

## The Law on Foreign Investments in Russian Strategic Companies



**Further information**

If you would like further information on any aspect of the issues described in this note please contact a person mentioned below or the person with whom you usually deal.

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This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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# Contents

<b>STRATEGIC COMPANIES</b>	<b>1</b>
<b>FOREIGN INVESTORS</b>	<b>1</b>
<b>TRANSACTIONS SUBJECT TO PRIOR CONSENT</b>	<b>1</b>
<b>CLEARANCE CRITERIA</b>	<b>1</b>
<b>OBTAINING PRIOR CLEARANCE</b>	<b>1</b>
<b>FAILURE TO OBTAIN PRIOR CLEARANCE</b>	<b>2</b>
<b>TRANSACTIONS SUBJECT TO POST-NOTIFICATION</b>	<b>2</b>
<b>PROHIBITION ON CONTROL BY FOREIGN STATE ENTITIES</b>	<b>2</b>
<b>AGREEMENTS CONCLUDED OUTSIDE THE RUSSIAN FEDERATION AND INDIRECT ACQUISITIONS</b>	<b>2</b>
<b>EXCEPTIONS</b>	<b>2</b>

# The Law on Foreign Investments in Russian Strategic Companies

In April 2008, the Russian parliament passed a law on the "Procedure for Foreign Investments in Companies of Strategic Significance for the Defence and Security of the State" No. 57-FZ (the "**Foreign Investments Law**").

The Foreign Investments Law restricts investments by foreign investors in companies that are deemed to be strategic ("**Strategic Companies**") by requiring such investors to obtain prior Russian government clearance before, or to submit a post-transaction notification after, entering into certain transactions, or, in some cases, prohibiting such investments.

In addition, the Foreign Investments Law establishes special additional regulations for strategic companies involved in mining exploration activities and/or the exploitation of subsoil plots of federal status ("**Strategic Mining Companies**")<sup>1</sup>.

This note sets out a brief overview of the main effects of the Foreign Investments Law.

## STRATEGIC COMPANIES

Strategic Companies are companies carrying out business activities in strategic sectors, including services provided by natural monopolies (for instance, trunk pipeline transportation of crude oil and oil products, pipeline transportation of gas, transportation by rail), television and radio broadcasting in certain territories and certain other sectors (a complete list of business activities in strategic sectors is set out in Annex to this note).

## FOREIGN INVESTORS

Foreign investors comprise:

- (non-Russian incorporated companies and foreign individuals (the "**Foreign Private Investors**"));
- foreign states, international organisations and companies under their control (the "**Foreign State Entities**"); and
- Russian companies and organisations under the control of Foreign Private Investors or Foreign State Entities.

## TRANSACTIONS SUBJECT TO PRIOR CONSENT

### Clearance criteria

Transactions requiring the prior consent of a special governmental commission (prior clearance) include:

- the acquisition of rights to hold, directly or indirectly, votes attached to voting shares in a Strategic Company or a Strategic Mining Company; or
- the acquisition of rights to appoint a chief executive officer, to appoint a collective executive body and/or unconditional rights to elect a board of directors of a Strategic Company or Strategic Mining Company,

in either case as a result of which the number of votes acquired by a foreign investor or the makeup of the executive body/board of directors appointed/elected by a foreign investor, exceeds the following percentages:

	Foreign Private Investors	Foreign State Entities
<b>Strategic Companies</b>	> 50%	> 25%
<b>Strategic Mining Companies</b>	≥ 25% <sup>2</sup>	> 5%

- the acquisition of rights by a Foreign State Entity allowing the Foreign State Entity to block the passing of a decision taken by the management bodies of a Strategic Company; and
- the acquisition of rights by a foreign investor allowing the foreign investor to determine the business activities of a Strategic Company or to perform the functions of its management company.

In addition, the acquisition of rights, directly or indirectly, to hold more than 25% of the votes attached to voting shares in any Russian company (not necessarily a strategic one) are subject to prior clearance if the acquisition is effected by a Foreign State Entity.

Under the Foreign Investments Law, an "acquisition" is broadly defined and includes sale and purchase agreements, trust, assignment and other contracts, including indirect acquisitions.

### Obtaining prior clearance

A transaction requiring prior clearance must be approved by a governmental commission. The application shall be filed with the Federal Antimonopoly Service of the Russian Federation (the "**FAS**"). The initial period within which the governmental commission must make a decision upon the application is three months from the submission of the application.

<sup>1</sup> Subsoil plots of federal status include, inter alia, plots with exploitation potential of more than 70 million tones of recoverable oil or 50 billion cubic meters of gas.

<sup>2</sup> Prior to 18 December 2011, such threshold was 10% or more.

However, the decision period may be extended up to six months in total.

A refusal to approve a transaction may be challenged in the *High Arbitrazh Court* of the Russian Federation.

#### **Failure to obtain prior clearance**

A transaction made without prior clearance, where such clearance is required, is void. The parties to such transactions will be ordered to return everything received under the transactions. If it is not possible to effect a complete return, the court may deprive the defaulting foreign investor of voting rights at general meetings upon a claim of the FAS.

Decisions taken by management bodies of a Strategic Company and transactions made by the latter after a foreign investor has invested without prior clearance may be challenged by the FAS before the court.

#### **TRANSACTIONS SUBJECT TO POST-NOTIFICATION**

The Foreign Investments Law requires foreign investors to notify the FAS of an acquisition of more than five per cent of the shares in a Strategic Company unless the transaction has already been granted prior clearance if it falls into one of the categories of transaction requiring prior clearance.

#### **PROHIBITION ON CONTROL BY FOREIGN STATE ENTITIES**

The Foreign Investments Law prohibits Foreign State Entities from acquiring any "control" of Strategic Companies.

In particular, in relation to foreign investors including Foreign State Entities, ownership of more than 50% of the voting shares in a Strategic Company or 25% or more of the voting shares in Strategic Mining Company amounts to "control"<sup>3</sup>.

This cannot be derogated by consent of the Russian government. Foreign State Entities are therefore limited to acquiring up to 50% of the shares in a Strategic Company or 25% minus 1 voting share of the shares in a Strategic Mining Company respectively.

#### **AGREEMENTS CONCLUDED OUTSIDE THE RUSSIAN FEDERATION AND INDIRECT ACQUISITIONS**

The Foreign Investments Law applies to agreements concluded outside the Russian Federation.

The Foreign Investments Law applies to the acquisition of entities who directly or indirectly control Strategic Companies.

#### **EXCEPTIONS**

The Foreign Investments Law does not apply to the acquisitions of Strategic Companies by entities under the control of the Russian Federation or individuals that qualify as Russian residents in accordance with Russian tax laws (except for the individuals with double citizenship). Generally, a Russian resident is an individual that can prove his or her physical presence in the territory of Russia for more than 183 days during a year.

The Foreign Investments Law does not apply to investments in a Strategic Mining Company by Foreign Private Investors provided that more than 50% of voting shares in the Strategic Mining Company are held by the Russian Federation and/or if the Russian Federation has the right to hold, directly or indirectly, more than 50% of votes attached to the voting shares in the Strategic Mining Company.

The Foreign Investments Law does not apply to transactions regarding a Strategic Company or Strategic Mining Company entered into by the Foreign State Entities in which an international financial organisation participates. On 3 February 2012 the Russian Government approved a list of such international financial organisations, and this list includes, inter alia, International Bank for Reconstruction and Development and International Finance Corporation.

February 2012

<sup>3</sup> The "control" definition also includes inter alia rights to determine the business activities of a Strategic Company, to perform the functions of its management company and rights to appoint a chief executive officer, to appoint a collective executive body and/or unconditional rights to elect a board of directors of a Strategic Company (more than 50% of the total number of members) or Strategic Mining Company (25% or more of the total number of members).

## ANNEX

### THE LIST OF BUSINESS ACTIVITIES CARRIED OUT BY THE STRATEGIC COMPANIES

1. Services provided by natural monopolies
  - Trunk pipeline transportation of crude oil and oil products.
  - Pipeline transportation of gas.
  - Transportation by rail.
  - Services provided in transportation terminals, ports and airports.
  - Services relating to the use of inland waterway infrastructure.
  - Operational dispatch management in power industry.
  - Electric power or heat energy transmission services (subject to the type of facility network used).
2. Mining exploration and/or exploitation of a subsoil plot of federal status.
3. Television broadcasting in territories inhabited by at least one half of the total population of a particular constituent entity of the Russian Federation.
4. Radio broadcasting in territories inhabited by at least one half of the total population of a particular constituent entity of the Russian Federation.
5. Operations involving active influence on hydro meteorological processes and phenomena.
6. Operations involving active influence on geophysical processes and phenomena.
7. Activity involving the use of agents of infection.
8. Deployment, construction, commissioning and decommissioning of nuclear installations, sources of radiation, as well as nuclear material and agent sites and nuclear waste storage sites, save for activity with respect to commissioning of nuclear installations carried out by the legal entities in the civil economy sector not as its main activity.
9. Handling of nuclear materials and radioactive substances, including handling the same during exploration and production of uranium ores, as well as during manufacture, use, processing, shipment and storage of the same.
10. Handling of radioactive waste during storage, processing, shipment and storage.
11. Use of radioactive materials and/or radioactive substances during research and development work.
12. Design engineering of nuclear installations, sources of radiation, as well as nuclear material and agent sites and nuclear waste storage sites.
13. Design and manufacture of the equipment for nuclear installations, sources of radiation, as well as nuclear material and agent sites and nuclear waste storage sites.
14. Expert appraisal of design, engineering and production documents corroborating nuclear and radiation safety of nuclear installations, sources of radiation, as well as nuclear material and agent sites and nuclear waste storage sites, and also handling of nuclear materials, radioactive agents and radioactive waste.
15. Development and manufacture of cryptographic devices, as well as data and telecommunication systems, such development and manufacture being subject to licensing under the Russian law.
16. Distribution of cryptographic devices, such distribution being subject to licensing under the Russian law, save for such activity carried out by banks with no Russian Federation's share in its charter capital.
17. Technical maintenance of cryptographic devices, such maintenance being subject to licensing under the Russian law, save for such activity carried out by banks with no Russian Federation's share in its charter capital.
18. Provision of data encryption services, save for such activity carried out by banks with no Russian Federation's share in its charter capital.
19. Detection of electronic bugging devices located indoors or inside technical equipments (except whenever such activity meets own requirements of a legal entity).
20. Development, manufacture, sale and purchase for resale of special bugging devices by corporate business entities.
21. Development of combat arms and military equipment.
22. Manufacture of combat arms and military equipment.
23. Repair of combat arms and military equipment.
24. Disposal of combat arms and military equipment.
25. Trade in combat arms and military equipment.
26. Manufacture of firearms and principal components thereof (except for side arms and some other types of arms).

27. Manufacture of service cartridges and components thereof (except for cartridges used in civil and duty weapons).
28. Trade in fire arms and components thereof and service cartridges (except for cold arms, civil and duty weapons and cartridges used therein).
29. Development and manufacture of ammunition and components thereof.
30. Disposal of ammunition and components thereof.
31. Manufacture and distribution of industrial explosives.
32. Aviation security control.
33. Space activities.
34. Development of aviation equipment, including dual-purpose aviation equipment.
35. Manufacture of aviation equipment, including dual-purpose aviation equipment.
36. Repair of aviation equipment, including dual-purpose aviation equipment (except for parts and components to be repaired by civil aviation companies).
37. Testing of aviation equipment, including dual-purpose aviation equipment.
38. Business of an entity included in the register determined by Article 23 of the Federal Law On Protection of Competition and acting as a dominating business
  - at a communication services market within the geographical boundaries of the Russian Federation (except for services of Internet providers);
  - at a fixed telephone communication services market in the territory covering at least five constituent entities of the Russian Federation;
  - at a fixed telephone communication services market within the geographical boundaries of the cities with a federal status.
39. Business of an entity acting as dominating manufacturers of and traders in special metals and alloys used for production of combat arms and military equipment.
40. Extraction of aquatic biological resources.
41. Business of an entity acting as printers with a production output of at least 200 million copy sheets per month.
42. Business of an entity acting as editors and/or publishers of a periodical, each issue circulating in at least one million copies.

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