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A Legal Overview to Foreign Investments in Russia's Strategic Sectors

Introduction and background

This note gives an overview of Russia's regulatory regime for foreign investments into strategic sectors of Russian industry. The regime is primarily regulated by the Federal Law № 57-FZ dated 29 April 2008 "On the procedure of foreign investment in companies having strategic significance for the preservation of national defence and state security" (the "**Strategic Investment Law**")[1]. The Strategic Investment Law was meant to consolidate the legal regime regarding foreign investments in various Russian strategic industries and also establish a transparent procedure for granting foreign investors access to such industries on a "one stop shop" basis.

In terms of general changes introduced by the Strategic Investment Law, the regulatory thresholds for foreign investment into strategic entities were lowered whilst the list of strategic entities covered by the restrictions was significantly increased. In addition the Strategic Investment Law incorporated amendments to certain existing Russian Federal laws, including the Federal Law "On Subsoil" ("**Subsoil Law**"). Strategic sectors only make up a small part of the Russian economy. However, over the three years since introduction of the new regime a significant number of transactions have proved to involve a strategic element, even when this might not at first sight appear to be the case. Furthermore, having advised on many "strategic transactions" over this period, we feel that there are a range of legal and practical issues that investors should be aware of before structuring the acquisition of a stake in a Russian company.

General scope of the Strategic Investment Law

Application

The Strategic Investment Law applies to:

- any foreign investor (individual or corporate, including a Russian company under foreign control or a foreign company ultimately controlled by a Russian individual), or a group that includes a foreign investor (a "**Foreign Investor**"), carrying out transactions concerning shares in a strategic entity, which would ultimately give a Foreign Investor a certain stake in, or control over, a strategic entity; and
- foreign governments and international organisations and any of their subsidiaries (including subsidiaries incorporated in the Russian Federation) ("**Public Foreign Investors**") seeking to gain a certain stake in, or control over a strategic entity.

[1] The Strategic Investment Law came into force on 7 May 2008.

Key Issues

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The provisions of the Strategic Investment Law only apply to transactions relating to the transfer of shares or participatory interests in a Strategic Entity (as defined below). By contrast, these provisions do not apply to transactions relating to the transfer of a Strategic Entity's assets or to situations where an existing legal entity controlled by a Foreign Investor starts operations that are strategic in nature (although there may be exceptional circumstances, for example, in relation to PPP projects, that may arguably fall under the scope of the Strategic Investment Law).

The Strategic Investment Law is not generally retroactive. However, its provisions apply to both transactions entered into after the date the law came into force as well as those entered into prior to the enactment date but not completed. There are also certain requirements for Foreign Investors who were shareholders of Strategic Entities as at the date of enactment of the Strategic Investment Law. Such Foreign Investors were required (by November 2008) to file information about their ownership of 5% or more of a Strategic Entity, in any event provided that such stake was acquired before enactment of the Strategic Investment Law.

Strategic Entity

For the purposes of the Strategic Investment Law, a strategic entity is an entity incorporated in the Russian Federation that performs at least one activity of strategic importance (a "**Strategic Entity**"). Article 6 of the Strategic Investment Law lists 42 types of activity which are deemed as having strategic importance and these may be split into four broad categories:

- **Natural Resources** - including activity affecting geophysical processes, geological exploration and recovery of natural resources, provided that such natural resources are located in a subsoil block which is deemed "of federal importance" (see more on this below);
- **Defence** - including activity connected with weapons and military equipment, radioactive materials, space, aviation and encryption;
- **Media** - including television and radio broadcasting, certain printing and publishing activities; and
- **Monopolies** - including the activities of not only certain communications and metals companies (which occupy a dominant position in the Russian market) but also various natural monopolies.

Any involvement of a Russian entity in an activity of strategic importance is sufficient to mean that it will be considered a Strategic Entity, regardless of whether such activity is the main part of the entity's business or not.

Consequently, the approval requirements set out in the Strategic Investment Law extend to a number of activities which do not strictly speaking interfere with national defence and state security, e.g. a bank's cryptographic activities or the use of yeast (which is considered as an infectious disease agent) by the manufacturers of dairy products. In practice, this has meant that a number of transactions relating to banks, as well as manufacturers of dairy products, juices, pharmaceuticals, medical products and media companies with insignificant broadcasting activities, have beenly subject to clearance under the Strategic Investment Law.

Amendments to the Strategic Investment Law, providing for specific exclusions from the list of strategic activities, particularly in relation to healthcare-related activities and banks' cryptographic operations, have been included into the first set of amendments to the Strategic Investment Law, which was approved by the Russian government in February 2011 and is expected to be adopted during the course of 2011.

Definition of "control" (Article 5)

The Strategic Investment Law provides that a Foreign Investor will exercise "control" over a Strategic Entity where such Foreign Investor, directly or indirectly:

- has more than 50% of the voting shares in the Strategic Entity;
- has the right to appoint a sole executive officer (e.g. CEO) and/or more than 50% of a management board or other management body of the Strategic Entity;
- has the right to appoint more than 50% of the board of directors of the Strategic Entity; or
- is entitled (on the basis of an agreement or otherwise) to manage or otherwise determine decisions taken by the Strategic Entity (including by virtue of being a managing company with respect to the Strategic Entity).

These Strategic Investment Law provisions are more detailed than previous laws regulating state control over various sectors (e.g. the competition and banking laws). They are formulated in a way to encompass all possible

types of acquisition of substantial stakes in, or control over, Strategic Entities.

As a general rule, it is the cumulative holding of a single Foreign Investor or "group" of Foreign Investors which is relevant for the purposes of these control tests. For example, if one Foreign Investor owns 49% of a Strategic Entity and another Foreign Investor intends to acquire 5%, such acquisition will not require governmental approval to the extent that the two Foreign Investors are not part of the same corporate group or have not otherwise concluded an agreement between them which would have this effect.

The rules for any Strategic Entity conducting geological study of and/or investigation into, and recovery of subsoil resources from, a subsoil block of federal importance (a "**Subsoil Strategic Entity**") are slightly different and are considered separately below.

Transactions requiring prior approval or notice and Public Foreign Investor restriction (Articles 2, 7 and 14)

Further to a governmental decree dated 6 July 2008, the Russian Federal Antimonopoly Service was appointed as the regulator for the purposes of the Strategic Investment Law ("**FAS**").

Prior Approval

Prior approval is required for transactions that would allow:

- a Foreign Investor, which is not itself controlled (directly or indirectly) by an Public Foreign Investor, to control a Strategic Entity (see definition of "control" above); or
- a Public Foreign Investor to acquire, directly or indirectly, 25% or more of *any* Russian entity, whether strategic or non-strategic.[2]

It is worth noting that while a Public Foreign Investor may, following a prior approval, acquire more than 25% of the voting shares of a Strategic Entity, the Strategic Investment Law absolutely prohibits a Public Foreign Investor from gaining "control" (see definition above) over a Strategic Entity.

[2] The prior approval requirement was extended to non-strategic entities as a result of amendments to Federal Law № 160-FZ "On foreign investment in the Russian Federation" of 9 July 1999. In other words, there are two separate laws that may trigger the approval process set out in the Strategic Investment Law.

Notification

In addition, a Foreign Investor must notify FAS of any transaction that would allow the Foreign Investor to acquire 5% or more of the shares in a Strategic Entity. The relevant notification must be delivered to FAS within 45 days of conclusion of the relevant transaction.[3]

Exemptions (Article 4)

The Strategic Investment Law exempts a Foreign Investor from the requirement to obtain prior approval if, before the transaction, the same Foreign Investor already controls, directly or indirectly, more than 50% of the voting shares in the Strategic Entity. While the scope of this exemption is not entirely clear, it is generally understood to mean that the subsequent increase of an existing controlling shareholding in a Strategic Entity, which was approved at the time of initially acquiring such control, does not require a fresh approval (note, however, that this exemption does not appear to apply in relation to Subsoil Strategic Entities).

Sanctions (Article 15)

The Strategic Investment Law provides for extraordinarily severe sanctions for violations of its requirements.

Transactions carried out in violation of the clearance regime are null and void. Such a transaction will carry the consequences of invalidity according to general Russian civil law provisions, including an obligation on each party to return to the other property or money transferred under the transaction.

In the event that such civil law consequences cannot be applied for any reason, the Russian courts will strip the relevant shares of all voting and quorum rights. The courts can also deem void any decisions made by shareholders and management bodies of the relevant Strategic Entity following the transaction.

In the situation where a Strategic Entity is held by an offshore target entity, the effect of these sanctions is currently unclear. The available instruments of stripping voting rights and declaring decisions of the Strategic Entity void imply, however, that the Strategic Investment Law can be enforced by taking measures at the Russian level even in foreign-to-foreign transactions and without having to take measures outside the territory of the Russian Federation.

Procedure for obtaining approval

In order to obtain approval for a transaction, the Foreign Investor (or Public Foreign Investor, as appropriate) must prepare and submit an application to FAS together with any supporting documentation. The contents of any application include the following: draft business plan in prescribed form, documents evidencing the Foreign Investor's constitution (including details of its group companies) and any draft documents detailing the terms and conditions of the proposed transaction. The business plan is considered one of the core documents by FAS and should therefore be drafted carefully and in line with the prescribed requirements.

The approval procedure for applications is conducted in two stages, as follows:

- an initial review of the application by FAS; and
- if FAS decides that the application requires further assessment, it is ultimately passed to a committee, headed by the Prime Minister, consisting of representatives from various state bodies (as determined by a governmental decree dated 6 July 2008), including the Ministry of Defence, the Ministry of Natural Resources and the Federal Security Service (the "**Committee**").

A diagrammatic overview of the approval process is set out at the end of this note.

Within 14 days following the filing of an application, FAS must register it. FAS generally checks that the application is complete and that it contains all requisite documents. Following this initial assessment FAS determines whether control over a Strategic Entity will be established as a result of the transaction in question.

If FAS determines at this first stage that:

- no control over a Strategic Entity would be established as a result of the transaction, it will clear the application without passing it to the Committee - in this case the parties are free to proceed with the transaction without needing any further consent; or
- a Public Foreign Investor would gain control over a Strategic Entity as a result of the transaction (which is generally prohibited, as stated above), it will reject the application without passing it to the Committee.

FAS will pass the application to the Committee:

- if it determines that the overall effect of the transaction in fact establishes control over a Strategic Entity; or
- where no control would be established, but as a result of the transaction a Public Foreign Investor would gain (directly or indirectly):
  - more than 25% of the voting shares in a Strategic Entity or another right to block decisions of the management bodies of such Strategic Entity; or
  - more than 5% of the voting shares in a Subsoil Strategic Entity.

The Committee will then review the application and decide whether to approve or reject the proposed transaction. The assistance of various State agencies, such as the Federal Security Service and the Commission on the Protection of State Secrets, may be enlisted for the purposes of assessing the overall effect of the transaction in question.

Neither the Strategic Investment Law, nor the secondary legislation provide for specific criteria the Committee should take into account when assessing an application. However, one may assume that a transaction will only be approved to the extent that it does not as a whole, in the opinion of the Committee, constitute a potential threat to Russian defence or other security interests.

The application review process should be completed within 3 months from registration of the application's filing by FAS. In exceptional cases the deadline may be extended by the Committee for an additional 3 months. In practice the overall process has often taken significantly longer, mainly due to the fact that the Committee has only been convened very irregularly.

Any approval may be expressed as being conditional upon certain obligations having been fulfilled by the Foreign Investor (or Public Foreign Investor, as appropriate). Any approval notice issued to an applicant should state how long such approval remains valid.

There is no express requirement for the Committee or FAS to state the reasons for rejecting an application. However, since Article 11(7) of the Strategic Investment Law gives applicants a right to appeal a decision in court, one can assume that a decision rejecting an application will include reasons for such rejection.

[3] Government Resolution No. 795 dated 27 October 2008 introduced these notification requirements.

During the period since introduction of the Strategic Investment Law in May 2008 until March 2011, the Committee has considered a total of 67 transactions. Out of this total, 53 transactions were cleared unconditionally, 9 transactions were approved with conditions, and 5 transactions were rejected.

Merger control issues

In November 2008, technical amendments were made to Russian antimonopoly legislation in order to provide for coherence between the Strategic Investment Law and the merger control regime.

As a rule, the notification and approval requirements established by the Strategic Investment Law are separate from the merger control regime. However, where transactions require clearance under both regimes, FAS will postpone the merger control review until clearance under the Strategic Investment Law is obtained. If a transaction is blocked under the Strategic Investment Law process, this automatically constitutes the basis for FAS to deny merger clearance also.

Additional clearance requirements applicable to Public Foreign Investors

In connection with the introduction of the Strategic Investment Law, amendments were also made to the Federal Law № 160-FZ "On foreign investment in the Russian Federation" of 9 July 1999. As a result of these amendments, any Public Foreign Investor acquiring 25% or more of a Strategic Entity as well as any non-strategic Russian entity must also obtain clearance in accordance with the procedure set out in the Strategic Investment Law. In other words, for Public Foreign Investors, there are two separate laws that may trigger the approval process as set down by the Strategic Investment Law and the notification requirements are not dependent on the Russian entity being strategic in nature.

Changes to other Federal Laws

The Strategic Investment Law also amended the existing provisions of certain other Russian Federal laws, including (without limitation) the following:

- **Investigative Activity Law** - Russian federal enforcement agencies were granted a new right to conduct investigations in order to determine the existence of control, or measures to obtain control, over a Strategic Entity by a Foreign Investor.
- **Joint Stock Companies Law** - in the event that a Foreign Investor has to make a mandatory offer to buy shares, or pursuant to any other provision of the Joint Stock Companies Law which results in the Foreign Investor's shareholding exceeding the 50% threshold prescribed by the Strategic Investment Law, then the Foreign Investor will only be entitled to buy that amount of shares (pro rata from the potential sellers) which keep its shareholding within the 50% threshold.
- **Communications Law** - a new definition states that mobile communications providers shall be deemed to occupy a dominant position in a geographical market if they control more than 25% of such market (the usual threshold is 35%).
- **Competition Law -** the criteria for determining whether an entity occupies a "dominant position" may be established not only under the Competition Law, but also under other Russian federal laws (e.g. the 25% threshold set out above for mobile communications providers under the amended Communications Law).

Special regime for investments in the subsoil sector

In addition to the procedures set out above, the Strategic Investment Law implemented changes to the Subsoil Law and set out specific restrictions for transactions involving Subsoil Strategic Entities.

In particular, certain Russian subsoil blocks are deemed of federal importance. A list of these (the "**Official List**") is published by the Russian government acting through the management body of the Federal Subsoil Fund. The Official List currently includes more than 1200 subsoil blocks and is available at http://www.rosnedra.com/article/3486.html.

Subsoil blocks of federal importance

The criteria for a subsoil block's eligibility for the Official List include those subsoil blocks:

- containing deposits and traces of uranium, diamonds, extra-pure quartz, yttrium rare earth elements, nickel, cobalt, tantalum, niobium, beryllium, lithium, and platinum metals;
- located within Russian territory and containing, according to the State Balance of Mineral Reserves:
  - recoverable oil reserves in excess of 70 million tons;
  - natural gas reserves in excess of 50 billion cubic meters;
  - lode gold reserves in excess of 50 tons;

- copper reserves in excess of 500,000 tons;

- located in Russian internal or territorial waters and its continental shelf; or
- necessitating the use of land plots that form part of Russian defence and security zones.

It should be noted that a subsoil block, even if it meets the criteria set out above, is only technically considered "of federal importance" from the date that it is entered into the Official List.

Rights to explore and exploit subsoil blocks of federal importance

An entity may acquire the right to use a subsoil block of federal importance by open tender or auction. The Federal Subsoil Fund draws up, registers and grants licenses for subsoil usage and the main criteria which it applies when selecting a winner are:

- the scientific and technical level of a development programme's geological survey and proposed subsoil use;
- the basic terms of a development programme;
- the contribution to the social and economic development of the area surrounding the subsoil block;
- the effectiveness of measures aimed at protecting the subsoil block and its immediate environment; and
- the provision of national defences and security - since it will be difficult for a Foreign Investor to satisfy such provision, the criterion has been criticised as favouring Russian applicants.

There are specific additional criteria for an entity seeking to obtain the use of a subsoil block of federal importance on the Russian continental shelf, as follows:

- the relevant entity must be incorporated in Russia;
- the relevant entity must have at least 5 years' experience in continental shelf exploitation; and
- the Russian Federation must either hold more than 50% of the voting shares in the relevant entity or have the ability to, directly or indirectly, control more than 50% of such voting shares.

In practice, these criteria only allow OJSC NK Rosneft and OJSC Gazprom to exploit subsoil blocks of federal importance on the Russian continental shelf.

Restrictions on transactions involving Subsoil Strategic Entities

A transfer of subsoil rights is prohibited (unless a prior approval is granted under the procedure above) if it would allow a Foreign Investor, directly or indirectly, to:

- control 10% or more of the voting shares in a Subsoil Strategic Entity;
- have the right to appoint a sole executive officer (e.g. CEO) and/or 10% or more of a management body or board of directors of the Subsoil Strategic Entity; or
- manage or otherwise determine decisions taken by the Subsoil Strategic Entity.

In addition to these "control" restrictions for Foreign Investors, a prior approval (granted under the procedure above) is required to allow a Public Foreign Investor to acquire, directly or indirectly, more than 5% of the voting shares of a Subsoil Strategic Entity.

Exemptions

Transactions involving a Subsoil Strategic Entity are generally exempt from the provisions of the Strategic Investment Law where, before the transaction, the Russian Federation controls, directly or indirectly, 50% or more of the relevant voting shares.

Notable recent case law: Megafon

Court practice on the Strategic Investment Law remains limited and no decision of the Committee has yet been challenged in court. However, Russian courts have considered several appeals regarding agreements concluded in violation of the Strategic Investment Law.

In June 2010 the Moscow arbitrazh court ruled that a joint venture agreement between TeliaSonera and Altimo was void as it provided for a change of control over the Russian mobile telephone operator Megafon, in violation of the restrictions set out in the Strategic Investment Law. Later this ruling was upheld by the cassation court.

Under the joint venture agreement, TeliaSonera and Altimo agreed to contribute their shares in Megafon to a new company. The court ruled that the joint venture agreement allowed TeliaSonera to acquire control over the new company and thus effectively acquire control over Megafon.

The court stressed that the Strategic Investment Law prohibits both (i) effective establishment of control over Strategic Entities and (ii) the conclusion of agreements

which provide conditions for this. The court also concluded that TeliaSonera was controlled by foreign states and consequently the joint venture agreement was void, as the Strategic Investment Law prohibits transactions by Public Foreign Investors resulting in the establishment of control over Strategic Entities.

The conclusions made by the court in this case are subject to wide debate as they may have far-reaching consequences for the contractual structuring of a foreign investment. In particular, this is due to the court's statement that strategic investment clearance should precede the conclusion of any agreement which provides conditions for establishing control over a Strategic Entity. Another noteworthy conclusion is that control over a Foreign Investor by several foreign states is deemed to be joint control for the purposes of the Strategic Investment Law.

Upcoming legislative amendments

As stated above, the Strategic Investment Law drew much criticism upon its enactment because of the various gaps and contradictions in its provisions. Over the three years since the law's enactment various amendments have been developed and formulated by FAS into a bill ("**Amendment Bill**") which was approved by the Russian government in February 2011 and submitted to the State Duma for consideration. A summary of the key changes proposed by this Amendment Bill is as follows.

Since the Strategic Investment Law entered into force in 2008, the applicability of its restrictions to banks holding an encryption license has been heavily debated. The Amendment Bill proposes that certain types of activities be excluded from the list of activities which are deemed to have strategic importance. Exemption will be introduced for (i) the encoding and cryptographic activities performed by banks (except for banks in which the state owns a stake of the share capital); (ii) the operation of certain types of radiation sources (e.g. x-ray equipment in healthcare); and (iii) the use of particular types of infectious agents, e.g. in the dairy industry.

Another exemption proposed by the Amendment Bill concerns Subsoil Strategic Entities. The Amendment Bill exempts a Foreign Investor from the requirement to obtain prior approval in the case of an additional share issue by a Subsoil Strategic Entity, provided such share issue does not lead to an increase of the Foreign Investor's shareholding in the relevant entity.

The Amendment Bill also proposes a number of procedural amendments in relation to the application review process and the conclusion of an agreement between FAS and the applicant in the case of a conditional clearance.

Case studies

In order to demonstrate the Strategic Investment Law principles in context we examine three different scenarios as theoretical examples below. These examples represent our view of how the legislation should currently work in practice on the basis of the officially published version of the Strategic Investment Law. As stated above, there are still gaps in the legislation; also secondary legislation and court practice are expected to provide additional clarity on the interpretation of the provisions. As a result, our examples below are necessarily qualified to this extent.

Example 1

A UK sovereign wealth fund (acting by a Russian joint stock company subsidiary, in which the fund owns 60% of the shares) wishes to acquire from a Russian joint stock company 7% of the participatory interests of a Russian limited liability company which has a licence to conduct geological studies of a beryllium deposit in the Urals Mountains.

Analysis: The transaction would require the prior approval of the Committee ("**Prior Approval**").

- The purchasing entity is incorporated in Russia but nevertheless is a subsidiary of a foreign organisation which would likely qualify as a Public Foreign Investor since sovereign wealth funds are state owned entities (the fact that the Russian subsidiary is not wholly owned by the UK sovereign wealth fund is irrelevant);
- The Strategic Investment Law applies equally to transactions involving Russian limited liability companies (where ownership interests are held by way of participatory interest percentages) as it does to those involving Russian joint stock companies (where ownership interests are held by way of shares);
- A beryllium deposit in the Urals Mountains would be considered to be a subsoil block of federal importance and therefore the target company is a Subsoil Strategic Entity; and
- The Public Foreign Investor is seeking (indirectly) to acquire 7% of the Subsoil Strategic Entity in question, which is in excess of the applicable 5%

threshold for a Prior Approval (but below the 10% 'control' threshold for a Subsoil Strategic Entity, which would be prohibited for a Public Foreign Investor). Therefore a Prior Approval would be required.

Example 2

A private Swedish company has signed a memorandum of understanding with a Chinese state company to acquire a direct 40% stake in a Russian joint stock company with licences to explore and develop a subsoil hydrocarbon block in Western Siberia which is listed in the State Balance of Mineral Reserves as containing recoverable oil reserves of 50 million tons.

Analysis: The transaction should neither require a Prior Approval, nor should it be otherwise prohibited.

- The Swedish entity is a potential Foreign Investor as it is proposing to acquire shares in a Russian joint stock company which operates in a strategic industry;
- It should be noted that the involvement of a Chinese state company is generally irrelevant as it is the vendor in this case and so will not be gaining any sort of control (NB if the Chinese state company had acquired its stake prior to enactment of the Strategic Investment Law (i.e. before 5 May 2008), it would have been obliged to provide certain information regarding such stake to the Russian government before 5 November 2008)); and
- The recoverable oil reserves only total 50 million tons (below the 70 million ton threshold) - therefore this subsoil block, not being published in the Official List, cannot be considered to be of federal importance and so the Russian joint stock company target does not qualify as a Subsoil Strategic Entity. As a result of this the transfer restrictions will not apply.

Example 3

A consortium of investors, which includes a US public company but is mostly made up of Russian investment companies (the "**Consortium**"), has agreed heads of terms in respect of a Russian limited liability company (the "**Opco**") which is currently held (via a Cypriot offshore company, the "**Target**") 15% by the Consortium and 85% by a Russian government agency (the "**Agency**"). The Opco has a mining licence to explore and exploit a copper deposit on the Kola Peninsula with reserves of 800,000 tons.

The basic terms of the deal are that:

(a) the Agency will transfer 20% of its shares in the Target to the Consortium; and

(b) the existing shareholders agreement in respect of the Target will be amended to allow the Consortium to appoint the Target's CEO and control the Cypriot management board (which generally provides written instructions to Opco's general director on various management issues).

Analysis: The transaction should neither require a Prior Approval nor should it be otherwise prohibited.

- The Consortium contains a non-Russian company and so is a potential Foreign Investor as it is proposing to acquire shares (indirectly) in a Russian limited liability company which operates in a strategic industry. Given the fact that the Consortium is in fact controlled by Russian investment companies, it is possible that the Consortium will not in fact be deemed a Foreign Investor, but this will not be clear until an application for Prior Approval is made to FAS. We will assume for the purposes of illustration in this example that the Consortium is considered to be a Foreign Investor;
- Since the copper deposit is on the Kola Peninsula and has reserves of 800,000 tons (above the 500,000 ton threshold for a subsoil block of federal importance) this means that Opco is a Subsoil Strategic Entity from the date that this subsoil block is published in the Official List;
- The Consortium is seeking 20% of the total participation interests in a Subsoil Strategic Entity (above the 10% threshold), which suggests that the transaction would be prohibited under the Strategic Investment Law unless a Prior Approval is granted;
- In addition, as a result of the transaction the Consortium will gain the right under the amended shareholders agreement both to appoint the Target's CEO and also control the Cypriot management board which effectively runs Opco. These are also factors which point to the proposed transaction being generally prohibited without a Prior Approval;
- However in this case the Agency already owns (indirectly) 85% of the Subsoil Strategic Entity. Therefore the transaction can proceed with no Strategic Investment Law restrictions, since any transaction involving a Subsoil Strategic Entity is

generally exempt from the provisions of the Strategic Investment Law where, before the transaction, the Russian Federation controls, directly or indirectly, 50% or more of the relevant voting shares; and

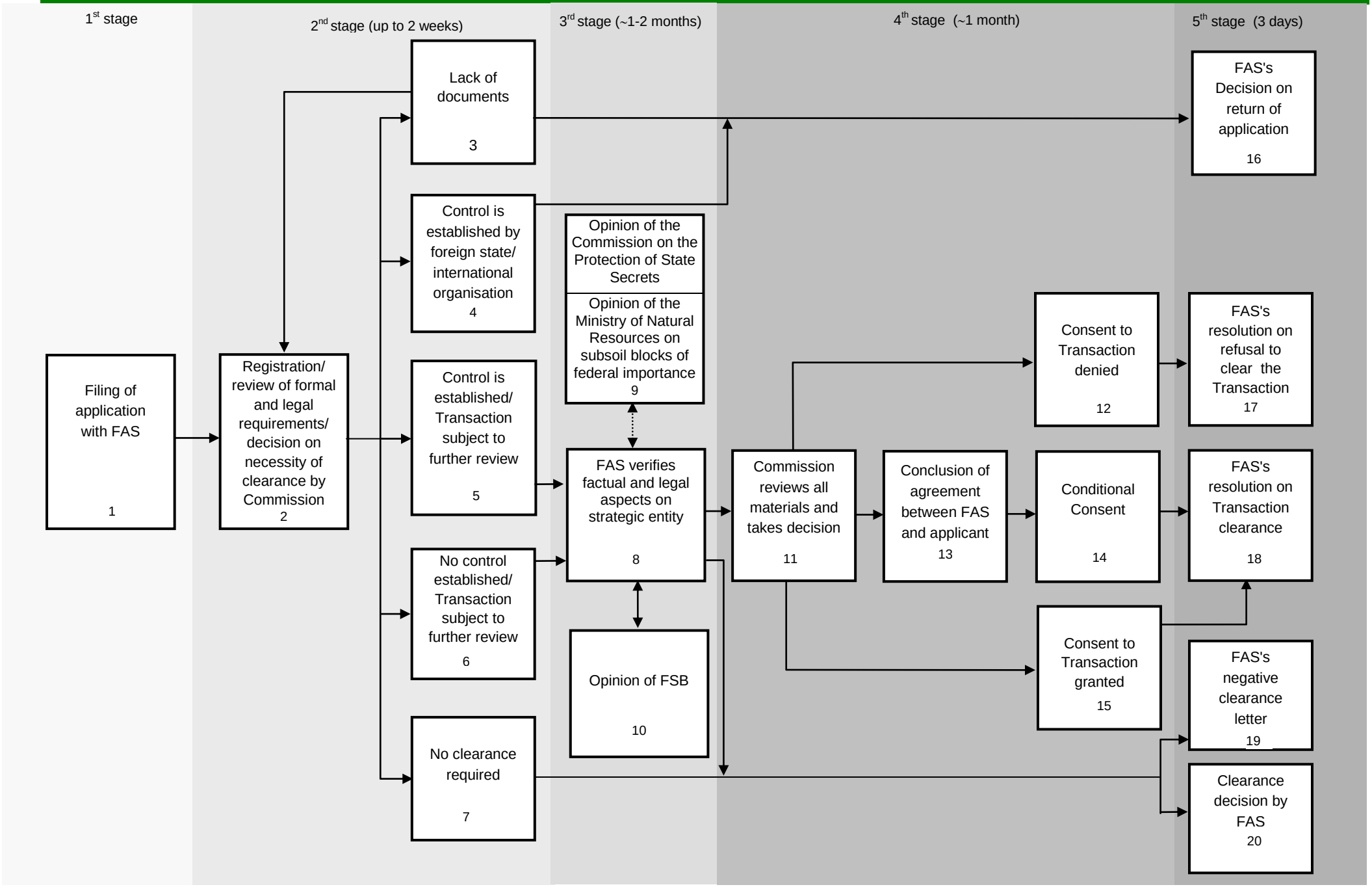
- It is worth noting that, in the event that a subsoil block was offshore from the Kola Peninsula, in Russian internal/territorial waters or continental shelf, this would mean that it would automatically qualify as being of federal importance, without the need to meet the relevant reserve threshold.

Outlook

In enacting the Strategic Investment Law the Russian Federation significantly expanded the Russian legislation governing foreign investment across a wide range of industries. To a great extent the Strategic Investment Law clarified what had for a number of years been the default position on the issues in question, as well as providing for a clear process of seeking relevant approvals. Over the first three years of its application, it has become clear that the provisions of the Strategic Investment Law contain numerous contradictions and uncertainties. The Amendment Bill currently being considered by the State Duma only addresses a small number of these contradictions and uncertainties and should, therefore, not be expected to solve all legislative weaknesses.

In practice, it remains difficult for foreign investors to determine the scope of application of the Strategic Investment Law. In addition, numerous investors have complained about the burdensome approval process and the significant delays caused by it. The Russian government has, however, stressed that foreign investments into Russia are most welcome and that the application of the Strategic Investment Law should not hinder such investments. The statistics after three years of application indeed show that only very few transactions have been blocked by the Committee. It is therefore hoped that FAS and the Committee will do everything they can both to clarify their administrative practice in applying the provisions of the Strategic Investment Law and to streamline the approval process.

PROCEDURAL DIAGRAM



Number of box	*Statutory timeframe*[4]	*Comments*
Stage 1: Submission of the application		
1		The Strategic Investment Law requires two copies of the application to be filed with FAS, together with several other documents.
Stage 2: Preliminary review of the application by FAS		
2-7	14 days	FAS registers the application, checks the completeness of all documents and concludes whether or not the Transaction is subject to the Strategic Investment Law clearance procedure.
2, 3, 16	Same period as above	If the application is incomplete, FAS will suspend its review and request the outstanding documents from the applicant. If those documents are not provided within 1 month, the application will be returned to the applicant without review.
2, 7, 19	3 days	If FAS concludes that no control over a strategic entity is acquired and, accordingly, the Commission's clearance is not required, FAS will return the application with a negative clearance letter.
2, 4, 16	3 days	If FAS concludes that the applicant is an entity controlled by the state or an international organisation which is prohibited from acquiring control over a strategic entity, the application will be returned without having been reviewed.
Stage 3: Analysis of the impact of the Transaction		
8	30 days	If FAS establishes that the Transaction is subject to clearance, it will verify if the strategic entity is engaged in certain activities (e.g. licensed activities, supplies under government's defence orders, etc.) and/or meets other criteria set out in the Strategic Investment Law.
8, 10	3 days	FAS requests the Federal Security Service's opinion (the "**FSB**") as to whether or not the Transaction may impact on national security.
10	20 days	The FSB prepares an opinion on any such potential impact and delivers it to FAS.
8, 9	3 days	If the strategic entity holds a license for handling state classified information, FAS will also request that the Commission on the Protection of State Secrets comments on whether or not the applicant and/or its officers or employees would potentially be permitted access to such classified information.
9	14 days	The Commission on the Protection of State Secrets confirms whether or not the relevant foreign state has a treaty with the Russian Federation[5] for the mutual protection of state secrets.
8, 9, 10	3 days	Once FAS has completed its internal checks and the FSB and other relevant state authorities have provided their opinions, FAS will submit the application to the Commission together with other materials and its own recommendation in relation to the clearance of the Transaction.
Stage 4: Clearance		
11, 13	30 days[6]	The Commission reviews the application and other materials provided for its review by FAS. In the event that the Commission intends to clear the Transaction on a conditional basis, it will prepare a list of additional obligations to be imposed on the applicant and will instruct FAS to draft and sign the relevant agreement with the applicant[7].
13	20 days	FAS prepares the agreement and enters into it with the applicant. Failure to enter into such agreement on the conditions set out by the Commission and FAS will result in the Commission's refusal to clear the Transaction.
12, 13, 14, 15		Further to the review of the application and other documents concerning the Transaction, and subject to the applicant entering into the agreement with FAS (in the case of conditional clearance), the Commission will decide to either: • clear the Transaction; • clear the Transaction on conditional basis; or • refuse clearance of the Transaction.
Stage 5: Final resolution		
17, 18	3 days	FAS has to formalise the Commission's decision in a final resolution to be sent to the applicant.
		The Commission's decision on whether or not the Transaction should be cleared can be challenged in the Supreme Arbitrazh Court of the Russian Federation.

[4] The terms stated in the column below should in each case be counted from the date the previous stage has been completed or the date FAS became aware of the information in question (as the case may be).

[5] The Strategic Investment Law does not contain a list of grounds on which the clearance would be denied. Accordingly, there is no reason to presume that in the absence of such treaty the Transaction would not be cleared. One should note, however, that currently foreigners and stateless persons are only allowed to access state classified information on the basis of such treaties.

[6] In exceptional cases, the Commission is allowed to extend the overall term of review for another 3 months.

[7] The statutory recommended form of agreement to be entered into between the applicant and FAS is detailed in the Resolution of the Federal Antimonopoly Service No. 357 of 17 September 2008.