

FOREIGN INVESTMENT AND INVESTMENT IN STRATEGIC ENTITIES: REGULATORY LIBERALIZATION

November 14, 2011

To Our Clients and Friends:

On November 1, 2011, the State Duma of the Russian Federation adopted in the third reading¹ the Bill² on Amendments to Art. 6 of the Foreign Investments Law³ and the Strategic Investments Law.⁴ The Bill was adopted by the Federation Council on November 9, 2011. It will become law after the President of the Russian Federation signs it and 30 days after its official publication.

The following is a summary of the key amendments introduced by the Bill:

STRATEGIC SUBSOIL USERS⁵

Increase in the threshold for prior approval of transactions from 10% to 25%

The Bill increases the threshold for the approval of the acquisition of the right to directly or indirectly control the total number of votes in a strategic subsoil user from 10% to 25%.

This amendment makes it easier for foreigners to invest in strategic subsoil users.

¹ On March 28, 2011 we announced the adoption of this Bill in the first reading. During consideration of the Bill upon the second and third readings a number of material amendments were introduced into the Bill. This client update sets forth all of the material amendments to the Strategic Investments Law and the Foreign Investments Law introduced by the Bill adopted in the third reading.

² Bill No. 503176-5 (the "Bill").

³ Federal Law No. 160-FZ on Foreign Investment in the Russian Federation dated July 9, 1999 ("Foreign Investments Law").

⁴ Federal Law No. 57-FZ on Foreign Investment in Commercial Entities with Strategic Importance for National Defense and National Security dated April 29, 2008 ("Strategic Investments Law").

⁵ Commercial entities of strategic importance that use subsoil sites of federal importance ("strategic subsoil user").

Abolition of requirement for prior approval if no increase in shareholding interest

The Bill abolishes the requirement for prior approval of the acquisition by a foreign investor of shares (participation interests) in a strategic subsoil user if such foreign investor already has the right to directly or indirectly control 25% or more of the total number of votes attributable to the voting shares (participation interests) in such commercial entity, provided that this acquisition of additional shares (participation interests) does not increase the share of the foreign investor in the charter capital of such strategic entity.

This amendment dispenses with the need to obtain approval for certain corporate transactions where the number of shares (participation interests) held increases without a corresponding increase in the shareholding interest held by a foreign investor in a strategic entity, such as when shares are split or consolidated, or in certain cases of corporate reorganizations and intragroup transactions.

Strategic Investments Law now applies not only to direct, but also to indirect acquisition of shares in a strategic subsoil user, and to the acquisition of the right to directly or indirectly hold such shares if the shareholding interest of a foreign investor increases

The previous version of the Strategic Investments Law allowed for a foreign investor holding a certain number of shares (participation interests) in a strategic subsoil user in excess of the threshold established by the Strategic Investments Law to argue that it was obliged to obtain prior approval only for those transactions that were related to the direct acquisition of additional shares (participation interests) in the strategic subsoil user.

The Bill rules out this argument and expressly states that such approval is required even for the indirect acquisition of shares (participation interests) in a strategic subsoil user, as well as for the acquisition of the right to directly or indirectly hold such shares (participation interests).

TRANSACTIONS BETWEEN ORGANIZATIONS CONTROLLED BY THE RUSSIAN FEDERATION OR BY RUSSIAN NATIONALS

The Bill sets forth that the Strategic Investments Law does not apply to transactions involving strategic companies⁶ between entities controlled by the Russian Federation or controlled by Russian nationals who are tax residents of the Russian Federation,⁷ provided that they do not have dual citizenship.

The test to determine whether the Russian Federation or a Russian national controls such organizations is set forth in the broadly worded criteria for determining whether or not a company is controlled (Article 5 (clauses one and two) of the Strategic Investments Law).

The aim of the Strategic Investments Law has always been to govern investment in strategic companies by foreign, not Russian, investors. Despite this, because of its broadly worded provisions the old version of the law came to govern transactions by Russian investors whose group included foreign companies. The Bill introduces amendments that match the aims of the Strategic Investments Law, releasing both Russian investors and foreign companies controlled by the Russian Federation or, in a number of cases, Russian nationals, from the requirement to obtain approval for transactions involving strategic companies.

FOREIGN INVESTMENT IN CERTAIN SECTORS

The Bill deletes the following types of activities from the list of strategic activities:⁸

- operation of radioactive facilities by a commercial entity in the civilian economy for which such activity is not its principal activity; and
- banking operations involving the dissemination and/or servicing of encryption facilities, and/or provision of data encryption services, other than for those banks in which the state has a share. (The amendments introduced by the Bill only affect banks without state

⁶ *Companies with strategic importance for national defense and national security.*

⁷ *Pursuant to Art. 207 of the Tax Code of the Russian Federation, as a general rule a tax resident is deemed to be an individual who spends not less than 183 calendar days in the Russian Federation in any given continuous 12-month period.*

⁸ *A provision was struck from the Bill that deleted the use of Group IV pathogens of infectious diseases from the list of strategic activities. This activity is performed in the food industry.*

participation and do not apply to non-banking lending institutions that also use encryption and cryptographic facilities in providing online services to customers.)

These amendments simplify investments in the banking and healthcare sectors. The Strategic Investments Law was never intended to qualify the entities operating in these sectors as strategic, and they were captured by the Strategic Investments Law only because of their ancillary activities.

INTERNATIONAL FINANCIAL INSTITUTIONS

The Bill introduces amendments to the provisions of the Strategic Investments Law and the Foreign Investments Law governing acquisitions by international financial institutions of control rights, or more than 25% (or more than 5% in the case of strategic subsoil users), of the shares (participation interests) in both strategic and non-strategic Russian commercial entities.⁹

The Bill abolishes the requirement for prior approval of such transactions if the acquisition is made by an international financial institution created under international treaties to which the Russian Federation is a party or with which the Russian Federation has entered into international treaties.¹⁰ In accordance with the Bill, a list of such international financial institutions must be approved by the Government of the Russian Federation.

⁹ Art. 6 of the Foreign Investments Law *foreign states that international organizations or organizations controlled by international organizations must obtain approval not only for the acquisition of control rights or more than 25% of the shares/participation interests in strategic commercial entities (or 5% in the case of strategic subsoil users), but also for the acquisition of control rights or more than 25% of the shares/participation interests in non-strategic Russian commercial entities as set forth in the Foreign Investments Law.*

¹⁰ *E.g., the International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC), European Bank for Reconstruction and Development (EBRD), provided they are included in the list approved by the Government of the Russian Federation.*

REDUCTION OF THE REVIEW PERIOD

The Bill reduces the period for review by the Governmental Commission on Oversight of Foreign Investment in the Russian Federation (the “Commission”) of a transaction that requires a written guarantee by the acquirer of the performance of certain obligations. The Commission will approve the transaction at the same time as it establishes the requirement to execute an agreement guaranteeing the performance of certain obligations as a condition precedent to such approval. The Bill abolishes the procedure whereby the Commission first sets the requirement to execute the agreement as a condition precedent to approval of the transaction, and then approves the transaction subject to compliance with such requirement.

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If you would like to receive a Russian copy of the revised version of the Laws or further information on this matter, please contact any of the persons indicated below.

Dmitri V. Nikiforov
+7 495 956 3858
dvnikiforov@debevoise.com

Alan V. Kartashkin
+7 495 956 3858
avkartashkin@debevoise.com

Alyona N. Kucher
+7 495 956 3858
ankucher@debevoise.com

Natalia A. Drebezhina
+7 495 956 3858
nadrebezhina@debevoise.com

Anna V. Maximenko
+7 495 956 3858
avmaximenko@debevoise.com