assets and we developments are expected in this area.

2.9 Other Government Initiatives

All indications are that the Russian government will strongly support the digital economy generally and blockchain specifically, but that a very negative view of cryptocurrency will prevail.

From time to time, state bodies establish various committees and advisory councils on blockchain and the digital economy. For example, there is an expert council on the digital economy and blockchain under the State Duma (the lower chamber of the Russian parliament).

3. CRYPTOCURRENCIES AND OTHER DIGITAL ASSETS

3.1 Ownership

Passage of the Digital Financial Assets Law has added some detail to the status of cryptocurrencies and other digital assets.

Ambiguous Legal Status of Cryptocurrency

The Digital Financial Assets Law separates digital currencies (cryptocurrencies) from other digital assets, and creates an awkward legal status for them under law. This is a critical distinction: UDRs and DFAs are considered “digital assets” and, under the Civil Code, digital assets are clearly protected as property, but cryptocurrencies are specifically left out of this category, leaving them in a difficult grey area.

While the law recognises cryptocurrencies as property for some purposes, such as for taxation, bankruptcy, anti-money laundering and anti-corruption, the law does not place cryptocurrencies in the category of digital rights understood in the Civil Code. This leaves cryptocurrencies somewhere outside of the category of “property” under civil law. Some commentators argue that cryptocurrencies are simply not property at all and the recognition of cryptocurrencies as such for some purposes is intended to allow the state to further tax and regulate them as objects of value. Ultimately, however, the provisions of the law do not prohibit the holding of cryptocurrencies.

Prohibition on Use of Cryptocurrency as Legal Tender

The rights to, and transfers of, cryptocurrencies are also mainly determined by the terms of the relevant information system, but there are some additional issues. First, the Digital Financial Assets Law provides that cryptocurrencies are not to be used as legal tender. This leaves cryptocurrencies as objects of value but one that cannot be used as a currency.

This prohibition on use of cryptocurrencies as legal tender creates a complicated, if not unique, limitation on their disposal as property. The fact that they are intended to operate as mediums of exchange, makes the interplay between the prohibition on their use as legal tender and the possibility of their disposal as property conceptually difficult. A reflection of this awkward legal status is noted in **2.5 Judicial Decisions and Litigation**, discussing how courts have, despite the passage of the Digital Financial Assets Law, still ruled that cryptocurrencies are not property under law.

Special Measures Necessary to Enforce Rights to Digital Assets

Interestingly, the Digital Financial Assets Law has a provision which essentially requires certain measures be taken by persons holding cryptocurrencies before their rights will be protected in court. Specifically, they must declare their acquisition of, holding of transactions with and operations undertaken involving the cryptocurrency. Ostensibly, this is designed to encourage compliance with tax and other regulatory rules, but how it will work in practice is not determined. In time, practice will hopefully fill in details on how this rule will work.

Transfer of Rights to a Digital Asset

As a general matter, the transfer of the rights to a digital asset is determined by the terms of the information system handling the digital asset. This is provided for under the Civil Code (generally), the Federal Law 259-ФЗ “On Attracting Investments Using Investment Platforms and on Amending Certain Legislative Acts of the Russian Federation” (the Crowdfunding Law) and the Digital Financial Assets Law.

More specifically, under the Crowdfunding Law and the Digital Financial Assets Law, rights transfer will occur from the moment that the information on that transfer is entered into the system under the operating terms of the system. Under the Civil Code, this transaction should be undertaken without the involvement of third parties – it should be automatically performed by the system. In almost all cases, these different approaches will yield the same result. The intention of the Civil Code provision is that the system should work automatically, which is likely implied in any event.

3.2 Categorisation

Russian law currently provides for two types of digital rights, which encompass a wide variety of digital assets and cryptocurrencies.

The two types of digital rights are UDRs and DFAs. Cryptocurrencies are in their own category. As discussed in **3.1 Ownership**, the legal status of cryptocurrencies is unsettled.

As a general matter, however, the definition of digital rights covers those rights which are very closely associated with and managed by an appropriate “information system”. If the proposed digital assets do not fit under the characterisation under law, they may be construed as securities, as other types of assets, or (as was the case before 2019) be considered to not exist at all under Russian law.

3.3 Stablecoins

As stablecoins are essentially asset-backed cryptocurrencies, stablecoins would be treated as cryptocurrencies under Russian law. Notably, they cannot be used as legal tender in Russia.

3.4 Use of Digital Assets

Although cryptocurrencies are technically not digital assets under Russian law, both digital assets and cryptocurrencies will be discussed in this section.

Digital assets such as UDRs and DFAs are fully considered to be property under law and can be used and disposed of as such. As digital assets are newly understood under law, practices and regulation in the use of such assets will develop over time.

Cryptocurrencies are a different story. They cannot be used for payments which frustrates their essential purpose. This is directly provided for under the Digital Financial Assets Law and, by implication, under other Russian legislation which clearly establishes the rouble as the exclusive currency and prohibits the introduction of new currencies or currency surrogates. The Central Bank of Russia is very keen to ensure that cryptocurrencies do not become a currency sur-

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rogate, so one should expect vigorous enforcement against use of cryptocurrencies as legal tender.

While cryptocurrencies are considered property for some purposes under law, and there is no specific prohibition against effecting transactions involving cryptocurrency (but not using it as payment), there is great scepticism with regard to transactions involving them. Tax authorities, law enforcement and other authorities are concerned about the lack of transparency involved in cryptocurrency transactions and have been highly sceptical of the legitimacy of cryptocurrencies.

3.5 Non-fungible Tokens

Generally speaking, non-fungible tokens (NFTs) would most often be treated as UDRs under Russian rules. As digital assets, NFTs are property under law and can be used and disposed of as such.

4. EXCHANGES, MARKETS AND WALLET PROVIDERS

4.1 Types of Markets

Firstly, it should be noted that although the Digital Financial Assets Law created a certain legal framework for the circulation of digital assets and cryptocurrencies, there is still no specific regulation of exchanges for cryptocurrencies. According to the Digital Financial Assets Law, use of cryptocurrencies as legal tender and their advertising are prohibited. The law has certain limited exceptions, but the law may still significantly affect the market. As mentioned at **2.6 Enforcement Actions**, Roscomnadzor actively bans websites of crypto-exchanges.

Nevertheless, natural persons use various crypto-exchanges for sale and purchase of cryp-

tocurrencies. The largest are: Binance, Exmo, BTC-Alpha, Yobit, and KuCoin.

As to the market in digital rights more generally (eg, stablecoins), currently this market essentially does not exist and the Digital Financial Assets Law does not mention stablecoins at all.

4.2 On-Ramps and Off-Ramps

Exchange of fiat currency for cryptocurrencies is usually done through exchanges registered outside Russia. In Russia, the exchange of fiat currency for cryptocurrencies is in a legal grey area under currency rules and may potentially result in adverse legal consequences. For example, in 2017, the Ministry of Internal Affairs initiated a criminal case in the Kostroma Region against persons who exchanged bitcoins for fiat currency. The Digital Financial Assets Law does not clarify the situation.

4.3 KYC/AML

The Digital Financial Assets Law introduced an obligation on the operators of DFAs to identify clients and to collect and submit clients' details and details of their transactions as and when required by applicable anti-money laundering law.

4.4 Regulation of Markets

The Digital Financial Assets Law established that Russian law shall govern the issuance, registration of rights and circulation of (meaning any transactions with) DFAs under this law, including transactions involving foreign persons.

4.5 Re-hypothecation of Assets

The Digital Financial Assets Law does not have an exhaustive list of transactions with DFAs which are allowed. However, the law names sale and purchase transactions and the exchange of one digital asset for another. It could be argued that a pledge of DFAs is also possible.

4.6 Wallet Providers

There is no regulation of businesses that provide storage solutions for cryptographic keys.

5. CAPITAL MARKETS AND FUNDRAISING

5.1 Initial Coin Offerings

Russia has specific regulations for the securities market, with special definitions and some quite unique concepts and specific requirements, which differ from regulations typically applied in Western countries. Generally, tokens and other digital rights do not meet the criteria applicable to securities, because securities (including so-called “uncertified” securities) must meet various mandatory requirements under law. For example, only rights that are issued in compliance with applicable laws – and which may be exercised and recorded in compliance with the rules applicable to registration of those rights – may be recognised as uncertified securities in Russia. Accordingly, this definition limits securities to instruments that are explicitly mentioned as securities in the law.

In 2019, the changes in the Civil Code introduced a definition of digital rights, which is also linked to requirements to be set out in special federal laws. Currently two such federal laws are already in force:

- the Digital Financial Assets Law, creating a legal framework for the tokenisation of certain financial assets referred to in the law as digital financial assets (DFAs); and
- the Federal Law No 259-FZ “On Raising Investments via Investment Platforms and on the Amendments to Certain Legislative Acts of the Russian Federation” dated 2 August 2019 (the Crowdfunding Law), creating a complex regime for the operators of crowdfunding platforms in Russia and for fundrais-

ing through the sale of utility digital rights (UDRs) (an analogue of utility tokens).

Both of the above-mentioned laws use the same approach as general Russian securities law and set out special requirements for each type of the digital rights that must be met to be recognised as DFAs or UDRs accordingly. In addition, the newly created legal framework for such digital rights is closely linked to the general securities law provisions. For example, under the Digital Financial Assets Law the issuance, recording of rights to and circulation of registrable (issue-grade) securities, the exercise of the rights in relation to which may be certified by the DFAs, is regulated by the securities law, subject to specifics set out in the Digital Assets Law.

Foreign Financial Instruments

There are provisions of Russian securities law applicable to so-called “foreign financial instruments” and “foreign securities”. Accordingly, tokens originating from outside Russia may be viewed as “foreign financial instruments”.

This term is not clearly defined, but an initial offering of foreign financial instruments in Russia is prohibited without registration of a prospectus. In addition, any transactions in Russia with foreign financial instruments which do not meet certain minimal criteria and cannot be classified as securities in accordance with international standards are not permitted. Foreign securities that have not been admitted to public placement and/or “circulation” (trading) in Russia – as well as foreign financial instruments that have not been recognised as securities in accordance with procedures established under Russian law – may not be offered in any form or by any means, including advertisement, to an unlimited (unidentified) number of investors or to persons who are not “qualified investors” as that term is defined under Russian law.

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In addition, it is prohibited by law to offer or publicly advertise, without Russian prospectus registration, foreign financial instruments in Russia to persons, who are not qualified investors. There are also further restrictions and requirements for transacting with foreign securities with the participation of unqualified investors, including, a requirement to effect transactions via a Russian licensed broker and an obligation to hold foreign securities with a Russian depository.

In addition to the term “foreign financial instruments” used in the securities law, the Digital Financial Assets Law and some directives of the Central Bank of Russia have introduced a new term “digital financial assets, issued in information systems organised under foreign law” (foreign DFAs) which is not clearly defined. The Digital Financial Assets Law prohibited certain categories of Russian state officials and their families from owning or using any foreign DFAs (similar prohibition already existed for any other foreign financial instruments) and introduced a requirement to effect transactions with foreign DFAs in Russia only via Russian DFA exchange operators. In addition, the Central Bank of Russia established that only so-called qualified investors are entitled to acquire foreign DFAs.

The Crowdfunding Law

The Crowdfunding Law permits only four types of investments via investment platforms. These are:

- provision of loans;
- acquisition of issuable securities placed via an investment platform (other than securities designed for qualified investors only, as well as securities of banks, non-credit financial organisations and structured bonds);
- acquisition of UDRs; and
- acquisition of DFAs.

According to the Crowdfunding Law, UDRs include three types of digital rights. These are:

- the right to demand transfer of things (other than types of property which are subject to state registration, or transactions which are subject to state registration or notary certification);
- the right to demand the transfer of an exclusive right to the results of intellectual activities and (or) the use of intellectual property; and
- the right to demand performance of works or the provision of services.

The law sets forth, among other things, the following features of UDRs.

- Such rights may be offered only if they originate in the investment platform in accordance with the requirements of the Crowdfunding Law; in particular, they must initially originate as a digital right on the basis of a contact for the purchase of the UDRs in compliance with the relevant provisions of law.
- The scope and terms for exercise of such rights, as well as the quantity of the offered rights are determined by the fundraiser pursuant to a contact for the purchase of the digital utility right made on the investment platform.
- The scope of rights and terms of their exercise may not be changed after the investment offer has been made.
- Such a right can be created, exercised, disposed, transferred, pledged or restricted only on the investment platform.

Digital Financial Assets Law

According to the Digital Financial Assets Law, DFAs include only four types of digital rights. These are:

- the right to monetary claims;
- the possibility to exercise rights under registrable (issue-grade) securities;

- the right to participate in the capital of a non-public joint-stock company; and
- the right to demand transfer of registrable securities.

Mixed digital rights comprising various types of DFAs and other digital rights are also possible.

The law sets forth, among other things, the following features of DFAs.

- The issuance, recording of the rights to and circulation of such digital rights is carried out by means of making or amending entries in an information system, including distributed ledger-based information systems.
- The type and scope of the digital rights represented by the DFAs, as well as the quantity of the offered DFAs and relevant consideration are determined by the person issuing DFAs in a special document called the “decision on issuance of the digital financial assets” (DFAs Decision) in compliance with the Digital Financial Assets Law.
- The DFAs Decision should be made electronically and signed with an enhanced qualified electronic signature and placed on the website of the person issuing the DFAs and on the website of the operator of the information system on which the DFAs are issued (DFA Issuance Operator); the DFAs and UDRs may be issued/offered only with involvement of the special registered Russian operators.

5.2 Initial Exchange Offerings

Within the current legal environment, DFA Issuance Operators, DFA exchange operators and the operators of the crowdfunding platforms providing investment facilitating services in respect of the UDRs may be seen as some sort of analogue to a “digital asset exchange” in Russia. Russian law classifies all of these operators as non-credit financial organisations, whose activities are regulated, controlled and supervised by

the Central Bank of Russia. As a result: (i) foreign operators are no longer allowed to conduct business similar to the business of DFA Issuance Operators, DFA exchange operators and operators of crowdfunding platforms in Russia, and (ii) only Russian legal entities specially registered with the Central Bank of Russia and complying with all relevant provisions of the Digital Financial Assets Law and/or the Crowdfunding Law are eligible.

DFA Issuance Operators, DFA Exchange Operators and Investment Platform Operators

The above-listed operators must, in addition to standard Russian corporate law requirements, meet further various special requirements of the Digital Financial Assets Law and/or Crowdfunding Law. For example, DFA Issuance Operators must approve the special internal rules for the functioning of the information system on which DFAs are issued and DFA exchange operators must approve the rules for exchange of DFAs regulating transacting with them. Such rules must be reviewed and approved by the Central Bank of Russia before DFA Issuance Operators and DFA exchange operators may be registered as such.

Further requirements include, among other things:

- qualification requirements for the directors and other operator's officials;
- requirements in respect of persons holding, directly or indirectly, 10% or more of the shares of the operator; and
- obligation to comply with know-you-customer (KYC) procedures in respect of clients.

The DFA Issuance Operators are responsible for the proper functioning of the information system on which the DFAs are issued, for the integrity and accuracy of information stored in the system and for the correct functioning of the

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algorithms of the distributed ledger-based information system. The DFA Issuance Operators are liable for the losses suffered by the users of the information system caused, among other things, by loss of information stored in the information system, breach by the operator against the requirements applicable to the functioning of the information system or any other non-compliance of the information system with the requirements set forth in the law.

Fundraiser and Investor Requirements

Issuers of the DFAs and fundraisers

Pursuant to the Digital Financial Assets Law, only legal entities and Russian registered individual entrepreneurs may issue DFAs using the information system of the DFA Issuance Operators.

The Crowdfunding Law also introduced special requirements for fundraisers and investors. In particular, the fundraiser should be a Russian legal entity or individual entrepreneur in compliance with the requirements of the rules of the investment platform and Russian law. The fundraiser must provide the Russian operator with information about itself and the investment proposal (offer) in Russian and in a standard form prescribed by the rules of the investment platform. The investor and fundraiser must enter into an investment agreement using the investment platform's infrastructure, through acceptance of the investment offer by the investor. The investment agreement is deemed to have been executed only upon transfer of the investor's funds from the escrow account of the Russian operator to the bank account of the fundraiser.

Investments

The Crowdfunding Law also sets forth various restrictions applicable to the size and type of investments. In particular, the fundraiser may attract, in total, investments worth not more than RUB1 billion (approximately USD14 million) via

investment platforms during one calendar year. This limitation is not applicable to Russian public joint-stock companies raising investments by issuance of UDRs or DFAs.

Investors

On the basis of the authorities granted by the Digital Financial Assets Law, the Central Bank of Russia has established that only so-called qualified investors are entitled to acquire certain DFAs, such as the ones issued in information systems organised under foreign law, certifying rights in respect of registrable securities intended only for qualified investors; or DFAs relating to monetary claims without a fixed term for the performance of the relevant obligation. Furthermore, individual investors, being non-qualified investors, are entitled to acquire DFAs (other than the above-mentioned restricted DFAs) through the DFA exchange operator in an amount not exceeding RUB600,000 (approximately USD 8,000) within a one-year term. Should the relevant restrictions be breached, or the limit be exceeded, the operator can be requested to purchase back digital rights inappropriately acquired by such investor and to compensate all related costs incurred by the investor.

The Crowdfunding Law also sets forth also special rules for investments made by natural persons: the size of the aggregate investments of an individual via investment platforms (taken together) may not exceed RUB600,000 (approximately USD8,000) during one calendar year. Should the limit be exceeded, the relevant operator will be required to purchase, from the individual non-qualified investor, digital rights acquired in the amount exceeding the established limit.

5.3 Investment Funds

Generally, the investments of investments funds and other collective investment schemes are regulated and controlled by the Central Bank

of Russia. The composition and structure of the assets held by the funds is prescribed by the Central Bank of Russia for each type of fund.

5.4 Broker-Dealers and Other Financial Intermediaries

Currently, general provisions regulating brokerage, dealership and other activities of financial intermediaries are applicable to the extent that dealing in digital assets is permitted by Russian law.

6. SMART CONTRACTS

6.1 Enforceability

Russian law allows parties significant flexibility in establishing their contractual relationships, and there are provisions that appear to be aimed at smart contracts for digital rights. That said, the provisions are general and sparse, there is no specific rule providing for the legal enforceability of smart contracts.

Under general Russian contract law, it is possible for private parties to agree to contractual arrangements through various types of digital means, arguably including the use of a blockchain-based network, so long as the basics of contract formation are met. These basic requirements include identification of the parties, the subject, rights and obligations of the contract and assent to the contract.

With regard to digital rights more directly, the provision in the Civil Code describing digital rights provides that transactions with these digital rights are to be carried out through the relevant system (presumably, but not necessarily a blockchain) without the involvement of third parties. Moreover, similar provisions are found in the Crowdfunding Law. With this in mind, one can conclude that smart contracts are enforceable with regard to digital rights, so long as the

parties have agreed to the use of the investment platform or system for this purpose.

6.2 Developer Liability

Russian law would not consider developers as fiduciaries, but there could be liability under more general provisions of civil law and a contract.

7. LENDING, CUSTODY AND SECURED TRANSACTIONS

7.1 Decentralised Finance Platforms

The Russian law recognises several categories of digital assets which may emerge and circulate in decentralised platforms.

- Digital currencies - cryptocurrencies.
- Two categories of digital rights:
 - (a) utility digital rights (UDRs) – these may denote the right to goods, services, IP or IP rights; and
 - (b) digital financial assets (DFAs) – these may denote the right to monetary claims, security holder's rights, holding over shares of a joint-stock company or claim for transfer of securities.

Currently, Russian law allows for loans of fiat money, things of generic description and securities, but does not allow for loans of cryptocurrency or digital assets like UDRs or DFAs. Therefore, the direct lending of these digital assets pursuant to a loan agreement is not regulated and seems not to be possible under current laws. The law, however, generally allows transactions in UDRs and DFAs on digital platforms and therefore transactions that have the same economic effect as a loan may be possible, subject to the rules of the relevant digital platform.

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As regards cryptocurrencies, the law mentions that Russian residents may own cryptocurrencies and enter into transactions in respect thereof. Nevertheless, whether one can lend a cryptocurrency under Russian law is still not clear.

- Firstly, cryptocurrencies are not designated as an asset for the purposes of civil law.
- Secondly, the law does not clarify which particular transactions in respect of cryptocurrencies are permitted.

This may hinder recognition and enforcement of cryptocurrency loans by a Russian court. Besides, the law provides that for the rights of Russian residents to cryptocurrency to be recognised in Russia one must report to the tax authorities the holding of the cryptocurrency and carry out any transaction with cryptocurrency according to the tax laws. The tax laws, however, do not provide for any detailed rules on transacting in cryptocurrencies including the lending thereof yet.

7.2 Security

As mentioned in **7.1 Decentralised Finance**, the transactions which may be entered into in respect of cryptocurrencies are not defined under Russian law. As long as cryptocurrencies are not recognised as an asset for the purposes of civil law, enforcement of a security interest over cryptocurrencies by a Russian court does not seem possible.

On the other hand, UDRs and DFAs are capable of being subject to a security interest by virtue of direct provision of the law.

UDRs and DFAs can be acquired, alienated, encumbered and otherwise exercised within the digital platform from which such UDRs or DFAs originate according to the rules of that digital platform. Therefore, a security interest over UDRs and DFAs, such as a pledge, can

be taken according to the rules of the relevant digital platform. The current law does not give any further details as to how such security is recorded, maintained and released, apparently leaving those details to be determined by the rules of each particular digital platform.

UDRs and DFAs can be held by the owner thereof directly in the digital platform's information system or via a depositary. In the latter case the holder of the UDR or DFA can instruct the depositary to pledge or otherwise encumber that digital right in the digital platform's information system.

There is one more possible option for taking security, which is exclusively available for holders of UDRs, that is via the issue of a digital certificate of the UDRs. A digital certificate is a dematerialised security that certifies the UDRs held by the owner of that digital certificate. The rights to the dematerialised securities are recorded by a depositary. A digital certificate, being a security, is capable of being subject to pledge and other encumbrances applicable to dematerialised securities. The effect of taking security over the digital certificate would be equivalent to taking security over the respective UDRs themselves.

A specific form of security interest (in a broad sense of the word) over UDRs or DFAs can potentially also be obtained by means of utilising a smart contract for the purpose of securing a transaction. For more details on smart contracts see **6. Smart Contracts**.

7.3 Custody

Transfer of digital rights to a custodian and the activity of custodians is regulated only in respect of UDRs and DFAs, whereas in respect of cryptocurrencies no regulation exists yet.

There is no mandatory requirement to transfer UDRs and DFAs to a custodian (called a depository in Russia). The UDRs and DFAs can be held by their owner directly in the digital platform's information system or via a depository. In respect of a UDR the depository may issue a digital certificate of the UDR, which is a dematerialised security certifying that the UDRs are owned by the holder of the digital certificate.

Currently, there are a number of general regulatory requirements specific to acting as a depository in respect of UDRs and DFAs. For instance, depositories have to ensure that the digital rights of their clients are recorded and accounted for separately from their own digital rights. The depositories are also subject to the regulatory requirements generally applicable to depositories of securities in Russia, and should adopt internal rules in respect of their depository activity in respect of UDRs and DFAs and adhere to the relevant laws regulating these digital rights.

8. DATA PRIVACY AND PROTECTION

8.1 Data Privacy

Russian data privacy law will apply to blockchain-based products or services to the extent that the personal data of Russian individuals (citizens and residents) is involved. Russian law construes "personal data" as that which may be used to identify an individual. This definition is very broad, but so far, Russian regulators have applied it rather narrowly. We do, however, expect that, over time, the application will be applied more widely.

Where the data is anonymous or encrypted, the data would not fall within the definition of personal data under the law, but if there is a key, which can be used by people with access to the data, and which will allow the identification of the

individuals involved, the data would be personal data under the law.

Russian law requires consent for disclosure or transfer of personal data, especially where the transfer is made abroad, so, to the extent that the personal data is available through the blockchain, we would expect that formal consent would be required. This consent can be made in a separate document or as part of a larger agreement.

Regarding the right to be forgotten, the general rule under Russian law is that a holder of personal data is to hold the data for as long as necessary for the purpose at hand or as otherwise agreed or required under law. Given the concerns of tax authorities and law enforcement, we would advise looking at data retention less with concern about the right to be forgotten and more with a view towards the retention periods required under law.

8.2 Data Protection

Under the general rules of Russian law, a holder of personal data must have measures in place to avoid unauthorised use or disclosure of that personal data. As the regulatory framework for digital rights develops, we would expect more specific data protection rules to be applied to blockchain-based products and services.

9. MINING AND STAKING

9.1 Mining

Mining of cryptocurrencies is not specifically prohibited under law, but the legal basis for it is uncertain.

The legal status of cryptocurrency mining is likely to evolve. The law does not clearly define "mining" in this context, but the Digital Financial Assets Law provides for the "issuance" and

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“organisation of the circulation” of cryptocurrencies, stating that these activities will be governed by law. So far, however, the specific laws for this have not been passed, but importantly, the law does not prohibit these activities.

The issue of digital currency in the Russian Federation is understood as actions involving the use of objects of the Russian information infrastructure and (or) user equipment located in the territory of the Russian Federation, aimed at providing opportunities for the use of digital currency by third parties.

The organisation of circulation of digital currency in the Russian Federation is understood to mean the provision of services aimed at ensuring the completion of civil transactions and (or) operations that entail the transfer of digital currency from one owner to another, using objects of the Russian information infrastructure.

To the extent that these provisions are understood to cover cryptocurrency mining, the activity is not prohibited and future legislation should be expected.

In a more general sense, as cryptocurrencies have recently been recognised as a type of property for taxation purposes, any transaction

through which cryptocurrencies are earned may be construed as a commercial transaction (for example, a services transaction through which verification is provided for value), subject to reporting and taxation. If the mining is undertaken on a regular basis, it could be considered an “entrepreneurial activity” much like operating a business, entailing registration, reporting and taxation compliance.

There is a good deal of scepticism amongst lawmakers, regulators and law enforcement regarding cryptocurrency mining.

Some lawmakers, regulators and law enforcement officials are concerned that cryptocurrency mining may be used for money laundering and other criminal activity. While these negative sentiments toward cryptocurrency mining are clear, it is not clear when and in which form any specific rules governing mining will be enacted.

9.2 Staking

Russian law does not specifically regulate the staking of tokens. While the question of whether a transaction of staking might be considered a commercial activity or an investment, it is clear that any cryptocurrency received in the process would be considered taxable income and should be reported as such.

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DLA Piper has a Russian practice based in Moscow and St Petersburg comprised of two offices with nearly 100 legal professionals who are uniquely multidisciplinary, offering commercial legal solutions combined with a strong tax analysis and planning component. In addition to the Russia-qualified team, the firm has Russia-based English, French, German and US-qualified lawyers, who provide clients with a significant depth of local resource. Strengthened by DLA Piper's global blockchain group, the Russian practice offers strategic regulatory and transactional guidance to companies in

nearly every sector, among them internet and social media companies building content databases; banking, insurance and other financial services companies reducing transaction processing times; healthcare companies using tokens to secure medical records; and agricultural and industrial companies improving their supply chain logistics. The firm assists companies at every stage of the business life cycle, from early-stage start-ups raising funds through blockchain-enabled means to commercial institutions operating at the intersection of finance and technology.

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RUSSIA LAW AND PRACTICE

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