



legal update

The Strategic Sectors Law – the First Year of Enforcement

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It has been almost a year since the adoption of Federal law No. 57 of 29th April 2008 entitled “On Foreign Investment in Companies with Strategic Significance for National Security and Defense” (the “Strategic Sectors Law.”)

The law governs relations when foreign companies wish to purchase shares of Russian companies that have a strategic significance for national security in Russia. In addition to economic sectors directly related to national defense and security, the law covers many other strategic sectors, including mining operations, telecommunications and mass media.

During this past year, the Federal Antimonopoly Service (FAS) accepted several dozens of applications for the purchase of assets in accordance with the law. The FAS has approved only a few of these applications; yet, up until now, only some of them included the imposition of the specific obligations on a foreign investor. Other applications remain pending.

Application of the Law

All applicants under the law can be divided into two groups: the first group consists of actual foreign legal persons and organizations; the second group consists of foreign organizations beneficially owned by Russian natural persons.

Disclosure of Information

The main procedural problem faced by applicants that wish to purchase Russian assets in accordance with the law consists of the amount of disclosure of information that applicants must make.

The first issue relating to the disclosure of information arises from foreign legal persons beneficially owned by Russian natural persons. These applicants do not want to disclose information to the Federal Antimonopoly Service on the real beneficial owners of these companies because of likely problems with the Russian taxation authorities and their general unwillingness to make information on the actual owners of these companies public. In these cases, such applicants often submit to the FAS false or contradictory information about the beneficial owners of foreign companies or on a group of persons who wish to purchase Russian assets.

Interestingly, these applicants do not take into account that they previously submitted applications to the Federal Antimonopoly Service for the purchase of some assets within the framework of the Federal Law on the Protection of Competition. At that time, they provided the FAS with different information on the beneficiaries of the foreign company or on the group of persons who own the foreign company.

The information provided by a foreign company to the FAS is often contradictory to the information that the Federal Antimonopoly Service gets from open information sources (such as mass media or press releases) on the foreign company or on the group of persons who own the foreign company.

One further and equally important problem arises from such a disclosure: foreign companies do not want to disclose shareholder agreements to the Federal Antimonopoly Service. It is common practice that when a foreign company is owned by several shareholders, the shareholders conclude a shareholder agreement to control the procedures for funding and operating the company, the terms and conditions for distribution of profits and other important matters. The contents of such agreements are usually a commercial secret, therefore foreign companies do not wish to disclose the terms and conditions contained in them. However, the Federal Antimonopoly Service demands that such agreements are taken into account in the process of reviewing applications for the purchase of Russian assets, to avoid any restrictions on competition or threats to national security.

In addition, the Federal Antimonopoly Service needs to review these shareholder agreements when making the decision as to whether to require the applicant to

meet other obligations as part of their purchase of Russian assets.

Lack of Understanding by Foreign Investors of the Importance of the Approval of the Transaction

Another important problem often not understood by foreign investors is that foreign companies do not always consider it necessary to submit an application to the Federal Antimonopoly Service if the proposed transaction for the purchase of Russian assets takes place within a group of persons that already own the assets. In such case, the actual owner controlling the asset is the same person. However, formally under Russian law, the owner changes, and therefore such a transaction is subject to approval by the Federal Antimonopoly Service, the national security bodies and the Government Commission under the Strategic Sectors Law.

Foreign companies also do not often realize that it is necessary to get approval from the Federal Antimonopoly Service for transactions involving the purchase of banking assets that have cryptographic licenses, which are covered by the Strategic Sectors Law.

Formulation of Terms and Conditions of Agreements Imposing Specific Obligations on a Foreign Investor

Some transactions approved by the Federal Antimonopoly Service and the Government Commission will be approved only if the foreign investor will agree to specific conditions governing the purchase of assets that are set forth in a special agreement.

At a session of the Government Commission for Control over Foreign Investments on October 10, 2008, the Chairman of the Government Commission, Prime Minister Vladimir Putin, said that such conditions could be imposed on each of the following: guaranteeing the security of national secrets, any obligation to process raw

materials extracted on the territory of the Russian Federation, any obligation to hold positions of employment, and any obligation to fully implement the submitted business plan for development of the company.

Such conditions might also consist of ensuring the delivery of raw materials to specific consumers connected in the processing chain with the company that is being purchased, the guarantee of non-discriminatory access by third party customers to the infrastructure of the company, as well as a number of other restrictions that might be defined depending on the nature of the activity of the company and market conditions.

Time Limits Set Forth in the Law

There are specified time limits in the law governing the review of applications by the Federal Antimonopoly Service and the Government Commission. In accordance with the law, the FAS must register the application and check to see if all necessary documents have been attached within 14 days of its submission. If some documents are missing or the information is incomplete or insufficient for any reason, the FAS may extend this 14 day period until the information is provided.

The duration for the review of an application in such case therefore depends on how quickly the foreign investor submits the additional information, and thereafter, on the time required for the FAS to review such additional documents.

Beyond the Federal Antimonopoly Service, the Government Commission holds its sessions once every two or three months. Within the operational processes of the Government Commission, to make a decision there must be two sessions for each application, one for determining the applicant's obligations, and the other for making the final decision. For this reason, the deadlines set forth in the law for reviewing the applications of foreign investors by the Federal Antimonopoly Service and the Government Commission are impossible to meet.

Definitions

In applying the law, a number of problems have come to light that can only be resolved through further legislation. For example, the law does not provide a clear criterion by which a transaction can be clearly classified as a transaction that may result in a threat to national security and defense. Each time this question is asked, it is resolved on the basis of many factors that have no clear definition.

The law sets forth a rather loose definition of "control" and "being controlled" by a company purchased by a foreign investor. Pursuant to the law, "control" is a right of a foreign investor to make or block decisions of a Russian company that is being purchased. At the same time, the law is unclear in differentiating the right to make decisions, so the law even covers those cases where a foreign investor buys an insignificant part of a Russian company.

For example, a foreign company — a buyer of a minority stake in a Russian company — is entitled to make decisions about a target company on the approval of auditors' reports, business plans and decisions on dividends distribution, but is not entitled to decide on the increase of authorized capital or on the approval of large transactions.

For purposes of implementation of the law, the question is: which of the above-mentioned rights are important to the Federal Antimonopoly Service to fulfill its obligations under the law? Pursuant to the current definitions, the law appears to cover many more transactions than would seem at first sight.

One of the problems that remain unsettled by the law is whether the law applies when a company that is purchased by a foreign investor starts to become engaged in a strategic sector after the purchase of the shares of the company. According to the text of the law, it should not be applied to such cases; however, if one goes by the purposes of the law, in fact the law should apply to this situation. This is one example of a substantial gap in the law.

Conclusion

This brief overview of the application of the Strategic Sectors Law leads to the conclusion that the law still has too many unclear provisions that will result in subjective judgments about information and the development of subjective conditions for the approval of transactions by the Federal Antimonopoly Service and the Government Commission that are responsible for implementation of the Strategic Sectors Law.

Many foreign companies have not yet fully realized the importance of getting approval of transactions in accordance with the law; they underestimate the requirement of getting all required information together and submitting it to the Federal Antimonopoly Service on a timely basis.

A more rational and careful approach by foreign companies, by paying closer attention to the procedures for the review of applications for purchasing Russian

assets, would allow foreign companies to get approvals and close transactions in a more efficient, timely and beneficial way in accordance with the law.

As a final note, the law is undergoing a regulatory review and a number of amendments are being prepared. Hopefully, these amendments will settle some of the problematic areas mentioned above and make the process of getting approval more transparent and expeditious. ■

The opinions in this article are those of the author and do not necessarily reflect those of the USRBC.

Buy America Provisions in the American Recovery and Reinvestment Act: Impact on Russia

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On February 17, 2009 President Obama signed into law H.R. 1, the American Recovery and Reinvestment Act (ARRA). The ARRA provides \$789 billion in spending and tax cuts and contains several accountability and transparency provisions. In addition, the ARRA includes billions of dollars for information technology (particularly in the health care arena), transportation infrastructure, energy and environmental research and development, and remediation, repair and upgrades to public facilities at the federal, state and local levels — and much more.

The ARRA includes broad Buy America provisions (at Section 1605) that could seriously impact imports of Russian iron and steel, and of products from many other countries. Section 1605 of the Act requires the use of U.S.-made steel, iron and manufactured goods in construction, alteration, maintenance, and repair projects funded by the ARRA, unless to do so would violate U.S. obligations under international agreements or if other exceptions are in place. Under Section 1605, the Buy American provisions do not apply if the head of the federal department or agency finds that applying the provisions would be against

the public interest, the goods are not produced or available in the United States in sufficient quantities or quality, or if use of U.S.-made goods would increase the project's cost by more than 25 percent. If the head of an agency conducting a procurement decides to waive the provisions, he must publish an explanation in the Federal Register.

In the Joint Explanatory Statement to Section 1605, the conferees state that Section 1605, except in certain circumstances, provides for the use of U.S.-made iron, steel and manufactured goods. The conferees also state that, “Section 1605(d) is not intended to repeal by implication the President’s authority under Title III of the Trade Agreements Act of 1979.” Further, “[t]he conferees anticipate that the Administration will rely on the authority under 19 U.S.C. 2511(b) to the extent necessary to comply with U.S. obligations under the WTO Agreement on Government Procurement (GPA) and under U.S. free trade agreements.”

The Buy America provision is being challenged by domestic critics as well as by trading partners. The Peterson Institute for International Economics estimates that, because of the highly

mechanized nature of the steel industry, only around 1,000 jobs will be created in a labor force of 140 million people. On the other hand, America’s exports of 9 million metric tons of steel every year could be impacted by as much as one percent because of retaliation by other countries (and the figure could be much higher). That would result, at a minimum, in 6,500 jobs being lost in the same industry. The EU, many of whose members are signatory to the GPA, has requested the GPA Committee to spell out the specifics as to how the rules will be applied to GPA members. Other countries are equally concerned.

Since Russia is neither a member of WTO nor a signatory to a free trade agreement with the United States, its domestic steel producers as well as producers of other base metals will not be in a position to avail themselves directly of treaty protection. However, Russian steel producers with subsidiaries located in the United States, such as Severstal or Evraz, or those located in countries that are signatories to the GPA will have some protection. This is also true of Russian steel producers with subsidiaries located in countries that have free trade agreements with the United