

Strategic Investments regime in Russia

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Introduction and background

The strategic investments regime in Russia was established 10 years ago, when the Federal Law "On the Procedure for Foreign Investments in Companies having Strategic Importance for the National Security and Defense" No. 57-FZ dated April 29, 2008 (the "Strategic Investments Law") came into force on May 07, 2008. The Strategic Investments Law establishes the procedure for securing clearances to the transactions, as well as notification procedure on the transactions implemented in different strategic sectors of Russian economy.

Pursuant to the provisions of the law and regulations, the Federal Antimonopoly Service (the "FAS") as well as the Government

Commission on Monitoring Foreign Investments chaired by the Prime-Minister of Russia (the "Commission" or the "Government Commission") are authorized to exercise control over foreign investments in Russia, where the Commission shall decide on granting clearance to the transaction and the FAS acts as an intermediary between the applicant and the Commission.

The current note provides an overview of the legal regime for the foreign investments in strategic sectors of the Russian economy, existing procedure for obtaining strategic investments clearance and highlights recent trends and legislative amendments enacted just recently by the Russian regulators.

Legal framework

Acquisition by a foreign investor of shares (participatory interest) or other forms of control (both direct and indirect) in respect of Russian companies having strategic importance (the "Strategic Companies") might be subject to clearance with the Russian state authorities under the Strategic Investments Law, which is the major law building up the legal framework for exercising control over foreign strategic investments in Russia.

At the same time, there are also by-laws regulating functions of the Government Commission, a procedure for consideration and analysis of the transactions in Russia such as:

- Decree of the Government of the Russian Federation "On the Government Commission on Monitoring Foreign Investments" No. 510 dated July 06, 2008
- Decree of the Government of the Russian Federation "On approval of rules for preliminary clearance of the transactions and establishment of control of foreign investors or a group of persons, including a foreign investor, over the companies of strategic importance for the national security and defense" No. 838 dated October 17, 2009
- Order of the FAS No. 23 dated January 20, 2012 regulating consideration of requests on necessity to secure strategic clearance

Scope of application of the Strategic Investments Law

The Strategic Investments Law:

- regulates acquisition of control over Russian Strategic Companies;
- foresees cases when the transactions require pre- or post-transaction notifications of the Government Commission;
- provides a list of 47 strategic activities, regarded as being of strategic importance.

The following relations fall within the scope of the Strategic Investments Law:

- acquisition of shares (participatory interests) of the Strategic Companies by foreign investors, or a group of persons; **AND (OR)**
- acquisition by foreign investors, or a group of persons, of the fixed production assets of the Strategic Companies, balance sheet value of which is 25 percent or more of balance sheet value of assets of the transferring company, for the last reporting date, according to its accounting reports; **AND ALSO**
- other transactions, including at stock exchanges, or actions as a result of which control of foreign investors, or a group of persons, over the Strategic Companies is established.

Strategic Company

The Strategic Company is a company incorporated in the Russian Federation which performs at least one of the 47 activities of strategic importance listed in Article 6 of the Strategic Investments Law.

Strategic Activities / Industries

- Nuclear and Radioactive materials
- Military Equipment
- Aviation and Space
- Oil and Gas
- Natural Resources
- Mining Exploration and Production
- Mass Media and Telecommunications
- Extraction of Aquatic Biological Resources
- Coding and Cryptographic Equipment
- Printing and Publishing
- Use of Agents of Infectious Diseases (except for companies engaged into food production)
- Services provided by natural monopolies such as:
 - Oil and Gas Pipeline Transport
 - Railroad Transport
 - Terminals, Ports and Airports
 - Electric or Heat Energy and etc.

Foreign Investors

The following persons are considered as foreign investors for the purposes of the Strategic Investments Law:

- foreign companies and organizations, regardless of having status of a legal entity
- organizations under foreign control, including those incorporated in Russia
- foreign citizens, apatrides (persons without citizenship) having inhabitancy outside Russia, and Russian citizens having dual citizenship
- foreign states*
- international organizations*

**For foreign states and international organizations, there is a prohibition on transactions resulting in the establishment of control over the Strategic Companies. The same prohibition applies to companies which do not disclose information.*

Exemptions

The following transactions involving the Strategic Companies fall outside the scope of the Strategic Investments Law:

- transactions, in which a foreign investor already possesses more than 50% of the voting shares in the authorized capital of the Strategic Company prior to the transaction, or if a foreign investor is under control of the company, which already exercises control over the Strategic Company. This exemption does not apply to situations where the Strategic Company is involved in use of subsoil plot of federal value (higher threshold of ownership by a foreign investor or its group of more than 75% of the voting shares shall be applied in this case)
- strategic clearance is not required if purchaser is controlled by:
 - a) the Russian Federation;
 - b) a constituent entity of the Russian Federation;
 - c) a citizen of the Russian Federation, who is a Russian tax resident (excluding Russian citizens having dual citizenship).
- strategic clearance is not required in respect of the Strategic Companies involved in use of subsoil plot of federal value in case the Russian Federation may dispose more than 50% of their voting shares and retains this right as the result of the transaction.

“Control” in accordance with the Strategic Investments Law

According to the provisions of the Strategic Investments Law the term “control” means the following:

General definition:

- possibility of a foreign investor, or group of persons, directly, or through third parties, to determine decisions made by the Strategic Companies by securing of control of voting shares (participatory interests) in the authorized capital of such companies at general meetings of shareholders (participants) of such companies, by participation in their boards of directors (supervisory board) and other managerial bodies of such companies;
- conclusion with the Strategic Company of the contract on control of the functions of the managing director (managing organization), or a similar agreement;
- Special criteria for the Strategic Companies involved in the use of subsoil plot of federal value;
- possibility of a foreign investor, or a group of persons, directly or indirectly to dispose 25% and more of the voting shares (participatory interest) in the authorized capital of the Strategic Company involved in use of subsoil plot of federal value;
- right of a foreign investor, or a group of persons, to appoint an individual executive body and (or) 25% and more of the collegial executive body of the Strategic Company;
- unconditional possibility of a foreign investor or a group of persons to elect 25% and more of board of directors (supervisory board), or other collegial body of management of such company.

“Controlled person” in accordance with the Strategic Investments Law

1. According to the provisions of Article 5 of the Strategic Investments Law, the Strategic Company is considered being under control (**controlled person**) of a foreign investor, a group of persons (**controlling person**) in case at least one of the following criteria is met:
 - the controlling person has a right, directly or indirectly, to dispose of more than 50% (more than 25% for the Strategic Companies involved in use of subsoil plot of federal value) of voting shares (participatory interests) in the authorized capital of the controlled person;
 - the controlling person on the basis of the contract, or on other basis, acquired the rights, or powers, to determine the decisions made by the controlled person, including terms and conditions of implementation of business activity by the controlled person;
 - the controlling person has the right to appoint an individual executive body and (or) more than 50% (25% and more for the Strategic Companies involved in use of subsoil plot of federal value) of the collegial executive body of the controlled person and (or) has an unconditional opportunity to choose more than 50% (25% and more for the Strategic Companies involved in use of subsoil plot of federal value) of the board of directors (supervisory board), or other collegial managerial body of the controlled person;
 - the controlling person carries out powers of a management company of the controlled person.
2. Please note that the controlled person is considered being under control of the controlling person also in case the controlling person has the right, directly or indirectly, to dispose on any ground of **less than 50% of total voting shares** (participatory interests) in the authorized capital of the controlled person, provided that the ratio between the number of shares held by the controlling person and other shareholder enables the controlling person to define the decisions made by the controlled person.
3. The control is also established in situations, when foreign states, international organizations, companies which do not disclose information, and also organizations which are under their control collectively hold **more than 50% of voting shares** (or less for the cases when the company is involved in use of subsoil plot of federal value) of the Strategic Company.
4. Herewith, foreign states, international organizations, companies which do not disclose information, and also organizations which are under their control, including those created in the territory of the Russian Federation, are not entitled to implement transactions, other actions involving establishment of control over the Strategic Companies and (or) to carry out the transactions providing acquisition of fixed production assets of the Strategic Companies, the balance sheet value of which **exceeds 25%** of balance sheet value of assets of the transferring company, for the last reporting date, according to its accounting reports.
5. Transactions, as a result of which the foreign states, international organizations, companies which do not disclose information, or organizations under their control receive the right to dispose of, directly or indirectly, **more than 25% of voting shares** (participatory interests) in the authorized capital of Strategic Company, or other opportunity to block decisions of managerial bodies of Strategic Company, or have the right, directly or indirectly, to dispose **more than 5% of voting shares** (participatory interest) in the authorized capitals of the Strategic Companies involved in use of subsoil plot of federal value, are subject to receiving preliminary consent of the Government Commission.

Pre-Transaction and Post-Transaction notifications

The Transactions subject to strategic clearance could be divided into those requiring pre- and post-transaction notifications:

Pre-transaction notifications

Pre-transaction filing is necessary for establishment of control and other transactions with voting shares and rights, as described above, or acquisition of fixed production assets of the Strategic Company.

Post-transaction notifications

Post-transaction notification shall be filed in case of acquisition of 5% and more of the shares (participatory interests) in the authorized capitals of the Strategic Companies and, in case of closing transactions preliminary approved by the Government Commission.

Filing procedure and documents required

For the **pre-transaction notification**, a foreign investor shall obtain consent of the Government Commission, prior to implementation of the transaction. Preliminary proceedings are held by the FAS and other state bodies.

The procedure for consideration of the pre-transaction notification consists of three stages:

- The notification is reviewed by the FAS, which checks on compliance of the notification with the formal requirements.
- Then, the FAS sends requests related to the notification to other government authorities being in charge of state security and national defense.
- Finally, the Government Commission considers the notification along with the reports provided by the specified government authorities and adopts a decision on taking the notification into consideration.

As in the case with merger control clearance in accordance with the Competition Law, for the strategic investments filing very much the same information and documents are required: data regarding the purchaser and the Strategic Company, their activity, respective groups' description, information on the transaction etc.

The period for obtaining the approval constitutes about 3 months from the moment of submission of the notification. It could be additionally prolonged for up to 3 months for extra analysis and request for additional information and documents.

The **post-transaction notification** shall be submitted to the FAS within 45 calendar days from the date of closing of the transaction.

Then, it should be considered within 30 days from the date of submission of the relevant documents. Upon the results of consideration of the notification special notice shall be granted.

Decisions of the Government Commission

As the result of consideration the Government Commission may adopt one of the following decisions:

- to refuse in clearance of the transaction
- to give a consent to the transaction
- to give a consent to the transaction, imposing certain obligations on the purchaser

Merger control issues

As a rule, the notification and approval requirements established by the Strategic Investments Law are separate from the merger control regime provided for by the Competition Law. However, where transactions require clearance under both regimes, the FAS will postpone the merger control review until

clearance under the Strategic Investments Law is obtained. If a transaction is blocked under the Strategic Investments Law process, this automatically constitutes the ground for the competition authority to deny merger clearance as well.

Sanctions

Importance of obtaining strategic clearance cannot be overestimated since violation of the Strategic Investments Law requirements may result in invalidation of the transaction, or deprivation of the foreign investor of his right to vote at the general meetings of shareholders/participants of the Strategic Company.

Transactions executed in breach of the Strategic Investments Law are null and void. If it is impossible to apply the consequences of invalidity of a void transaction, the court may, upon the lawsuit of the FAS adopt a decision:

- deprive a foreign investor of its right to vote at the shareholders' (participant's) meeting of the Strategic Company;
- invalidate the decisions of the management bodies of the Strategic Company adopted after establishment of control, in breach of the Strategic Investments Law.

Moreover, according to the Russian Code on Administrative Offences administrative fines are to be imposed in case of failure to obtain preliminary approval, or to notify after the transaction and also for submission of misleading information to the authority.

Failure to provide required information, and failure to comply with the requirements above, may result in the imposition of the following fines:

- Failure to secure pre-transaction clearance - up to **RUB 1 000 000** on companies (approx. USD 15 950, EUR 13 551)
- Failure to notify on the transactions implemented - up to **RUB 500 000** on companies (approx. USD 7 980, EUR 6 775)

The most frequent violations are related to failure to submit post-transaction notifications, or information required for consideration of the notifications.

Statistics and notable cases

10-years statistics¹:

- 516 notifications submitted
- Among them, more than 200 notifications returned, since the clearance was not required
- 229 considered, of which 216 cleared
- Only 13 rejected.

Landmark rejections

- Acquisition of 100% shares of the Russian power company, Electroshield Samara, by Schneider Electric (France)(2012);
- Acquisition of 100% shares of the Russian pharmaceutical company, NPO Petrovax Pharm, by Abbot (USA) (2013);
- Acquisition of 50% of shares of the Fashion Press, publishing Cosmopolitan and Esquire in Russia, from Sanoma by Hearst Shkulev Media (partially owned by Hearst (USA)) failed to clear (2015).

Invalidation of transactions

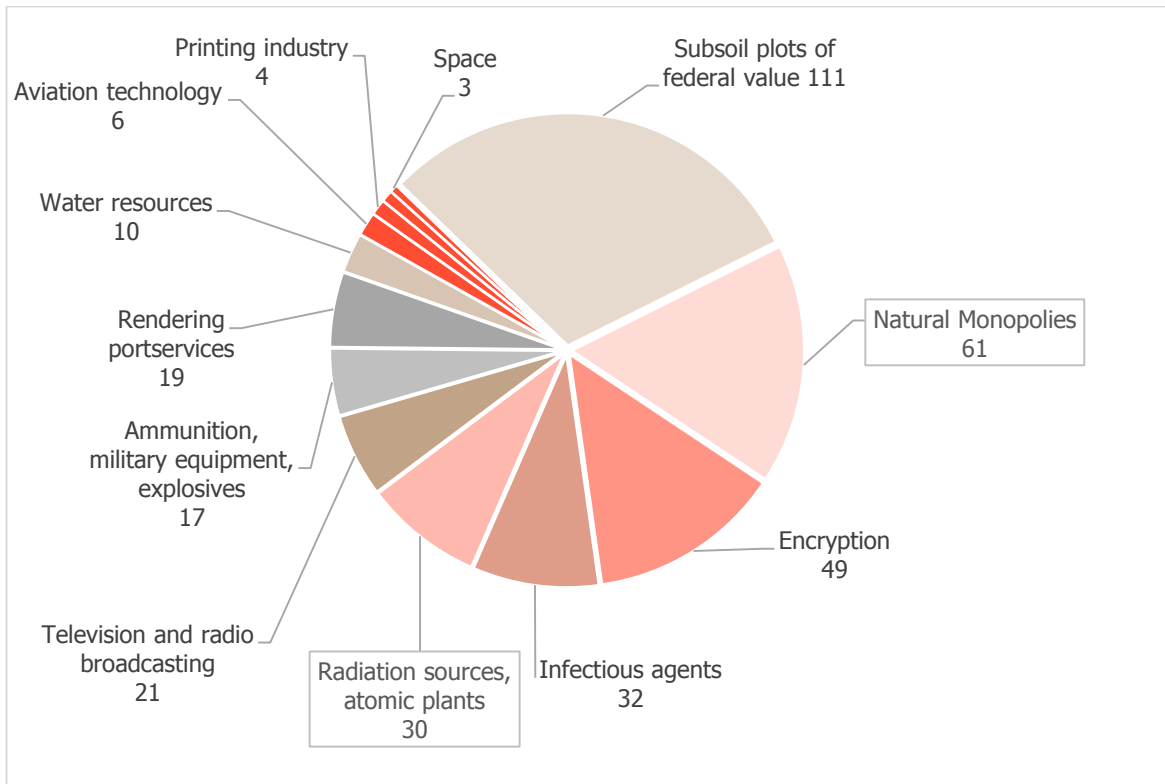
- In the **Astrakhan Port case**, the FAS initiated court proceedings against Khazar Sea Shipping Lines, South Shipping Agency, Azoress Shipping Company L.L.FZE (all indirectly controlled by Islamic Republic of Iran) with respect to the acquisition of Astrakhan Port JSC shares by those companies, in violation of the Strategic Investments Law. The court agreed with the FAS and invalidated the transaction, making the foreign investors return the shares to the Seller. After a number of attempts to appeal the decision, the companies settled with the FAS and sold the shares to another company, which had obtained preliminary clearance of the Government Commission to that acquisition.
- In the **Velent Trans LLC case**, the former company, being controlled by a foreign investor, acquired 99,9667% of shares of Yuzhno-Uralskiy Heavy Engineering JSC, being a Strategic Company, without securing the preliminary approval of the Government Commission. The FAS filed a lawsuit requesting the court to invalidate the transaction. The company settled with the FAS, having agreed to sell the shares acquired to RMC LLC, a Russian company controlled by a Russian citizen.

¹ The data is provided based on the statistics published by the FAS, available at <https://fas.gov.ru/publications/15311> (in Russian only)

Deprivation of rights to vote

- In the **specialized seaport Vitino case**, the FAS found that London High Court of Justice had appointed citizens of the United Kingdom as temporary managers for the Cyprian company Yuzarel Investments Limited. As a result of the appointment, the specified temporary management obtained rights to exercise operational management of the company and determine the decisions of its subsidiary Seaport Vitino LLC, being Strategic Company. The strategic clearance, required for such actions, was not received. The FAS asked the Russian court to invalidate the decisions of Yuzarel and to deprive it of its voting rights. Yuzarel transferred 100% of shares to a Russian company and deprived itself of control.
- In the **BSS LLC case**, the FAS established that BSS LLC, the only participant of which was SATTERFIELD MANAGEMENT LTD (the United Kingdom), established control over LISSI LLC, which was a Strategic Company, without obtaining strategic clearance. The FAS initiated proceedings in court to deprive BSS LLC of its right to vote at the participant's meeting of LISSI LLC. The courts agreed with the FAS.

The Chart below demonstrates the breakdown by industries of applications submitted in 2008 – 2017².



² The data is provided based on the statistics published by the FAS, available at <https://fas.gov.ru/documents/622161> (in Russian only)

Recent amendments

Recently a number of amendments has been introduced to the Strategic Investments Law, which significantly affected the strategic investments regime. Among them are the following:

- granting the right to the **Russian Prime Minister** to suggest any transaction for clearance of the Government Commission
- granting the right to the **Government Commission** to impose any obligations on applicants, by virtue of agreements on ensuring fulfillment of certain obligations/commitments
- introduction of a concept of “companies not disclosing information”

“Any transactions” might require clearance of the Government Commission

After amendments to the Foreign Investments Law made in 2017 to support national defense and state security, upon the decision of the Russian Prime Minister, any transactions of foreign investors with regard to Russian entities, which do not even relate to the specified 47 types of strategic activities, might be brought to the Government Commission for clearance under the procedure specified in the Strategic Investments Law.

Generally, there are three categories of transactions, which might be of interest of the Russian Prime Minister and might be considered by the **Government Commission**:

1. Transactions in respect of Russian companies not involved in implementation of the strategic activities, however, implementing activities that might be directly connected with those 47 activities of the strategic importance;
2. Large trans-border transactions, involving transfer of assets/subsidiaries located in Russia, on which the economic defense of Russia might depend;
3. Transactions with public investors usually operating in different cultural and legal environment. This primarily relates to eastern countries.

The procedure for adoption of the decision by the **Prime Minister** is as follows:

1. Within 5 business days from the date the Russian competition authority becomes aware of the transaction of a foreign investor with respect to the Russian company, it shall send requests, on the necessity to inform the Russian Prime Minister, to the federal authorities, or organizations, responsible for implementation of national policy and statutory regulation in the considered sphere, into which the Russian entity is involved;
2. After that, within 15 business days, addressees shall submit their suggestions to the FAS;
3. In case the Russian Prime Minister adopts a decision on the necessity of securing the preliminary clearance to the transaction, the FAS shall inform the foreign investor of the decision taken within 3 business days.

Agreements ensuring fulfillment of certain obligations

When, after the consideration process, the **Government Commission** has concerns that the transaction, to be implemented by the foreign investor, might influence the national defence and security of the state, it could elaborate commitments/obligations to be imposed on the parties to the transaction to mitigate the risks and negative impact of the transaction.

Such obligations might include limitation of access to the state secrets, maintenance of production facilities, fulfillment of defense procurement supplies and so on. The recent amendments determined, that the Commission may impose any other obligations not listed in the Strategic Investments Law, fulfillment of which is related to maintenance of the national security and defense. In other words, **the list of obligations is not exhaustive**.

Companies, which do not disclose information

On June 12, 2018 the **Federal Law No. 122-FZ** "On amendment of some laws of the Russian Federation changing the definition of the "foreign investor" entered into force. Previous amendments of July 2017 to the Strategic Investments Law prohibited offshore companies from acquiring control in the Strategic Companies and imposed on them other restrictions that were previously applicable only to public investors (foreign states and international organizations). In practice, these amendments caused a number of difficulties impeding the flow of foreign investments into the Russian economy.

The new law introduced a concept of "**companies not disclosing information**" and cancelled the concept of "offshore" companies. In accordance

with the amendments, those companies which do not disclose information on their beneficiaries, beneficiary owners and controlling persons relate to the specified category. The legal status of such companies is equal to public investors (foreign states and international organizations) for which the special regulation is established (please kindly see above).

The new concept seems to be more investor-friendly, as compared to the concept of offshore companies as of 2017, since now application of a stricter regime can be potentially avoided by providing the required information regarding the beneficiaries, beneficiary owners and controlling persons of a foreign investor (including those registered in offshore jurisdictions).

Our experience

ALRUD Law Firm specialists have a vast experience in consulting on the matters of strategic investments, across the full range of context and different sectors of economy. A brief description of some of notable and recent examples is provided below:

- ALRUD advised a **Chinese state-owned investor** on various strategic and foreign investments issues of acquisition of control over a **Russian mining company**. This is the second example of Russian practice when a foreign state-controlled company was allowed to acquire control over a Russian strategic Company on the basis of the intergovernmental agreement (in this case, between the Russian Federation and the People's Republic of China). During the consultations held, ALRUD advised the client on possible strategic and foreign investments concerns related to further operation of the Russian company, including the enforceability of the shareholders agreement between the new state-owned investor and existing private shareholder.
- ALRUD advised and represented interests of **CEFC China Energy Company Limited**, a private conglomerate with interests in energy and financial services, during strategic clearance with respect to the acquisition of 14,16% of shares in **Rosneft Oil Company**, being a Strategic Company. That was the largest transaction requiring strategic clearance and reviewed by the government authorities in 2017. The case was complicated by a number of amendments to the legislation, which considerably affected the consideration procedure. After the latest amendments came into force, no strategic investments clearance was required any more, therefore, ALRUD specialists managed to get a firm confirmation of that fact from the government authorities, to avoid potential risks of breach in future.
- ALRUD is currently representing **Siemens AG**, a German conglomerate company focusing on the areas of electrification, automation and digitalization, regarding clearance in Russia of the global **Siemens – Alstom** transaction valued at €15 billion. The transaction will result in creation of a new European champion in the production of railway rolling stock. This complicated project involves a number of issues related to economics, politics and national defence and state security. The matter is extremely important for the Russian railway industry, as Siemens Group is one of strategic reliable partners of Russian Railways OJSC, providing innovative rolling stock for the most important routes with a high level of localization of production.

Key contacts



Vassily Rudomino

Senior Partner

Practices: Competition/Antitrust, Compliance,
Capital & Equity Markets, Corporate/M&A, Investments



E: VRudomino@alrud.com




German Zakharov

Partner

Practice: Competition/Antitrust, Compliance



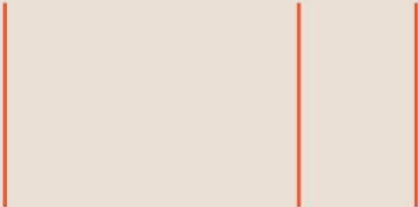
E: GZakharov@alrud.com



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ALRUD Law firm
Skakovaya st., 17, bld. 2, 6th fl.
Moscow, Russia, 125040

T: +7 495 234 96 92
+7 495 926 16 48
E: info@alrud.com



ALRUD