ALERT MEMORANDUM

Further Significant Amendments to the Russian Legislation on Foreign Investments: Transactions Made by Foreign Investors in Respect of Russian Businesses Became Subject to Discretionary Governmental Control

August 4, 2017

Following recent changes to Federal Law No. 57-FZ "On the Order of Accomplishing Foreign Investment in Entities Having Strategic Importance for Procuring State Defence and Security" of April 29, 2008 (the "FSIL") that became effective on July 1, 2017 (*please see our relevant Alert Memorandum* [1]), on July 30, 2017, new Federal Law No. 165-FZ of July 18, 2017 entered into effect, introducing amendments (the "Amendments") to Federal Law No. 160-FZ "On Foreign Investments in the Russian Federation" of July 9, 1999 (the "Foreign Investments Law") and FSIL.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

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[1] See: https://www.clearygottlieb.com/news-and-insights/publication-listing/offshores-restricted-from-participation-in-privatizations-and-acquisitions-of-russian-7-10-17.

A. Summary of the Amendments

In short, the Amendments in respect of the Foreign Investments Law:

— granted the Government of the Russian Federation a discretionary power to decide whether a transaction by a foreign investor in respect of any business entity incorporated in Russia is subject to a prior governmental control in accordance with the procedure set forth by the FSIL, even if such transaction does not involve any strategically important Russian entity;

— stipulated that such transactions completed in the absence of prior clearance are null and void and may be subject to other consequences provided by the FSIL; and

in respect of the FSIL:

— narrowed the number of cases where the FSIL does not apply to transactions made by acquirers controlled by the Russian Federation, its constituent entity or Russian citizens;

— made the list of restrictions and obligations that the Governmental Commission for Control over Foreign Investments in the Russian Federation (the "Commission") was able to impose on foreign investors of the target entity as a condition to clearance open-ended;

— set forth that foreign investors that fail to make such notifications upon acquisitions of 5 or more per cent equity interest in a strategically important entity may be deprived of their voting rights;

— introduced new and updated descriptions of certain existing types of strategic activities.

B. Foreign Investments Law

The Amendments set forth starting from July 30, 2017 that the chairman of the Commission (the "Chairman") may "*for the purposes of procuring the state defence and security*" in his or her sole discretion request a prior clearance of transactions being made by a foreign investor in respect of Russian business entities (*i.e.* joint-stock companies and limited liability companies). If the Chairman so decides, the Federal Antimonopoly Service (the "FAS") within three business days following the receipt of Chairman's decision ("Decision") should give a notice to the foreign investor that the respective transaction is subject to a prior approval by the Commission in accordance with the procedure established by the FSIL. For the purposes of these new provisions "foreign investors" also include (i) Russian citizens having citizenship of another state; and (ii) entities controlled by foreign investors, including those incorporated in the Russian Federation.

Transactions completed in the absence of a Commission's prior approval, if such approval is required based on a Decision, will be considered null and void. In certain circumstances the FAS may also claim in court that a foreign investor and/or entities controlled by it be deprived of their voting rights in respect of equity interests in the Russian entity.

These new provisions still raise a lot of questions as to their practical application. First, the Amendments failed to establish any certain criteria, which the Chairman would take into account in assessing whether a particular transaction should require a prior clearance by the Commission or not. Moreover, as drafted, the new provisions allow the Chairman to issue its Decision at any stage of a particular transaction process, which may adversely affect the transaction timing, for example, if a Decision is issued shortly before completion.

The Amendments did not introduce any procedure that would allow parties to clarify this issue in advance, for example, by submitting a prior request to the FAS and asking whether the Chairman considers the particular transaction being subject to a prior Commission's approval. Therefore there is no current indication as to whether any response from the FAS or the Chairman in this regard might constitute a valid waiver by the Chairman of its rights to issue its Decision.

Further, the new provisions are drafted broadly to apply to any transaction made by a foreign investor "*in respect of Russian business entities*" and not only to acquisitions. Thus the scope of potentially concerned transactions is open-ended. In any event it should most likely include all types of transactions that are now subject to the FSIL (*see* Article 7 of the FSIL).

We expect that further discussions as to the practical impact of these new provisions of the Foreign Investments Law may take place and that the FAS or the Commission may provide some further guidance in this regard.

C. FSIL

Narrowing the Scope of Exemption for Russian Beneficiaries

The FSIL does not apply to transactions in respect of strategically important business entities if the acquirer is controlled by the Russian Federation, its constituent entity or a Russian citizen who is also a Russian tax resident (save for Russian citizens being at the same time citizens of another state) ("Russian Beneficiary").

However, the Amendments have significantly limited the scope of the criteria used for determining whether the acquirer is controlled by a Russian Beneficiary. Pursuant to the Amendments the acquirer may be considered being under control of a Russian Beneficiary only if such Russian Beneficiary is entitled to directly or indirectly dispose more than 50% of voting rights attached to equity interests in the acquirer. Therefore all other criteria (namely: (i) other contractual and non-contractual arrangements allowing to determine decisions taken by the acquirer, including its business activities, (ii) ability to appoint the sole executive body and/or more than 50% of a management board or supervisory board of the acquirer); (iii) exercising of the powers of a management company of the acquirer; and (iv) *de facto* control, where a stake not exceeding 50% is enough) no longer apply in this context.

Commission's Remedies

Prior to the Amendments, the FSIL contained an exhaustive list of restrictions and obligations that the Commission was able to impose on foreign investors of the target entity as a condition to clearance. Pursuant to the Amendments, the Commission is now allowed to impose any other restrictions and/or obligations, the performance of which shall be connected with the procurement of state defence and security. Literally it means that the list of available restrictions and obligations is now open-ended.

Consequences of Failures to Notify upon Minor Transactions

In addition to its clearance requirements, the FSIL also requires foreign investors to notify the FAS upon acquisition of 5 or more per cent equity interest in a strategically important entity. The Amendments now also set forth that foreign investors that fail to make such notifications may be deprived of their voting rights in respect of respective equity interests based on a court decision claimed by the FAS. The Amendments stipulate that the respective restrictions should be lifted upon the receipt by the FAS of the respective notification.

New Types of Strategic Activities

Pursuant to the Amendments, two new types of strategic activities, which thus now fall within the scope of the FSIL, have been added:

— Use of nuclear materials and radioactive substances in the course of carrying out works for the use of nuclear energy for defence purposes, including development, production, testing, transportation, exploitation, storage, liquidation and utilization of nuclear weapons and military nuclear facilities;

— Performing of activities by a business entity that is an operator of an e-trading platform in accordance with the laws of the Russian Federation on contractual system in the area of procurement of goods, works and services for state and municipal needs.

Moreover, prior to the Amendments the FSIL considered the "production and sale of metals, composites having specific qualities and raw materials used in the course of production of weapons and military equipment" as a strategic activity only if such kind of activity was performed by an entity having the dominant position in the respective market. Pursuant to the Amendments, this kind of activity is strategic and falls within the scope of the FSIL irrespective of "the dominant position" qualifier. It should be noted that any activity

performed by an entity having dominant position in a particular market is a strategic activity. [2]

Other Changes

The Amendments also introduced some further changes into the FSIL:

— Russian citizens having citizenship of another state now are considered "foreign investors" for the purposes of the FSIL;

— It is now clearly stated that any disputes in relation to violations of the FSIL fall within the exclusive competence of Russian state Arbitrazh courts;[3]

— Some further technical amendments were made to the descriptions of strategic activities.

If you have any questions, or if you wish to discuss the Amendments further, please feel free to contact your usual contacts at the firm. You may also contact Scott Senecal (ssenecal@cgsh.com), Murat Akuyev (makuyev@cgsh.com) or Yulia Solomakhina (ysolomakhina@cgsh.com) at the Moscow office of the firm at +7 495 660 85 00.

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[2] It should be noted that as in accordance with the amendments to the Federal Law "On Protection of Competition" of July 26, 2006, No. 135-FZ, the FAS since January 5, 2016 no longer maintains the "Register of Entities Having a 35% or Greater Market Share and Having Dominating Position", it became more complex to assess whether an entity having market share below 50% in fact has a dominant position in a particular market and, hence, whether it performs strategic activity.

[3] We note that it is consistent with the logics of so called "arbitration reform" that took place in September 2016, when Federal Law of December 29, 2015, No. 409-FZ that introduced a number of changes into the Arbitrazh Procedural Code of the Russian Federation came into effect.