NEWSLETTER

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Foreign investment in Russia. Recent amendments

On July 1, 2017 entered into force the Federal Law dated July 1, 2017 No. 155-FZ "On amendments to Article 5 of the Federal Law "On the Privatization of State and Municipal Property" and the Federal Law "On the Procedure for Making Foreign Investments in Companies which are of Strategic Importance for Ensuring the National Defense and State Security" (hereinafter – "Law No. 155-FZ" and "Strategic Investments Law" respectfully).

On July 19, 2017 was published and on July 30, 2017 shall become effective the Federal Law dated July 18, 2017 No. 165-FZ "On amendments to the Article 6 of the Federal Law "On Foreign Investments in the Russian Federation" and the Strategic Investments Law" (hereinafter – "Law No. 165-FZ" and "Foreign Investments Law" respectfully).

CORE AMENDMENTS

1. ***Highlights of amendments to the Foreign Investments Law***:

- to ensure the national defense and state security the Russian Prime Minister is empowered to decide to bring any transaction planned by a foreign investor to the review of the Government Commission on Monitoring Foreign Investments in the Russian Federation (hereinafter – the "Government Commission") in accordance with procedures of the Strategic Investments Law;
- in case of failure to comply with these requirements, consequences prescribed by the Article 15 of the Strategic Investments Law shall be applicable (transaction shall be null and void or a foreign investor shall be deprived of the right to vote at the general meeting of a target).

2. ***Highlights of amendments to the Strategic Investments Law:***

- the amendments prohibit offshore companies (and organizations under their control) to establish control over strategic entities, similarly to the existing prohibition for foreign states;
- the list of strategic activities is clarified and extended;
- the list of obligations that can be imposed by the Government Commission on a foreign investor in case of conditional clearance is not exhaustive anymore;
- new liability is introduced: for failure to submit post-closing notification on acquisition of more than 5% of shares in a strategic entity the court, under the FAS Russia claim, can deprive a foreign investor of voting rights at general meeting of a strategic entity;
- in relation to the Republic of Crimea or the city of Federal importance Sevastopol: foreign investors or group of entities registered in these territories have to notify the FAS Russia about possession of 5% shares and more in a strategic entity within 90 days as of entry the amendments into force.

<u>Peculiarities of the new amendments:</u>

I. Amendments to the Foreign Investments Law

The Law No. 165-FZ amends Article 6 of the Foreign Investments Law with a new provision: **upon decision of the Russian Prime Minister (chairman of the Government Commission), a transaction contemplated by a foreign investor** in relation to any **Russian entity** is subject to a pre-closing clearance in accordance with procedures of the Strategic Investments Law (submission of a notification to the FAS Russia, receiving opinions of relevant ministries and agencies by the FAS Russia and other). Taking into account that previously the Foreign Investments Law was applicable to the foreign states, international

organizations and organizations under their control only, so these amendments extend the scope of the Law to any private foreign investors and moreover to the Russian citizens having another citizenship.

In case such a decision is taken by the Prime Minister, the FAS Russia notifies a foreign investor about necessity to obtain a pre-transaction clearance. Currently, it is difficult to assess the associated risks, because there is no established procedure for making such a decision by the Prime Minister, and the only criteria is ensuring the national defense and state security.

Moreover, if a transaction is implemented in violation of the new requirements of the Foreign Investments Law, the transaction shall be null and void or a foreign investor shall be deprived of the right to vote at the general meeting of a target (as specified by Article 15 of the Strategic Investments Law).

II. Amendments to the Strategic Investments Law

1) Prohibition to acquire by offshore companies of control over strategic entities

Offshore companies, for the purposes of the Strategic Investments Law, as amended by the Law No. 155-FZ, are now given the same status as foreign states and international organizations. Criteria for being qualified as an offshore company are set by the Order of the Ministry of Finance of the Russian Federation as of November 13, 2007 No. 108н, which lists states and territories providing preferential tax regime and (or) not disclosing information on financial operations. Offshore companies include entities registered, in particular, in the following offshore zones: the BVI, the Cayman Islands, the UAE, Seychelles, special administrative regions of China (Hong Kong and Macau), separate administrative units of the Great Britain (the Isle of Man, the Channel Islands) and other.

According to the explanatory note these amendments are aimed at realization of the state policy regarding deoffshorization of the Russian economy and creation of incentives for return of exported capital.

Amendments to Article 2 of the Strategic Investments Law contain **prohibition to establish control or to acquire more than 25% of fixed production assets of a strategic entity** not only for foreign states and international organizations (organizations under their control), but now also for **offshore companies** and organizations under their control.

The criteria of control are set forth in Article 5 of the Strategic Investments Law, and the most common criteria is disposal of more than 50% of the in a controlled entity.

Transactions which result in acquisition by an offshore company or organization under its control of more than 25% and up to 50% minus 1 votes of a strategic entity (more than 5% and up to 25% minus 1 votes of entities using subsoil plots) or possibility to block decisions of management bodies of a strategic entity are subject to pre-transaction clearance with the Government Commission.

2) Restrictions concerning applicability of the existing exception from Strategic Investments Law scope

The Law No. 165-FZ allows to apply exception under part 9 of Article 2 of the Law (according to which the Law is not applicable to transactions in which the acquirer is an entity under control of the Russian Federation, subject of the Russian Federation, or Russian citizen without another citizenship being Russian tax resident) only if the acquirer is controlled via disposing directly or indirectly of more than 50% of votes. Thus, other criteria of control currently set forth in parts 1 and 2 Article 5 of the Law cannot serve as a legal ground for the exception application anymore, which expands the scope of the Law.

Besides, the amendments additionally highlight the FAS Russia approach[1], according to which Russian citizens having another citizenship are recognized as foreign investors from the perspective of the Law.

3) Clarifying and expanding the list of strategic activities

The Law No. 165-FZ corrects the list of strategic activities. In particular, due to the abolishment by the Forth Antimonopoly Package of the Register of 35%, now for considering a company as a strategic entity, it is required to have a dominant

[1] http://fas.gov.ru/press-center/news/detail.html?id=39821

position in the markets listed in this clause.

The requirement regarding existence of a dominant position is cancelled for manufacturers and sellers of metals and alloys with special properties, raw materials used in the manufacture of weapons and military equipment.

The list of strategic activities is extended by an additional one: carrying out activities by an operator of an electronic platform, in accordance with the legislation of the Russian Federation on contract system in procurement of goods, works, services for state and municipal needs.

The amendments also specify that not only licenses for carrying out certain activities, but also other permissive documents may be indicators of a company's strategic status. On the basis of law enforcement practice such documents may include certificates of self-regulatory organization, certificates of conformity and other documents.

4) Open list of obligations which may be imposed on investor

Under the Strategic Investments Law the Government Commission, when taking a decision on a conditional clearance, may impose on a foreign investor one or several obligations. The list of such obligations was exhaustive. But the Law No. 165-FZ establishes the open list of the obligations, empowering the Government Commission to define other obligations connected with ensuring the national defense and state security, which may be imposed on an applicant.

5) Liability for non-submitting by a foreign investor of a post-closing notification

The Law No. 165-FZ introduces a new liability for failure to submit by a foreign investor (or its group) of a post-closing notification regarding acquisition of 5% and more shares in a strategic entity. FAS Russia will have the right to bring the claim before the court for deprivation of the foreign investor of the right to vote at the general meeting of a strategic entity.

Herewith, the restoration of the voting rights is implemented not through court proceedings, but from the moment of receiving by a foreign investor of the FAS Russia's information that the legal requirements were complied with (thus, in fact, after submitting a post-closing notification and its consideration by the FAS Russia).

6) Expanding of the Law applicability to the new constituent entities of the Russian Federation

According to the Law No. 165-FZ the Strategic Investments Law now covers strategic entities, registered in the territory of the Republic of Crimea or the city of Federal importance Sevastopol. Thus, a foreign investor or a group of entities owing 5% or more of shares (participation interests) in a strategic entity shall submit to the FAS Russia this information within 90 days from the date of entry into force of the amendments. Non-submitting such an information entails consequences similar to the failure to submit a post-closing notification (see point 5 above).

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