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Multidirectional trends in the Russian strategic legislation: toughening the regulation while attracting investment

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M&A and other transactions involving foreign companies might sometimes raise national security concerns in specific areas of the economy such as military, dual use, advanced technology, etc. To mitigate those concerns, national governments dealing with a great number of transactions used to establish the strategic investment regimes. In many jurisdictions, strategic investment regime requires either strategic clearance, i.e. preliminary approval by the governmental authorities, or post-transaction notification in respect of specific transactions.

The strategic investments regime in Russia is relatively young, celebrating ten years of its implementation in 2018. However, during that short period, the legislation has been numerously amended and significantly expanded its scope of application so that today almost every major transaction involving foreign investors and concerning sensitive areas of the Russian economy could be subject to the strategic filing. At the same time, Russian economy, which is influenced by sanctions during the last four years, vitally needs foreign investments, and that fundamental truth, though not declared, determines the thinking of the lawmakers and the Government.

Thus, currently there are two multidirectional trends in the Russian strategic investments regime: toughening the regulation to defend strategic interests of the state and liberalization aimed at infusing money to the Russian economy.

As for the first trend, it is mainly characterized by “expansion” of the regulation. For instance, the Strategic Investments Law provides a list of 47 strategic activities regarded as being of strategic importance. During the last ten years, the list expanded, though, remained exhaustive. However, as a result of the amendments adopted in the last year, any transactions of foreign investors with regard to Russian entities might be brought to the Government Commission for clearance upon the decision of the Chairman of the Commission (the Russian Prime Minister). Although, there is no publicly available information on such kind of decisions of the Chairman yet, it has already been discussed in media, that two or three transactions are currently run through such a procedure.

Generally, the following transactions might be of interest of the Russian Prime Minister and brought into consideration by the Government Commission:

1. Transactions in respect of Russian companies, implementing activities that might be directly connected with those 47 activities of strategic importance. For example, there is an existing practice of demanding from companies engaged into activities neighboring with extraction of minerals (though not directly engaged into such extraction) to obtain a strategic clearance. Thus, Russian companies rendering in-the-field services to the oil-and-gas sector might be in a potential area of interest of the Governmental Commission.
2. Large trans-border transactions, involving transfer of assets/subsidiaries located in Russia, on which the economic defense of Russia might depend. For instance, while considering Bayer/Monsanto transaction, which formally required only merger control clearance in Russia, FAS Russia numerously indicated that such a transaction might influence food security of a state and, though unrelated to strategic activities, might still be subject to strategic clearance.
3. Transactions with public investors "operating in completely different cultural and legal environment". According to FAS Russia, this primarily relates to eastern countries (e.g., acquisition of Russian companies being important for the economy but not engaged in strategic activities by Chinese companies usually controlled by the Government of the People's Republic of China).

Currently, the procedure for determining whether the above listed transactions require strategic clearance is quite complicated. FAS Russia, which serves as the "secretary office" for the Government Commission, identifies the potential transaction, which might be of interest for the Governmental Commission, and sends the requests to the relevant federal authorities (which are responsible for implementation of national policy and statutory regulation in the sphere, where the Russian target entity is involved). In these requests, FAS Russia indicates the necessity to inform the Russian Prime Minister on the respective transaction.

The Russian Prime Minister takes into account the responses of the relevant federal authorities and adopts a decision on the necessity of securing the preliminary clearance for the transaction.

Thus, in practice, the expansion of regulation might result in unlimited powers of the Government Commission and FAS Russia.

At the same time, practical approach of the authorities to analyzing transactions tends to liberalization to a large extent. The recent practice demonstrates that FAS Russia and the Government Commission while considering transactions do not stick to formal requirements but try to get the bottom of business processes to produce a workable and mutually beneficial solution both for the parties and the state.

The current example is a transaction on acquisition of shares of Eurasia Drilling Company (EDC), the largest provider of drilling services in Russia. It was initially planned to be acquired by Schlumberger, however, during the consideration process, an international consortium (consisting of Mubadala fund from UAE, China-Eurasian Economic Cooperation Fund, etc. and led by the Russian Direct Investment Fund)

indicated its willingness to acquire the shares of EDC as well. Subsequently, the authorities started to discuss the terms of the transaction with both Schlumberger and the international consortium as well as with the national and international business community in order to come up with the best possible solution for the investors, on the one hand, and for the Russian economy – on the other. As a result of discussion, a new form of remedies was proposed. For example, Schlumberger was proposed to integrate its own technologies into EDC business and to share them with the Russian company in case it has to cease its operation and sell its business in Russia following the U.S. sanctions. Remedies in the form of sharing the technologies have also become a new trend in the Russian regulatory practice.

The liberalization trend could also be illustrated by erosion of barriers for foreign investors. The recent example is removal of the concept of offshore companies for national security review purposes. Until recently, all the offshore companies were subject to regime of a public investor (the same as for foreign states or international organizations) prohibiting them to acquire control and some other interests in Russian strategic companies. A number of companies registered in offshore jurisdictions and having intention to invest in Russian economy were ready to cooperate with FAS Russia and Government Commission and disclose all the necessary information. However, they could not do so because of the formal restriction.

This topic was heavily discussed within the business community, when FAS Russia gave credence to business and initiated significant changes in status of offshore companies. At the beginning of 2018 instead of “offshore companies” a concept of “companies, which do not disclose information” was introduced. In accordance with the amendments, the concept refers to those companies, which do not disclose information on their beneficiaries (persons to the benefit of which another company acts), beneficiary owners (persons that directly or indirectly ultimately possess more than 25% of shares or have a right to control activities of the company) and controlling persons. Thus, the amendments pursued liberalization of foreign investments regime and made national security review process more comfortable by reducing excessive administrative barriers.

As demonstrated above, current strategic investment legislation and enforcement practice is developing in different directions in Russia. The toughening of regulation for defense of the national economy is in line with the approach of other states. The most recent example is a set of amendments initiated by the U.K. in its National Security and Investments White Paper. The Government of Germany recently blocked two Chinese transactions because of national security concerns (both related to industrial sector). The U.S. decided to expand the powers of its Committee on Foreign Investment to defend its critical technologies. Thus, the changes in the Russian regulation reflect the global trend.

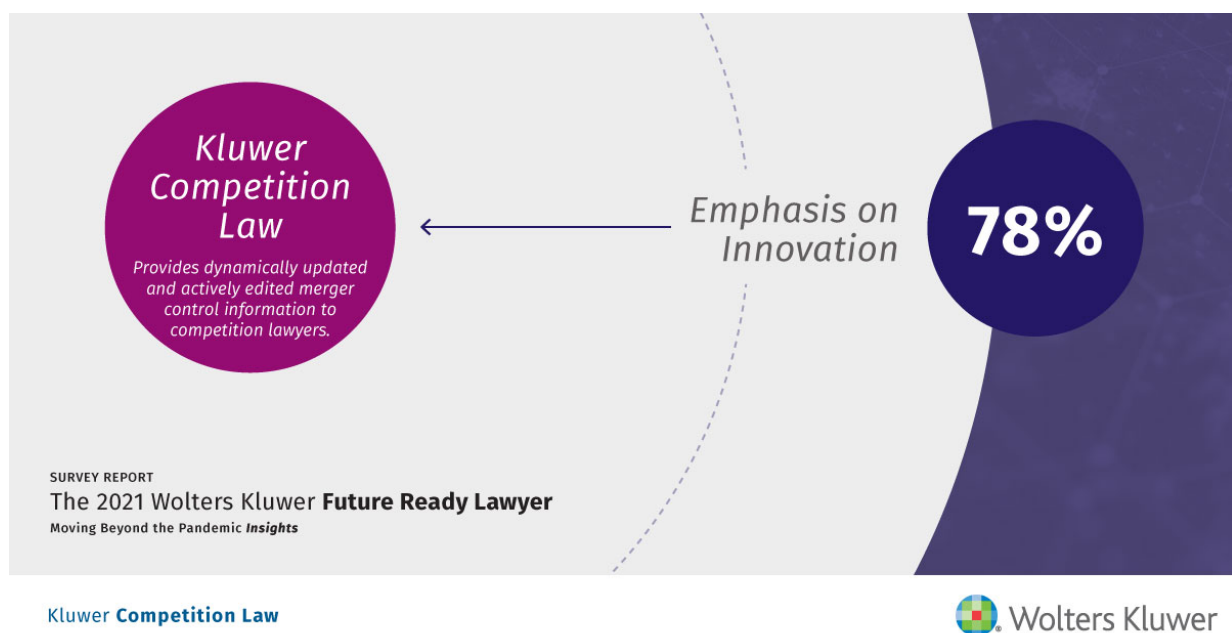
As for the liberalization trend, due to investment constraints caused by sanctions, we may expect further ease of regulation and enforcement in order to increase investment opportunities and attract investors, including those having interest in the areas related to national defense and security.

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