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Special Update on Amendments to Legislation Relating to Foreign Investments into Strategic Sectors in Russia

On 4 November 2014 the Russian President signed Federal Law № 343-FZ to amend the Law on foreign investments into strategic sectors (the "Law")[1] and certain other legislative acts.

The amendments entered into force on 6 December 2014.

The amendments are designed to improve control over foreign investments in Russian companies of strategic importance (the "**strategic companies**") and, in general, promote more liberal governance in this field.

On one hand, the amendments limit the scope of transactions which are subject to approval but, on the other hand, impose approval requirements for new types of transactions (such as, transactions with property of the strategic companies). The application of certain novelties would require a position of the regulatory authorities to be formed and relevant court practice to be developed.

This special update provides the most important amendments introduced to the Law.

For more information, please contact:

Grigory Chernyshov
Partner, Moscow
+ 7 495 787 3045
gchernyshov@whitecase.com

Ekaterina Tulaeva
Associate, Moscow
+ 7 495 645 4979
etulaeva@whitecase.com

Ksenia Tyunik
Associate, Moscow
+ 7 495 787 3026
ktyunik@whitecase.com

1 Federal Law № 57-FZ of 29 April 2008.

White & Case LLC
Tel: + 7 495 787 3000
Fax: + 7 495 787 3001
whitecase.com

The requirement on prior approval of transactions with property of the Strategic Companies

Pursuant to the amendments, approval from the Government Commission on Control over Foreign Investments in the Russian Federation (the "**Commission**") is now required for transactions entered into by foreign investors that result in the acquisition of the right of ownership, possession or use of the strategic company's property that: (a) is classified as fixed production assets and (b) the value of which constitutes 25% or more of the book value of the assets of the company determined as of the last reporting date based on its financial statements. Such property may be acquired, for example, on the basis of sale and purchase, donation, swap, lease, trust management or gratuitous use agreements.

A balance sheet of the strategic company for the last reporting date and information on the book value of the strategic company's assets shall be attached to the application for prior approval of transactions with the property.

A foreign investor that has obtained the Commission's approval to acquire property, which constitutes a certain percentage of the total book value of the strategic company's assets, will be able to acquire property of the company, during the term of such approval, and within the limits of the agreed percentage. Accordingly, a greater percentage of the property of the same strategic company will require the foreign investor to obtain a separate and additional approval from the Commission. We note that the adopted amendments prohibit the ability to acquire right of ownership, possession or use of such property by "state" foreign investors.

In practical terms, it was often easier for foreign investors to acquire so-called "strategic" property from the strategic company (and obtain a relevant license, if necessary) without the approval of the Commission, than to establish control over a given strategic company in compliance with prior approval requirements as envisaged by the Law. The amendments now eliminate this possibility.

The new amendments will require further improvement and clarifications from the Federal Antimonopoly Service (FAS). For example, it is clear that based on the broad wording of the Law, control measures may apply to transactions with property unrelated to the conduct by the strategic company of directly "strategic" activities. Also, FAS clarifications will be required on how to calculate the book value payment of the acquired property (i.e. either the total book value of assets, or the book value of the strategic company's production assets), as well as what information is required to attach to the application to confirm this calculation.

New criteria of control of "state" foreign investors over strategic companies

The amendments introduce additional criteria of control over the strategic company provided exclusively for "state" foreign investors, i.e. investors that are foreign states or international organizations[2] or under their control.

According to the new criterion, several independent "state" investors not forming part of one group of persons, will be deemed to control the strategic company if they have the right to dispose of, directly or indirectly, in aggregate: (i) more than 50% of shares (participatory interests) in the strategic company or (ii) less than 50% of shares (participatory interests) provided that the ratio of number of votes of these "state" investors and other shareholders (participants) of the company is such that the mentioned "state" investors can determine the resolutions adopted by the strategic companies.

The introduction of this criteria removes the uncertainties arising in the assessment of situations of *actual joint control* by independent "state" foreign investors (provided that none of them separately exercises control), and legislatively approves FAS practice that was previously ascertained in cases of actual *joint control* by several "state" government foreign investors over strategic companies.

Exceptions to the requirements for prior approval of transactions with respect to strategic subsoil users

Another important amendment is the introduction of exceptions to requirements for prior approval from the Commission for a number of transactions with respect to the strategic companies using subsoil deposits of federal significance. Approval from the Commission is no longer required for:

- transactions resulting in the acquisition of the right to dispose (directly or indirectly) shares (participatory interests) in strategic subsoil users if, prior to such acquisitions, the relevant foreign investor had the right to control more than 75% of shares (participatory interests) in the strategic subsoil user;
- transactions resulting in the transfer from one foreign investor to another (**without increasing share of participation**) of more than 25% of shares (participatory interests) in a strategic subsoil user, if the foreign investors are under control[3] of a person that already has control over the strategic subsoil user; and
- transactions involving the increase of a strategic subsoil user's charter capital if, as a result of such transition, a participation share of the foreign investor in the subsoil user does not increase.

2 Save for international financial organizations exempted as per Part 3 Article 2 of the Law.

3 In other words, both foreign investors must be subsidiaries of such person in which he has the right to directly or indirectly control more than 50%)

The purchaser must notify FAS, in the manner prescribed by Article 14 of the Law, on the performance of the above transactions.

These amendments are considered to be a significant step towards further liberalization of regulation on foreign investments in the sector of strategic subsoil use.

Specifying criteria on the exemption of transactions from prior approval ("exemptions")

Transactions with respect to strategic subsoil users where the Russian Federation has the right to dispose, directly or indirectly, more than 50% of voting shares (participatory interests) in the strategic subsoil user

The amendments, introduced additional criteria to the existing exception, pursuant to which the exemption applies if: (i) the Russian Federation has the right to dispose of more than 50 % of voting shares (participatory interests) in the strategic subsoil user *at the moment of performance of the transaction*; and (ii) the Russian Federation retains this right *after completion of such transaction*.

This exception, as before, does not apply if the acquisition is made by "state" foreign investors. If such exception applies to the transaction, it is not required to notify FAS about the acquisition.

Intra-group transactions with respect to strategic companies (except for strategic subsoil users)

The amendments specify the existing exemption, replacing the criterion of "group of persons" by criterion of "control". Accordingly, the acquisition does not require prior approval from the Commission if, prior to the acquisition, a foreign investor – purchaser (i) has the right to, directly or indirectly, dispose of more than 50% of the voting shares (participatory interests) in the strategic company or (ii) is under control of a person that has control over such company.

If the transaction falls under such exemption, a foreign investor must notify FAS about the completed transaction.

Transactions of companies controlled by the Russian Federation, constituent entities of the Russian federation or Russian citizens

The amendments introduced to the Law in 2011, excluded from its scope transactions between companies controlled by the Russian Federation or Russian citizens (i.e. under so-called "Russian" control). In practical terms, however, there were uncertainties that are now eliminated by the amendments.

The most important clarification is that for the purpose of exemption from approval, a criterion of "Russian" control must apply to the **purchaser only**, and not to both parties of the transaction, as stated earlier. However, as far as the control of Russian citizens, the amendments clarify that the purchaser must be under the control of **one** Russian person. Thereby, the uncertainties were eliminated in relation to the practical application of this exemption to situations when control was implemented by *several* Russian citizens (e.g., independent individuals as well as relatives forming part of one group of persons). The above-mentioned clarifications also reflect the existing FAS practice on these issues. As before, requirements that the controlling Russian citizens do not have dual citizenship and are Russian tax residents remain the same.

The amendments also add a new criterion to the exemption, pursuant to which prior approval is not required if the purchaser is not only under the control of the Russian Federation but also under the control of the constituent entity of the Russian Federation. This addition expands a scope of transactions subject to exemption, which was unreasonably limited before.

Changes to the list of strategic activities

Following the amendments, activities related to the use of agents of infectious diseases conducted by companies whose core business relates to food production is no longer considered strategic. This amendment will significantly limit the scope of transactions subject to prior approval as the transactions with respect to certain companies (such as cheese-making and dairy factories, bakeries and confectionaries) will no longer fall under the scope of the Law.

Activities related to the provision of services at Russian ports by natural monopoly companies listed in the relevant register are excluded from the list of strategic activities. However, these activities will be deemed strategic if they are conducted by companies listed in the Register as having a market share of more than 35% or holding a dominant position in the market. The actual list of services provided at ports is yet be approved by the Russian Government.

Introduced amendments expand the list of strategic activities conducted by companies engaged in mass media. In particular, the amendments clarify that a company may be deemed strategic if it acts not only as an editorial body or a publisher, but also as a founder of a periodical printing with total annual circulation, prior to the transaction or filing of an application, in excess of volumes set forth in the Law. The amendments introduce a list of circulation volume thresholds for different types of periodical printings depending on the frequency of their publication.

Other amendments

Possibility to extend the term for transaction approval

Pursuant to the Law, the purchaser must propose the validity term of the Commission's decision on the approval of the transaction when applying for prior approval of the transaction. Prior to the amendments, such term was specified in the decision and, if the parties were unable to complete the transaction during the specified period, they were required to obtain a new approval.

The amendments provide the purchaser with the possibility to apply for an extension of the validity term of the decision with an explanation as to why it should be extended. This novelty will remove excessive administrative barriers and make it easier for FAS and the Commission (in so much as there will be no need to re-submit an application supported by a large set of documents). In practical terms, however, a purchaser must apply for an extension of the term in advance since it may take the Commission a considerable period of time to make a decision, given the frequency of its meetings.

Expansion of the scope of obligations of a foreign investor by an agreement

Pursuant to the Law, in some cases the Commission may adopt a decision on approval of the transaction subject to agreement with a foreign investor on his fulfillment of certain obligations with respect to the strategic company. The amendments require that processing aquatic biological resources harvested/caught by the strategic company in Russia must be performed on Russian territory. This amendment is a reflection of government policy to encourage the development of industrial processing of aquatic biological resources on Russian territory and limit their resale abroad.

Requirement to notify FAS on prior approval of a transaction

The amendments impose an obligation on the purchaser to notify FAS about completion of previously approved transaction. Now this obligation is determined in Government Resolution No. 838 dated 17 October 2009.