3. Promoting Foreign Investment in Russia

3.1 General Provisions Regarding Foreign Investments

The Constitution and the Civil Code of the Russian Federation, as well as laws on joint stock and limited liability companies, securities markets and insolvency, provide the general legal framework for trade and investment in Russia.

Foreign investments are regulated by the Federal Law No. 160-FZ On Foreign Investments in the Russian Federation, dated 9 July 1999 (the “Law on Foreign Investments”). The Law on Foreign Investments guarantees foreign investors the right to invest and to receive revenues and profits from such investments, and sets forth the terms for foreign investors’ business activity in Russia.

The Law on Foreign Investments does not apply to the investment of foreign capital in banks and other credit organizations, insurance companies or non-commercial organizations; foreign investments in such entities are regulated under different Russian legislation.

The objective of the Law on Foreign Investments is to attract foreign materials, financial resources, and technology and management skills to improve the Russian economy, while providing stability for foreign investors.

The Law on Foreign Investments emphasizes the role of both federal and regional legislation, and stipulates that foreign investors must be treated no less favorably than domestic investors, with certain exceptions. Such exceptions may be introduced to protect the Russian constitutional system, morality, health and rights of persons, or in order to ensure state security and defense.

The Law on Foreign Investments permits foreign investment in most sectors of the Russian economy: government securities, stocks and bonds, direct investment in new businesses, the acquisition of existing Russian-owned enterprises, joint ventures, etc. Foreign investors are
protected against nationalization or expropriation unless such action is mandated by a federal law. In such cases, foreign investors are entitled to receive compensation for any investment and other losses.

One of the most important features of the Law on Foreign Investments is the tax stabilization clause, also known as the “Grandfather Clause”, set forth in Article 9. This clause applies to (i) foreign investors that are implementing “priority investment projects”, (ii) Russian companies with more than 25% foreign equity ownership, and (iii) Russian companies with foreign participation that are implementing “priority investment projects”, regardless of the percentage of foreign participation in the company.

Article 2 defines a priority investment project as a project with foreign investment of at least RUB 1 billion, or where a foreign investor has purchased an equity interest of at least RUB 100 million; in either case, the investment project must also be included in a list of projects approved by the Russian Government.

For companies and projects that qualify, the Grandfather Clause prohibits increasing the rates of certain federal taxes until initial investments have been recouped (up to a maximum of seven years, unless this period is extended by the Russian Government). Key exceptions to the Grandfather Clause are established for excise tax, VAT on domestic goods, and Pension Fund payments. Article 9.4 provides a further and potentially broad exception for laws protecting certain public or state interests. Article 9.5 contemplates the adoption of regulations to implement the Grandfather Clause. Despite all these exceptions and qualifications, it remains arguable whether the tax stabilization clause is of real benefit to foreign investors.

Please also note that Russia is a member of the World Trade Organization and has committed to implement its treaties and regulations.
3.2 Restrictions on Strategic Companies

Certain restrictions on foreign investments are imposed by Federal Law No. 57-FZ “On the Procedures for Foreign Investments in Companies of Strategic Significance for National Defense and Security,” dated 29 April 2008 (the “Law on Strategic Companies”). The Law on Strategic Companies is designed to regulate the acquisition of control over Russian strategic companies by foreign investors or “groups of persons” that include a foreign investor. Acquisitions by such entities of control over strategic companies (including through direct or indirect acquisitions of shares of strategic companies as well as acquisition of main production facilities of strategic companies having a value of 25% or more of the balance sheet value of the company’s assets) require the preliminary consent of the Russian Government or a post-transaction notification.

The Law on Strategic Companies provides a list of more than 40 activities that constitute strategic activities in Russia. Accordingly, any company engaged in such activities is viewed as a strategic company. Strategic activities include the following:

1. Works having an active impact on geophysical processes;
2. Works related to hydro-meteorological processes and events;
3. Activities related to the use of infectious agents which are subject to licensing;
4. Activities related to the nuclear industry and the storage of nuclear and radioactive materials;
5. Activities related to encryption and licensed encryption techniques, excluding distribution and maintenance of encryption techniques and related services performed by Russian banks that are not directly owned by the Russian Federation;
6. Activities related to the secret obtaining of information in premises and equipment (excluding activities performed for the internal purposes of legal entities);

7. Activities related to the production, trade, repair and utilization of weapons and military equipment, and their spare parts and ammunition (excluding bladed weapons, civil and service weapons) and explosive materials for industrial purposes;

8. Activities related to aviation equipment and security;

9. Space activities;

10. Activities related to television or radio broadcasting on a territory, where resides half or more of the population of a constituent entity of Russia;

11. Services provided by a company included in the register of natural monopolies (excluding natural monopolies in the public telecommunications and postal communications fields, services for the supply of heat energy and electrical energy through the distribution grid, and rendering services in ports of the Russian Federation);

12. Activities performed by a company included in the register of companies having more than a 35% market share in a particular market and occupying a dominant position in the following fields:

- communication services in the territory of Russia (excluding providing access to the Internet);
- fixed telephonic communication services in the territory of five or more constituent territories of Russia;
- fixed telephonic communication services in the territories of Moscow and St. Petersburg;
- rendering services in ports of the Russian Federation (in accordance with the list approved by the Russian Government)

13. Activities related to geological research of subsoil or mineral exploration and extraction of federal subsoil;

14. Procurement of aquatic biological resources (e.g. fishing);

15. Printing by a commercial entity if the commercial entity is capable of printing no less than two hundred million pages a month; and

16. Activities performed by editorial boards, publishing houses and the founders of printed publications provided that their circulation reaches certain thresholds specified by law.

Therefore, from the standpoint of foreign investment, it is important to verify all activities the target company is engaged in to assess whether it qualifies as strategic and is therefore subject to the restrictions outlined below.

### 3.3 Controlled Transactions

The following transactions and other actions involving the acquisition of control over strategic companies require the preliminary consent of the Russian Government:

1. For companies engaged in strategic activities other than the use of federal subsoil plots - transactions where a foreign investor or group of persons acquires:
   - Direct or indirect disposal of more than 50 percent of the total number of votes at shareholder level;
• The right to appoint (a) the chief executive officer, and/or (b) more than 50 percent of the members of a collegial executive body of a strategic company;

• The unconditional ability to elect more than 50 percent of the members of the board of directors (supervisory council) or other collegial governing body of a strategic company;

2. For strategic companies using federal subsoil plots – transactions with shares (participatory interests) where a foreign investor or group of persons acquires:

• Direct or indirect disposal of 25 or more percent of the total number of votes at the shareholder level;

• The right to appoint (a) the chief executive officer, and/or (b) 25 or more percent of the members of a collegial executive body of a strategic company;

• The unconditional ability to elect 25 or more percent of the members of the board of directors (supervisory council) or other collegial governing body of a strategic company;

3. For companies using federal subsoil plots – transactions aimed at the acquisition by a foreign investor or group of persons of the right of direct or indirect disposal of shares (participatory interests) if the foreign investor or group of persons already has (a) the right of direct or indirect disposal of more than 25 but less than 75 percent of the total number of votes attached to voting shares (except for acquisition by a foreign investor or group of persons of shares (participatory interests), which does not lead to an increase in the shareholding of such foreign investor or group of persons);
4. Agreements resulting in the acquisition by a foreign investor or by a group of persons of rights to perform the functions of a management company;

5. Other transactions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the governing bodies of a strategic company, including the rights to determine its business activities; and/or

6. Transactions and agreements aimed at the acquisition by a foreign state, international organization or organization controlled by them, of the right to dispose directly or indirectly of more than

   - Five percent of the total number of votes at shareholder level – for companies using federal subsoil plots; or
   - More than 25 percent of the total number of votes at the shareholder level or other means of blocking decisions of the governing bodies – for companies engaged in strategic activities other than the use of federal subsoil plots.

Similar criteria are employed by the Law on Strategic Companies when defining the notion of “control.” “Control” denotes not only a certain minimum shareholding level, but also rights to appoint governing bodies and otherwise determine the company’s business activity.

Preliminary consent is also required for the acquisition by a foreign investor of main production facilities of a strategic company if their value is 25% or more of the company’s book asset value.

The Law on Strategic Companies also provides for a requirement to provide post-transaction notification to the Federal Antimonopoly Service in case of:
• Acquisition of five or more percent of the shares (whether voting or not) in any strategic company;

• Completion of the transactions and other actions for which preliminary consent was previously obtained.

3.4 Special Restrictions for Foreign States, International Organizations and Organizations under Their Control

Investments of foreign states, international organizations and organizations under their control into Russian companies (strategic and non-strategic) are subject to additional clearance requirements under the Law on Foreign Investments. Any transaction which gives a foreign state, an international organization or an organization under their control the right to dispose directly or indirectly of more than 25 percent of the total number of votes attached to voting shares in any Russian company, or otherwise block decisions of the governing bodies of a Russian company, requires preliminary clearance with the Russian Government and the Federal Antimonopoly Service.

Moreover, foreign states, international organizations and organizations controlled by them are explicitly prohibited from acquiring control, as defined by the Law on Strategic Companies, over strategic companies. Namely, they are not allowed to acquire:

1. the right to dispose directly or indirectly of 25 or more percent of the total number of votes attached to voting shares – for companies using federal subsoil plots;

2. the right to dispose directly or indirectly of more than 50 percent of the total number of votes attached to voting shares – for companies engaged in strategic activities other than the use of federal subsoil plots;

3. Other rights mentioned in items 1, 2, 4 and 5 of the above section “Controlled Transactions.”
3.5 Consequences of Violation of the Law on Strategic Companies

Transactions executed in breach of the Law on Strategic Companies or the Law on Foreign Investments are deemed void. The parties to a void transaction may be ordered to return everything received under such transaction in a court action. If it is impossible to reverse a deal, a court may rule to deprive the foreign investor of voting rights at general shareholders meetings of a strategic company if the foreign investor has not complied with the requirements of the Law on Strategic Companies.