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Briefing note October 2012

A Legal Overview of Foreign Investment in Russia's Strategic Sectors

This note gives an overview of Russia's regulatory regime for foreign investment in strategic sectors of Russian industry. The regime is primarily regulated by the Federal Law № 57-FZ "On the Procedure of Making Foreign Investments in Companies of Strategic Importance for National Defense and State Security" of 29 April 2008 (the "**Strategic Investment Law**"), which came into force on 7 May 2008. The Strategic Investment Law consolidated the legal regime governing foreign investment in various Russian strategic industries and established a procedure for granting foreign investors access to such industries on a "one stop shop" basis.

Key Issues

At the end of 2011 amendments to the Strategic Investment Law were adopted which clarified some, though not nearly all, of the issues that had been heavily debated in the business and legal community since the regime was first introduced. Russian case law also emerged which helped to clarify the scope of application of the Strategic Investment Law, but also contributed to new uncertainties surrounding interpretation of the statutory requirements.

Strategic sectors make up only a small part of the Russian economy. However, since the introduction of the regime a significant number of transactions have proved to involve a strategic element, even when at first sight this might not appear to be the case. Furthermore, having advised on many "strategic transactions" across nearly all industry sectors to which the regime applies, we believe there are various legal and practical issues that investors should be aware of before structuring the acquisition of a stake in a Russian company.

General scope of application

Foreign Investor

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 involving shares in a strategic entity which would ultimately give the Foreign Investor a stake in, or control over, the 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 stake in, or control over, a strategic entity.

The provisions of the Strategic Investment Law primarily apply to transactions involving 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 certain exceptions,, such as PPP projects, which may arguably fall within 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 7 May 2008 (the date of enactment of the Strategic Investment Law) as well as those entered into prior to that date but which have yet to be 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.

Strategic Entity

For the purposes of the Strategic Investment Law, a strategic entity is an entity incorporated in the Russian Federation which performs at least one activity of strategic importance (a "**Strategic Entity**"). Article 6 of the Strategic Investment Law lists 42 types of activity that are deemed to be of strategic importance, and these may broadly be split into four 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 deemed to be "of federal importance" (see more on this below);
- **Defense**, including activity connected with weapons and military equipment, radioactive materials, space, aviation and encryption;
- **Media**, including television and radio broadcasting, and certain printing and publishing activities; and
- **Monopolies**, including the activities of not only certain communications and railway companies (which have 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.

The approval requirements set out in the Strategic Investment Law extend to a number of activities which do not, strictly speaking, affect national defense or state security, e.g. the use of yeast (which is considered an infectious disease agent) by dairy producers. In practice this has meant that a number of transactions relating to manufacturers of dairy products, juices, pharmaceuticals, medical products and media companies with insignificant broadcasting activities have been subject to clearance under the Strategic Investment Law.

The amendments to the Strategic Investment Law which came into force in December 2011 introduced specific exclusions from the list of strategic activities, particularly in relation to cryptographic operations of banks. The following licensed activities have been excluded from the regime if conducted by a bank in which the Russian Federation is not a stakeholder:

- distribution of encryption equipment;
- technical maintenance of encryption equipment; and
- rendering of encryption services.

Also, the use of sources of radiation was excluded from the list of strategic activities where it is an ancillary activity carried out by companies in the civil sector.

Definition of "control"

The Strategic Investment Law provides that a Foreign Investor exercises "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 provisions of the Strategic Investment Law are more detailed than the laws that regulated state control over various sectors prior to May 2008 (e.g. the competition and banking laws). They are formulated in such a way as 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%, the 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 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 notification and Public Foreign Investor restriction

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

Prior Approval

Prior approval is required for transactions that would allow:

- a Foreign Investor, which is not itself controlled (directly or indirectly) by a 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, or similar blocking rights over, any Russian entity, whether strategic or non-strategic.

It is worth noting that while a Public Foreign Investor may, subject to 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.

Notification

A Foreign Investor must also notify FAS of any transaction that would allow the Foreign Investor to acquire 5% or more of the shares in a Strategic Entity. The notification must be delivered to FAS within 45 days of closing of the relevant transaction.[1]

Exemptions

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 initial acquisition of such control, does not require fresh approval (note, however, that this exemption does not appear to apply to Subsoil Strategic Entities).

The Strategic Investment Law also provides an exemption from the requirement to obtain prior approval for transactions involving certain international financial organizations, such as the European Bank for Reconstruction and Development, Multilateral Investment Guarantee Agency, International Development Association, International Finance Corporation, etc.[2]

Finally, the Strategic Investment Law sets out an exemption for domestic Russian transactions which, by their nature, are not foreign investments although they involve foreign legal entities. Accordingly, approval is not required for transactions between entities that are each ultimately controlled by (i) the Russian Federation or (ii) a Russian citizen who does not hold any other citizenship and is a Russian tax resident.

It is a common characteristic of all of the above exemptions that the scope of their application is not entirely clear. In practice it is therefore advisable to take a cautious approach when relying on any of these exemptions.

Sanctions

The Strategic Investment Law provides for extraordinarily severe sanctions for violations of its requirements. Transactions performed in violation of the clearance regime are null and void. Such a transaction will carry the consequences of invalidity established by general provisions of Russian civil law,

[1] Government Decree No. 795 dated 27 October 2008 introduced rules for submitting these notifications.

[2] The full list of organisations is contained in Governmental Directive No. 119-r, dated 3 February 2012.

including the obligation for each party to return to the other party all 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 rule 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. Most notably, in spring 2012 FAS initiated enforcement actions through the Russian courts against Norway's Telenor group after the latter increased its shareholding in Russian telecoms operator VimpelCom.

Failure to obtain prior approval (or submission of an improper filing) may also give rise to administrative penalties. The applicable fines are, however, low. Pursuant to the Russian Administrative Offences Code, such fines may be up to RUB 1 million (approx. EUR 25,000) for a legal entity and up to RUB 50,000 (approx. EUR 1,300) for the responsible officers. Failure to submit a post-transfer notification (or submission of an improper notification) may entail fines of up to RUB 500,000 (approx. EUR 13,000) for a legal entity and up to RUB 30,000 (approx. EUR 800) for the responsible officers.

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 an application normally 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 approval procedure for applications is conducted in two stages:

- initial review of the application by FAS; and
- if FAS decides that the application requires further assessment, it is ultimately passed to a commission headed by the Prime Minister and consisting of representatives of various state bodies (the "**Commission**").

A schematic diagram depicting 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.

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 Commission - 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 Commission.

FAS will pass the application to the Commission:

- 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 the Strategic Entity; or
  - more than 5% of the voting shares in a Subsoil Strategic Entity.

The Commission then reviews the application and decides whether to approve or reject the proposed transaction. The assistance of various state authorities, such as the Federal Security Service, the Ministry of Defense, and the Commission on the Protection of State Secrets may be enlisted to assess the overall effect of the transaction in question.

Neither the Strategic Investment Law nor the secondary legislation establish any specific criteria the Commission should proceed from when assessing an application. However, one may assume that a transaction will only be approved if it does not as a whole, in the opinion of the Commission, constitute a potential threat to Russian defense or other security interests.

The application review process should be completed within 3 months from the date

FAS registers the filing of the application. In exceptional cases the deadline may be extended by the Commission for an additional 3 months.

Any approval may be expressed as being conditional upon certain obligations being 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.

Where a transaction is approved with conditions, the Commission decides what additional obligations are to be imposed on the applicant and instructs FAS to draft and execute a separate 'agreement on undertakings' with the applicant. If the applicant declines to enter into the agreement, the transaction will be blocked.

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

Since the enactment of the Strategic Investment Law in May 2008 and until April 2012 the Commission considered a total of 137 transactions. Of that number, 103 transactions were cleared unconditionally, 26 transactions were approved with conditions, and 8 transactions were rejected.

Merger control issues

As a rule, the notification and approval requirements established by the Strategic Investment Law are separate from the merger control regime provided for by Russian antitrust law. 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 as well.

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 Investments 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 or a 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.

Certain transactions by Public Foreign Investors are, however, exempt from the regime where the Public Foreign Investor is an international financial organization (see Exemptions above).

Special regime for investments in the subsoil sector

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

In particular, certain Russian subsoil blocks are deemed to be 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 is available at www.rosnedra.com/ category/144.html.

Subsoil blocks of federal importance

Where a subsoil block meets any of the following criteria, it may be put on the Official List :

- contains deposits or traces of uranium, diamonds, extra-pure quartz, yttrium rare earth elements, nickel, cobalt, tantalum, niobium, beryllium, lithium or platinum metals;
- is located onshore within Russian territory and contains, 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 or the continental shelf of Russia; or
- is required in order to use land plots that form part of Russian defense and security zones.

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

Rights to explore and develop 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 it applies when selecting a winner are:

- the scientific and technical level of the geological survey and proposed subsoil use in the respective development programme;
- the basic terms of the development programme;
- the contribution to the social and economic development of the area in the vicinity of the subsoil block;
- the effectiveness of measures aimed at protecting the subsoil block and its immediate environment; and
- providing for national defense and state security (since this criterion will be difficult for a Foreign Investor to satisfy, it has been criticised as favouring Russian applicants).

There are also specific additional criteria for an entity seeking approval of the use of a subsoil block of federal importance on the Russian continental shelf, specifically:

- 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 control, directly or indirectly, more than 50% of the voting shares.

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

Restrictions on transactions involving Subsoil Strategic Entities

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

- control 25% 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 25% or more of the board of directors or other management body 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, prior approval (granted under the procedure described 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.

Domestic Russian transactions involving a Subsoil Strategic Entity are exempt if they are implemented between entities that are each ultimately controlled by (i) the Russian Federation or (ii) a Russian citizen who does not hold any other citizenship and is a Russian tax resident (see the section on general Exemptions above).

Finally, while Foreign Investors are generally required to obtain separate approval in the event of any subsequent acquisitions of additional shares above the threshold of 25% of the voting shares in a Subsoil Strategic Entity, this requirement is lifted for the acquisition of new shares in a Subsoil Strategic Entity if the percentage stake held by the Foreign Investor does not increase. This exemption applies, in particular, where additional shares are issued pro rata among the existing shareholders without changing their respective stakes in the Subsoil Strategic Entity.

Notable case law

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

Megafon

In June 2010 the Arbitrazh Court of the City of Moscow 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 higher courts.

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 to acquire control over Megafon.

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

for this. The court also concluded that TeliaSonera was controlled by foreign states and that 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 court's conclusions in this case have been the subject of extensive debate, as they may have far-reaching consequences for the contractual structuring of foreign investment. In particular, this is due to the court's statement that strategic investment clearance should precede the conclusion of any agreement which sets out 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.

VimpelCom

Another noteworthy case also relates to a major player in the Russian telecoms sector – VimpelCom. In February 2012, the Norwegian state-controlled Telenor group increased its existing stake in a non-Russian VimpelCom holding company from 25.01% to 36.36% and entered into an option agreement for the acquisition of an additional 3.44%. The increase was implemented without Telenor seeking clearance under the Strategic Investment Law.

FAS initiated court action before the Russian state courts challenging the acquisition of shares and the option agreement. FAS argued that Telenor is a state-controlled group, i.e. a Public Foreign Investor, and that by increasing its stake to 36,36% in the VimpelCom holding company, it acquired control over the Russian subsidiary JSC VimpelCom, a Strategic Entity.

Moreover, FAS applied for, and the Russian court ordered, interim measures prohibiting, *inter alia*, (i) the holding company from exercising its voting rights in JSC VimpelCom relating to the appointment of management, approval of major and related-party transactions, and (ii) Telenor and its counter-party from implementing the option agreement.

In September 2012, despite the above interim measures, Telenor exercised its option right under the option agreement, however, the VimpelCom holding company refused to register the share transfer in its shareholders' register.

As of October 2012 the case is still pending, although it is expected that the dispute will be settled between FAS and Telenor before a final court decision is taken.

However, even without a final court decision the case shows that FAS is capable of bringing effective enforcement measures also in relation to foreign-to-foreign transactions that occur entirely outside Russia. In the Telenor case, the acquisition and option agreements were governed by foreign law and concluded between non-Russian entities in relation to shares in a non-Russian holding company.

Lastly, it is worth noting that the claims brought by FAS are not entirely clear as regards the substantive assessment of Telenor's increase. FAS could have focused on the fact that the increase to 36.36% in the non-Russian holding company enables state-controlled Telenor to block decisions at the level of JSC VimpelCom which is subject to clearance, though Telenor failed to obtain it. Instead, FAS appears to have taken the view that the increase to 36.36% provided Telenor with (*de facto)* control over JSC Vimpelcom, which a Public Foreign Investor is generally prohibited to have and for which Telenor could not even have sought clearance.

Case studies

To demonstrate the Strategic Investment Law principles in context, below we examine three different theoretical scenarios. These examples represent our view of how the legislation should currently work in practice based on the officially published version of the Strategic Investment Law. As stated above, there are still gaps in the legislation, though the secondary legislation and court practice are expected to provide some further clarity with regard to interpretation of the provisions. Consequently, our examples below are necessarily qualified to this extent.

Example 1

A UK sovereign wealth fund (acting through 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 in a Russian limited liability company that has a licence to conduct geological studies of a beryllium deposit in the Ural mountains.

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

- The purchasing entity may be incorporated in Russia, but nevertheless it is a subsidiary of a foreign organisation that would likely be categorized 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 (in which ownership interests are held by way of participatory interests) as it does to those involving Russian joint stock

companies (in which ownership interests are held by way of shares);

- A beryllium deposit in the Ural 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 exceeds the applicable 5% threshold for Prior Approval (but is below the 25% 'control' threshold for a Subsoil Strategic Entity, which would be prohibited for a Public Foreign Investor). Therefore 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 that holds licenses 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 not require Prior Approval, nor should it be prohibited on other grounds.

- The Swedish entity is a potential Foreign Investor, as it is proposing to acquire shares in a Russian joint stock company that operates in a strategic industry;
- The fact that a Chinese state company is involved should be irrelevant in this case, as it is the vendor and so will not be gaining any sort of control (note that 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, i.e. less than the 70 million ton threshold.– Therefore this subsoil block, not having been included 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. Hence the transfer restrictions will not apply.

Example 3

A consortium of investors which includes a US 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 ("**Opco**") that is fully owned by a Cypriot offshore company ("**Cypco**"). Cypco is 15%-owned by the Consortium and 85%-owned by a Russian government agency (the "**Agency**"). Opco has a mining license to explore and develop a copper deposit on the Kola Peninsula with reserves of 800,000 tons.

The basic terms of the deal are that:

1. Cypco will transfer 30% of its participatory interests in Opco to the Consortium; and
2. the existing shareholders agreement in respect of Cypco will be amended to allow the Consortium to appoint Cypco'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 (indirectly) acquire shares in a Russian limited liability company that operates in a strategic industry. Given that the Consortium is in fact controlled by Russian investment companies, it is possible that the Consortium will not 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 this subsoil block is published in the Official List;
- The Consortium is seeking to acquire 30% of the total participatory interests in the Subsoil Strategic Entity (i. e. more than the 25% threshold), which suggests that the transaction would be prohibited under the Strategic Investment Law unless 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 Cypco's CEO and also to control the Cypriot management board that effectively runs Opco. These are also factors that point to the proposed transaction being generally prohibited without Prior Approval;
- However, in this case the Agency already owns (indirectly) 85% of the Subsoil Strategic Entity. Therefore the transaction can proceed, 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;

It is worth noting that, had the subsoil block been located offshore from the Kola Peninsula in Russian internal/territorial waters or on Russia's continental shelf, this would mean that it would automatically be considered to be of federal importance, irrespective of whether or not the relevant reserve threshold was met.

Outlook

In enacting the Strategic Investment Law in 2008, the Russian Federation significantly expanded the Russian legislation governing foreign investment across a wide range of industries. The Strategic Investment Law has largely formalized what had already been the default position, while establishing a clear process for seeking the relevant approvals.

Over the first 4½ years of its application it has become clear that the provisions of the Strategic Investment Law contain numerous contradictions and uncertainties. Despite amendments introduced in 2011, most of these uncertainties remain unaddressed. In practice it remains difficult for foreign investors to determine the exact scope of application of the Strategic Investment Law. In addition, many investors have complained of the onerous approval process and the significant delays it causes.

The Russian government has, however, stressed that foreign investment is most welcome and that the Strategic Investment Law should not hinder such investment. The statistics indeed show that only very few transactions have been blocked by the Commission. At the same time, however, since 2011 the number of transactions approved with conditions has been increasing significantly.

It is hoped that FAS and the Commission will do everything they can to clarify the administrative practice of applying the provisions of the Strategic Investment Law and to streamline the approval process.

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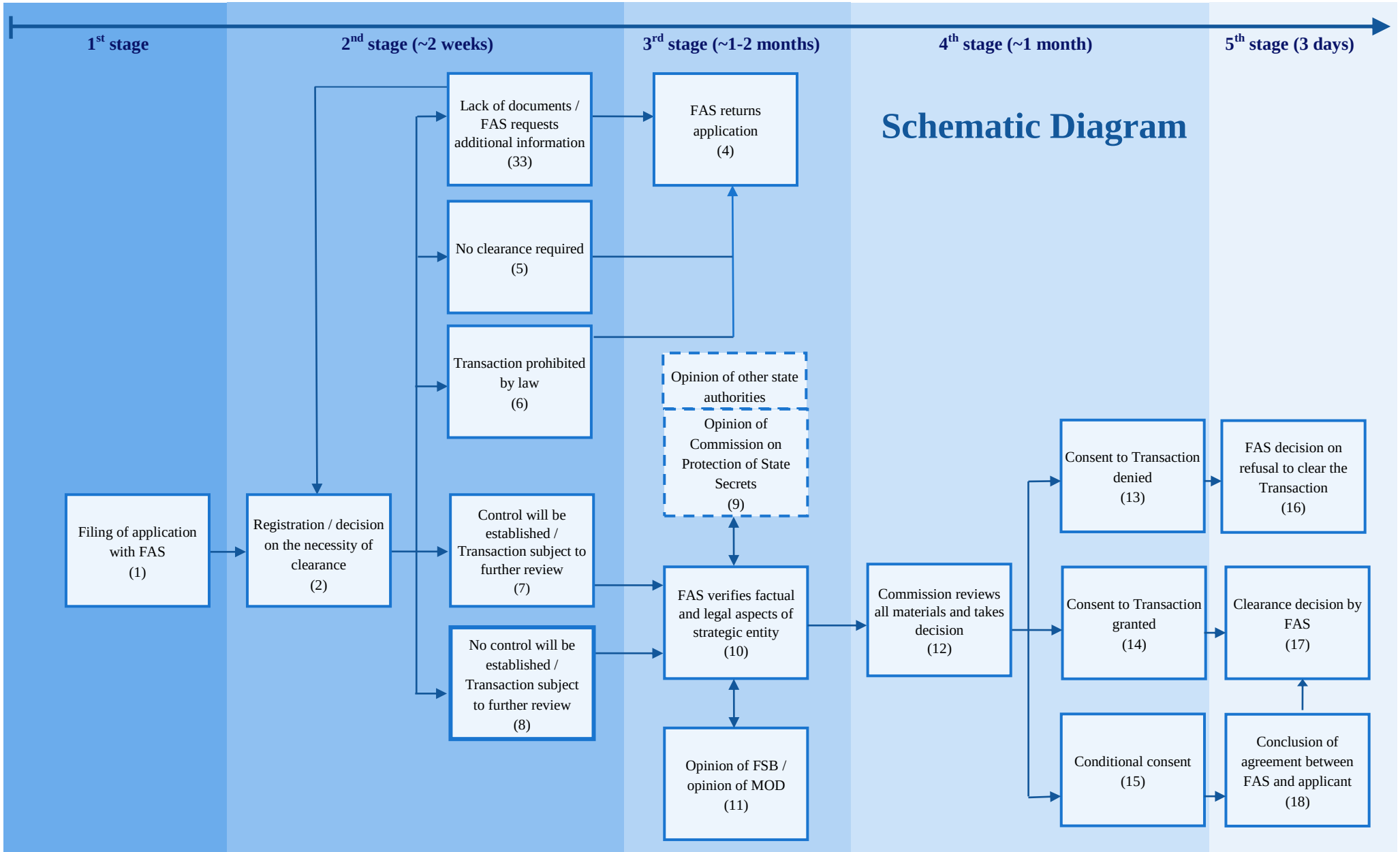
1st stage
2nd stage (~2 weeks)
3rd stage (~1-2 months)
4th stage (~1 month)
5th stage (3 days)
Schematic Diagram
Filing of application with FAS (1)
Registration / decision on the necessity of clearance (2)
Lack of documents / FAS requests additional information (33)
No clearance required (5)
Transaction prohibited by law (6)
Control will be established / Transaction subject to further review (7)
No control will be established / Transaction subject to further review (8)
FAS returns application (4)
Opinion of other state authorities
Opinion of Commission on Protection of State Secrets (9)
FAS verifies factual and legal aspects of strategic entity (10)
Opinion of FSB / opinion of MOD (11)
Commission reviews all materials and takes decision (12)
Consent to Transaction denied (13)
Consent to Transaction granted (14)
Conditional consent (15)
FAS decision on refusal to clear the Transaction (16)
Clearance decision by FAS (17)
Conclusion of agreement between FAS and applicant (18)

Number of box	*Statutory timeframe*[1]	*Comments*
Stage 1: Submission of the application		
1	No specific filing deadline.	The Strategic Investment Law requires that two copies of the application be filed with FAS, together with several other documents.
Stage 2: Preliminary review of the application by FAS		
2, 3, 5-8	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, 4	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, 5, 4	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, 6, 4	3 days	If FAS concludes that the applicant is an entity ultimately 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		
7, 8, 10	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 governmental defense orders, etc.) and/or meets other criteria set out in the Strategic Investment Law.
11	3 days	FAS requests the Federal Security Service's opinion (the "**FSB**") and the Ministry of Defense as to whether or not the Transaction may impact on national defense or state security.
11	20 days	The FSB and the Ministry of Defense prepare their opinions on any such potential impact and deliver them to FAS.
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. FAS is also entitled to send requests to other state authorities.
9	14 days	The Commission on the Protection of State Secrets confirms whether or not the relevant foreign state has a reciprocal treaty with the Russian Federation[2] governing the protection of state secrets.
9-12	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 regarding clearance of the Transaction.
Stage 4: Clearance		
12	3 months[3]	The Commission reviews the application and other materials provided for its review by FAS.
13-15	Same period as above	Upon review of the application and other documents concerning the Transaction, the Commission decides to either: • clear the Transaction; • clear the Transaction on a conditional basis; or • refuse clearance of the Transaction.
15, 18	30 days starting from receipt by FAS of the Commission's decision[4]	Commission decides on conditions. FAS drafts an 'agreement on undertakings'. Applicant and FAS enter into the agreement.[5] If no agreement is signed, clearance of the Transaction will be refused.
Stage 5: Final resolution		
16, 17	3 business days	FAS has to formalize 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 and the relevant FAS decision can be challenged in the Supreme Arbitrazh Court of the Russian Federation.		

1 The periods of time in the column below should in each case be counted from the date the previous stage is completed or the date FAS became aware of the information in question (as the case may be).

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

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

4 The applicant can apply for extension of this term by 14 days.

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

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