GIDE

GIDE LOYRETTE NOUEL

client alert

M&A | RUSSIA | AUGUST 2017

CHANGES IN FOREIGN INVESTMENTS REGIME AND SHAREHOLDER INFORMATION RIGHTS

STRICTER REGIME OF FOREIGN INVESTMENTS IN RUSSIAN ENTITIES

Important changes to the Russian regulation of foreign investments came into effect in July 2017.[1]

The changes tighten the regime of foreign investments involving the acquisition of Russian companies by foreign investors and consist in the following:

(a) significant extension of list of transactions which may potentially be subject to governmental approval as having meaning for security of the state security and defence;

(b) recognition of Russian citizens holding a second (foreign) citizenship as 'foreign investors' for the purposes of governmental control over investment transactions;

(c) establishment of the liability for a foreign investor who failed, in breach of its statutory obligations, to notify state authorities of its acquisition of a shareholding in a strategic[2] entity;

(d) banning foreign companies registered in jurisdictions or territories recognised as 'tax havens' and (or) not providing information on financial operations and entities under their control from acquiring control over strategic entities and the privatisation of state property; and

(e) granting full discretion to the Governmental Commission for the Control of Foreign Investments (the "**Commission**") in measures to be taken by the foreign investor as a condition for the Commission's approval of the investment transaction.

---

[1] The legal basis for the described changes includes Federal Law No. 155-FZ dated 1 July 2017 "*On Amendments to Article 5 of the Federal Law "On Privatization of State and Municipal Property" and Federal Law "On Procedure of Foreign Investments in Business Entities Having Strategic Importance for National Security and State Defence"*" (came into force on 1 July 2017) and the Federal Law No. 165-FZ dated 18 July 2017 "*On Amendments to Article 6 of the Federal Law "On Foreign Investments in the Russian Federation" and Federal Law "On Procedure of Foreign Investments in Business Entities Having Strategic Importance for National Security and State Defence"*" (came into force on 30 July 2017).

[2] A Russian entity is recognised as 'strategic', i.e. having strategic meaning for national security and state defence, if it conducts any of the 'strategic' activities listed in the Federal Law "On Procedure of Foreign Investments in Business Entities Having Strategic Importance for National Security and State Defence".

Extension of list of transactions being subject to governmental approval

The Chair of the Commission (who is in fact the Chairman of the Russian Government) has been granted the authority to consider **any** transaction of a foreign investor in respect of **almost any** Russian entity (and not only a strategic one)[3] as a transaction being subject to preliminary approval by the Commission as potentially significant for national security and state defence.

The new regulations do not specify what type of investment transactions relating to a Russian entity may trigger the Chair's decision: so far, any acquisition of a minority equity stake or, for example, establishing a new Russian entity may be made subject to clearance by the Commission. Equally, no grounds or criteria for the Commission's Chair to make the respective decision (e.g. transaction amount, thresholds for total assets of a Russian entity, etc.) have been given due statutory regulation: as a purpose of such a decision, though, it is only stated that the decision can be made '*for the purposes of ensuring national security and state defence*'. An explanatory note to the draft amendment law does not provide any clarifications in this regard, as the respective amendments were not contained therein from the very beginning, at submission to the Russian parliament, but were added to the draft law only during the second reading in parliament.

In any case, the procedural aspect of obtaining clearance from the Commission in this case is vague: it is stated that the Russian Federal Antimonopoly Service (the "**FAS**"), acting as an intermediary body between a foreign investor and the Commission, shall immediately notify the foreign investor of the decision of the Commission Chair and the need to obtain the Commission's preliminary approval for a planned transaction. There is no rule as to how the Chair could become aware of the intended transaction of the foreign investor and, therefore, in which cases the Chair could make the respective decision. Presumably, questionable transactions could be disclosed to the Commission by the FAS in the course of standard merger control procedures upon the foreign investor's filing, though some foreign investment transactions are not subject to the FAS merger control approval – it is, therefore, not clear what may trigger the Commission's intervention if there is no merger control filing.

Irrespective of the vagueness of the regulation, liability for its breach remains strict. Once the foreign investor is notified of the Commission Chair's decision, it cannot close the intended transaction before obtaining the Commission's approval therefor. Otherwise, the transaction is invalid and, if the restitution of shares is impossible for some reason, the foreign investor may be deprived of its voting rights on the acquired shares in the Russian company until its approval by the Commission.

In view of the above, a new legal issue for foreign investors intending to acquire Russian entities should be borne in mind. Detailed procedures of application of new rules and their construction by state authorities are expected from the Russian Government, the FAS and the courts.

[3] The only exception is financial organisations – banks, other credit institutions and insurance companies, acquisition of which by a foreign investor is subject to special approval of the Bank of Russia.

Russian citizens with a second (foreign) citizenship are recognised as 'foreign investors'

The regime established by the Federal Law "On Procedure of Foreign Investments in Business Entities Having Strategic Importance for National Security and State Defence" (the "**Strategic Law**") now extends to Russian citizens holding a foreign passport – such individuals are now treated as foreign investors in terms of the Strategic Law, and certain of their transactions with respect to Russian strategic entities may be subject to the Commission's approval.

Given the provisions described above, transactions involving such Russian citizens in respect of a Russian *non-strategic* entity may also be subject to the Commission's approval, if the Chair of the Commission so decides.

Liability for a foreign investor failing to notify State authorities of the acquisition of shares in a strategic entity

The Strategic Law contains an obligation for the foreign investor to notify the FAS of the acquisition of 5% or more shares in a Russian strategic entity.

This obligation is now furnished with a sanction for its breach: the court, further to a claim from the FAS, may deprive the foreign investor of its voting rights at the general meeting of shareholders of a strategic entity until the day the investor properly notifies the FAS of the respective acquisition of shares. In this case, the foreign investor's shares do not count towards the quorum and do not cast votes at the general meeting of shareholders.

Banning 'tax haven' companies and companies under their control from acquiring control over strategic entities and privatisation transactions

Companies registered in jurisdictions or territories recognised by the Russian Ministry of Finance as 'tax havens' and (or) not providing information on financial operations, as well as entities under their control (the "**Offshore Companies**") have been subjected to restrictions.[4]

The Offshore Companies are not allowed to:

(a) acquire control[5] over strategic entities;

(b) acquire, lease or otherwise use a strategic entity's fixed assets with a value exceeding 25% of the total balance sheet value of that entity's assets as of the latest reporting date; and

(c) participate in the privatisation of state or municipal property.

The acquisition of more than 25% of votes in a Russian strategic entity, or more than 5% of votes in a Russian strategic entity being a federal subsoil user, by an Offshore Company is subject to the Commission's preliminary approval.

[4] The Russian Ministry of Finance maintains a list of the respective jurisdictions and territories (approved by the order No. 108n of 13 November 2007 (as amended)): it covers, among others, such in-demand jurisdictions as the BVI, the Isle of Man, the Channel Islands, the Seychelles and the UAE.

[5] 'Control' is generally understood as holding more than 50% of votes, the ability to appoint the CEO or over 50% of the board of directors and (or) legal authority to determine decisions of the Russian strategic entity. However, this list of criteria is not exhaustive, and control over a strategic entity may be established in other ways. Each transaction should, therefore, be analysed on a case by case basis.

Granting full discretion to the Commission in determination of pre-condition measures to be taken by a foreign investor

Under the Strategic Law, the Commission is allowed to issue a conditioned approval of a transaction and oblige a foreign investor to perform certain duties set out by the Commission. If the duties are not performed, the investor may be deprived of its voting rights within the strategic entity. For that purpose, there was an exhaustive list of duties in the Strategic Law, including, for example, continuing supplies for state defence procurement by a Russian strategic company, completion of a business plan declared by the foreign investor when filing for the Commission's approval of the transaction, keeping an average headcount in the Russian strategic entity for a set term, etc.

The Commission is no longer limited to that list of duties and may impose on the foreign investor *any obligations* the Commission considers reasonably appropriate to '*ensure national security and state defence*'.

STRICTER RULES ON SHAREHOLDERS' ACCESS TO COMPANY RECORDS

Considerable limitations for minority shareholders of Russian joint-stock companies (JSC) regarding shareholder access to company records were enacted in July 2017. Some changes also concern shareholders of Russian limited liability companies (LLC)[6].

Information access in JSCs

In JSCs, shareholders enjoy three levels of access to corporate documents, depending on the percentage of their shareholdings. Within those levels, various groups of documents are available for the shareholder's attention:

(a) the **first access level** includes the documents which should be provided to **any shareholder of a JSC** (upon request). Mostly those are:

(i) foundation documents (charter, incorporation agreement, etc.);

(ii) documents which are often available publically (securities prospect, lists of affiliated persons, etc.);

(iii) documents available during the general meeting of shareholders or related thereto (annual financial statements, audit report thereto, etc.);

(iv) documents accompanying notifications sent to the JSC pursuant to mandatory rules (receipt of the VTOs/MTOs, conclusion of an SHA, etc.).

The regulation has changed in this regard, and the following documents are no longer available to such shareholders:

(i) documents confirming a JSC's title to its property;

(ii) appraiser's reports (except for the appraiser's reports regarding major transactions / related-party transactions and mentioned in the paragraph below – they are only available to the at least 1%-shareholders);

[6] The legal basis for the changes is the Federal Law No. 233-FZ dated 29 July 2017 "On Amendments to the Federal Law "On Joint-Stock Companies" and Article 50 of the Federal Law "On Limited Liability Companies"" (came into force on 30 July 2017).

(iii) information on major transactions and related-party transactions (except for the information mentioned in the paragraph below – they are only available to the at least 1%-shareholders);

(b) the **second access level** is a new rule intended to release JSCs from the obligation to present company records to shareholders holding a negligible percentage of shares.

This level covers documents (information) available by request to **shareholders holding at least 1% of voting shares** in a JSC: certain information on major transactions and related-party transactions and appraiser's reports on the value of property being the object of those transactions, and minutes of the JSC's board of directors.

Within this level, a non-public JSC shall also provide shareholders with access (upon request) to other documents that the JSC is obliged to keep as a matter of law, except for minutes of the management board and financial accounts. This obligation of a non-public JSC may be excluded in its charter or in the shareholder agreement to which all the shareholders of the JSC are parties.

Shareholders of both public JSCs and non-public JSCs inside this second level shall indicate their reasonable commercial purpose for requesting the listed documents from the JSC. However, a commercial purpose may be regarded as not being reasonable, if:

(i) the JSC is aware of that shareholder's bad faith;

(ii) the shareholder's interest in accessing the requested information is inappropriate;

(iii) the shareholder is a competitor of the JSC, or a competitor's affiliate, and the requested document is confidential, relates to competition and the disclosure of information therein may do harm to the commercial interests of the JSC;

(c) the **third access level** includes the documents available by request only to **shareholders holding at least 25% of voting shares** in a JSC: minutes of the management board and financial accounts of the JSC. However, the charter of a JSC may now lower the shareholding threshold that grants a shareholder the third level of access to its corporate records.

Irrespective of all the above, in non-public JSCs the shareholders may establish their own regime of access to corporate records and data that would be different from the regulations set out above, including the establishment of thresholds for various levels of access and the procedures for providing the data to shareholders. Such regulations may be introduced in the JSC's charter based on a unanimous decision of the shareholders.

The JSC is entitled to deny access to the requested documents to any shareholder irrespective of its shareholding percentage on specific grounds aimed at preventing any misuse of the shareholder's rights to access to company's documents – e.g. a JSC may deny access if, in particular:

(a) an electronic version of the document is available on the JSC's website or properly disclosed pursuant to the Russian legislation;

(b) a document is requested twice in two years (provided that the first request was properly satisfied);

(c) a document relates to a period that ended more than three years prior to the request date (excluding information on transactions which are still being performed at the moment of making the request);

(d) a document relates to a period when the shareholder was not a shareholder of the JSC.

Information access in LLCs

The shareholders of LLCs are not separated into access groups, as in JSCs. Nevertheless, the list of documents which any shareholder can access is almost identical to the list for JSCs (please see the paragraph describing the *first access level* above). It is notable, however, that the list is not closed, like the one for JSCs, and refers to other documents the shareholder may be able to access is prescribed in the LLC's charter, by-laws, decisions of the general meeting of shareholders, resolutions of the board of directors and other managing bodies of the LLC.

In addition, the list of grounds for the LLC's to refuse the shareholder access to the requested documents is considerably shorter than that in JSCs:

(a) an electronic version of the document is available on the LLC's website or properly disclosed pursuant to the Russian legislation;

(b) a document is requested twice in two years (provided that the first request was properly satisfied);

(c) a document relates to a period that ended three years before the request – this ground for refusal is not applicable, however, to most of the documents that any shareholder shall be given access to (documents of the *first access level*).

CONTACTS

BORIS ARKHIPOV
arkhipov@gide.com

TIM THEROUX
tim.theroux@gide.com

EKATERINA VILENSKAYA
vilenskaya@gide.com