

FOREIGN INVESTMENT IN STRATEGIC INDUSTRIES: FIRST SET OF AMENDMENTS

March 28, 2011

To Our Clients and Friends:

On March 23, 2011, the State Duma of the Russian Federation adopted in the first reading the Bill (the “Bill”) on Amendments to Federal Law No. 57-FZ on Foreign Investments in Commercial Entities of Strategic Importance for National Defense and National Security, dated April 29, 2008 (the “Law”), submitted to the State Duma by the Government of the Russian Federation. The Federal Antimonopoly Service (“FAS”) (the federal authority responsible for oversight of strategic investments) initiated the proposal to liberalize the regulatory regime and improve oversight of foreign investments in strategic entities. The impetus for the Bill was that two years of practical implementation of the Law revealed excessive administrative barriers to foreign investment in strategic sectors and ambiguities of the regulatory regime. Additionally, in 2010 the Russian Government declared its intent to make Russia more attractive for direct foreign investment by, *inter alia*, simplifying the procedure for foreign investment in strategic sectors.

The amendments introduced by the Bill will apply if adopted by the State Duma in three readings, approved by the Federation Council, signed by the President, and officially published.

The Bill is referred to as the “first set of amendments” and is expected to be followed shortly by a “second set of amendments,” which is currently being prepared by FAS for the Russian Government’s consideration.

The Bill reduces administrative barriers for foreign investors by:

- Excluding from the list of strategic activities, activities related to the use of Group IV pathogens of infectious diseases; operation of radioactive facilities posing a Category 4 potential radioactive hazard; and encryption activity of banks in which the state does not have a share.

This amendment simplifies investments in the food, banking and healthcare sectors by qualifying food producers that use Group IV pathogens of infectious diseases in their manufacturing processes (e.g., producers of dairy products); entities that use X-ray and similar equipment (e.g., hospitals); and banks without state participation that use encryption and cryptographic equipment to support some of their operations (e.g.,

provision of internet banking services) as not strategic. The Law was never intended to qualify the entities operating in these sectors as strategic and captured them only because of their ancillary activities.

As currently worded, the amendments deal only with banks without state participation and do not cover non-banking lending institutions that may also be engaged in encryption activities related to the provision of internet services to their clients.

- Excluding from transactions subject to strategic investment clearance the acquisition by a foreign investor of the shares of a strategic entity using subsoil sites of federal importance in which such foreign investor already directly or indirectly holds 10% or more of the voting shares, provided that this acquisition of additional shares does not increase the share of the foreign investor in the charter capital of such strategic entity.

This amendment allows foreign investors holding 10% or more of the voting shares of the strategic entity to exercise their preemptive rights without obtaining approval.

The Bill addresses the procedural aspects of strategic investment clearance by:

- Regulating the involvement of the Ministry of Defense in the process of strategic investment clearance and extending the period for the preparation of its joint (with the Federal Security Service) opinion on the transaction's impact on the state's defense and security from twenty to thirty days without impact on the total timing for consideration of the application.
- Extending the period for the execution of an agreement between the federal authority responsible for oversight of strategic investments (FAS) and the foreign investor with regards to the foreign investor's obligation in connection with the acquisition (subject to strategic investment clearance) from twenty to thirty days (if such agreement is required).

The Bill does not address the main areas of concern of foreign investors in strategic sectors, e.g., the definition of control, low thresholds for the acquisition of shares in strategic entities using subsoil sites of federal importance, etc.

The second set of amendments is expected to introduce more substantial changes to the Law. Currently, for the second set of amendments, FAS is, *inter alia*, proposing to:

- lift the threshold for the acquisition of shares in strategic entities using subsoil sites of federal importance from 10% to 25%;

- regulate the acquisition of a strategic entity by a group of entities that includes foreign investors only if the foreign investor participates in the transaction;
- clarify the application of the strategic investment clearance to the deposit of ordinary shares represented by depository receipts with a depository bank, and provide that strategic investment clearance will be required only for the acquisition of depository receipts by the beneficial owners;
- introduce a threshold for the acquisition of control equal to a 20% shareholding;
- introduce the requirement to approve the acquisition of assets of strategic entities providing the services of natural monopolies;
- provide that if the law requires a foreign investor to execute a transaction subject to strategic investment clearance (e.g., the obligation to acquire shares as a result of a mandatory tender offer), the foreign investor does not have to obtain prior strategic investment clearance for such a transaction, but must apply for its strategic investment clearance within three months following the acquisition of control.

It is not yet clear which draft of the second set of amendments will be presented for the consideration of the lawmakers, and when that might be. However, the Russian Government and FAS have indicated their goal to adopt a second set of amendments in 2011, preferably in the first part of the year.

We will closely monitor and update you on any developments related to the Bill and the second set of amendments.

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