Morgan Lewis

RUSSIA'S REGIME OF FOREIGN INVESTMENT RESTRICTIONS IN STRATEGIC SECTORS With Focus on Mineral Resource Investments

Overview Briefing for Clients

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Executive Summary

Opening Notes: This briefing summarizes the relevant initial packet of laws and amendments (enacted in 2008) and the various follow-on related law amendments, Government decrees and FAS and Ministry of Natural Resources instructions, rulings and explanations (both formal and informal) adopted since then to date. Readers should check for further possible important developments occurring after the date on the cover page. (And uncertainties as to application of the regime in a particular case may be clarified with the Authorized Agency – FAS.)

1. Enactment; Retroactive Force; Further Requirements (Section I)
   - Adopted in 2008; amendments of June 2008, Nov. 2011 and Nov. 2014
   - Further important notification / approval requirements (including for some non-strategic sector investments)
   - limited retroactive force
2. Industries / Enterprises Covered (Section II)
   - General – Foreign Strategic Investments Law ("FSIL") coverage
   - Strategic oil & gas and hard minerals fields investments (per special FSIL provisions, and companion SL / CSL / GSL amendments – see definitions below)
   - Certain power transmission companies, and other registered natural monopolies such as airports, marine ports, main oil/gas pipelines, railroads
   - Certain telecoms providers and media outlets, aviation/aerospace, others

Executive Summary *(cont'd)*

3. Scope of Investment Deals Covered (Section III)
   - Direct sphere of application – advance approval required
   - Wide scope of transactions / agreements / contexts covered
   - Various possible "loopholes" per drafting looseness (gradually being closed)
4. Approval Regime, Processes, Procedures (Section IV)
   - Basic regime (Authorized Agency = FAS, plus State Commission… (and Ministry of Defense, FSB – and MNR de facto where relevant)
   - Application submission basics (including FAS implementing rules); possible further amendments
   - Timing issues: seems can sign, with FSIL condition (but Megafon case decision cast some doubt on this); overlap with general FAS approval
   - Application review / approval basics (3 months + 3 months = 6 months)
   - Possible approval, approval with conditions, rejection
   - Decisions formally taken at scheduled periodic State Commission meetings; most recent – June 2016
   - Many deals considered/approved in a wide range of industries (and a few rejected) to date; we can provide examples/details
5. Consequences of Non-Compliance (Section V)
   - Direct legal consequence – void transaction (some FAS threats — e.g. Pacific Andes; Megafon, TGK and Astrakhan Port court cases)
   - Other possible consequences – loss of voting rights (Vimpelcom and LISSI cases) – and see slide 39
   - Required disinvestment upon rejection of application

Executive Summary *(cont'd)*

6. Laws Enacted/Amended

- Foreign Strategic Investments Law ("FSIL" – No. 57-FZ, enacted in May 2008)
- "First Amending Law" (No. 58-FZ, simultaneous with FSIL enactment), amended:
  - Subsoil Law ("SL") and Continental Shelf Law ("CSL")
  - Foreign Investment Law ("FIL")
  - Stock Company Law and LLC Law
  - Law on Communications, Law on State Reg. of Development of Aviation
  - Law on Competition
  - Investig. Activity Law, Admin. Violations Code ("AVC"), Arbit. Procedure Code
- "Second Amending Law": further amendments to CSL, SL and Gas Supply Law ("GSL"), enacted July 2008 – enshrined legality of non-auction / tender licensing of shelf oil fields and any strategic gas field (to Gazprom, Rosneft, affiliates, etc.) – and some further relevant CSL amendments of Dec. 2009
- "Third Amending Law" (of FSIL itself – Nov. 2011): raised mineral resource SE "control" threshold from 10% to 25%, various new clarifications / adjustments
- "Fourth Amending Law" (of FSIL itself – Nov. 2014): mostly liberalizing amendments, and some clarifications, *but asset deals clearance requirement added*

I. Entry Into Effect; Retroactive Force; Notifications

1. Effectiveness in Time; Retroactive Force (FSIL arts. 16, 17)

- FSIL and First Amending Law (and Commission / Agency) – in place from 2008
- Follow-on rules / forms in place; considerable practice to date
- Basic application (FSIL art. 16.1) – to:
  - relations connected with foreign investors' / groups' investments and transactions with, and control over, any strategic enterprise ("SE") – arising after law entered into force
  - and, as to such investment / transaction relations arising before law entered into force
    - the law applies to extent of rights / obligations that arise after its entry into force
    - e.g., by acquisition per exercise of put/call option, default purchase, operation of mandatory offer, realization on share pledge

I. Entry Into Effect; Retroactive Force; Notifications *(cont'd)*

2. Further Important Notification / Approval Requirements

- Required notification of any ≥5% strategic enterprise share/stake purchase post-FSIL enactment (FSIL art. 14) – per Rules enacted by Gov't Decree No. 795 of October 27, 2008 (non-compliance penalty seems limited to admin. fine)
- Required advance approval for acquisition (directly / indirectly) by any foreign gov't, int'l org. or controlled company of rights to >25% shares/stake in (or of ability to block management decisions of) *any* Russian company, per the general FSIL approval procedure rules (see companion amended FIL art. 6 on this point)
  - whether in a strategic sector or not
  - per FAS Dec. 2013 clarification, applies even to new company foundation
  - also issue re applicability of FSIL art. 15 / other penalty rules (void transaction, loss of voting rights) for violation (see Sections IV.1 last bullet and V.4 below)
  - if no SE involved – simplified procedure has been applied de facto (and confirmed by a 2012 Gov't regulation and Dec. 2013 FAS clarification)
- Third Amending Law also clarified exemption for IFIs (e.g., EBRD) of which Russia is member or where is an int'l agreement with Russia (list published by RF Gov't)

I. Entry Into Effect; Retroactive Force; Notifications *(cont'd)*

- Doesn't apply to transactions completed (apparently means shares/stake actually transferred) before the Law's May 2008 entry into force (FSIL art. 16.2)

- But some stated obligations to notify of pre-existing SE acquisitions / ownership stakes (seems *de facto* / for practical purposes moot by now)

- And see the important further special retroactive-force rules applicable for strategic fields mineral E&P investments – per the companion Subsoil Law amendments (see Section II.2 below)

II. Industries / Enterprises Covered (General – FSIL)

1. General – Foreign Strategic Investments Law ("FSIL")
   - Aimed at foreign investment into Russian "commercial enterprises having strategic significance for assurance of the country's defense and national security" – (for short, a "strategic enterprise" or "SE")
   - Where a "foreigner investor" or its "group of persons" would obtain (see slides 21-27 for details)
     - generally, >50% of shares/stake (or ≥25% fixed assets of) in a Russian SE
     - or other means of control (see also slide 28)
     - or ≥ 25% of shares/stake for SE engaged in mineral resource E&P on strategic field
     - but special stricter rules for foreign-gov't-owned companies (see slides 24-25)
   - No specific companies are named – rather, 45 specified areas of strategic activity, which may be grouped into 12 or 13 sub-categories – are set out for coverage (as long as the target company is engaged in at least one such), including:
     - E&P of mineral resources on "fields of federal significance" (a "strategic field" or "FFS") – as defined in related amendments to the Subsoil Law (details at Section II.2 below)
     - certain power (and perhaps heat) transmission enterprises that are registered as natural monopolies under law (application to some of the former RAO UES generating companies now having foreign investment – note the TGK cases)
     - certain other types of registered natural monopolies (e.g., airports, sea / river ports, main oil / gas pipelines, railroads)

II. Industries / Enterprises Covered (General – FSIL, *cont'd*)

- aviation / aerospace industry (with some carve-outs); transportation security-related business
- specialty metals, nuclear / radioactive facilities and materials, weapons / military, shipyards and other facilities of possible military use
- licensed use of certain biological / disease agents etc., except for food industries (per 2014 liberalizing amendment)
- cryptography industries (banks exempt unless RF has a stake in charter capital – per 2011 liberalizing amendment)
- companies using radioactive materials (unless in commercial sector and use is incidental – e.g. oilfield services cos., medical equipment production etc., per 2011 liberalizing amendment)
- certain telecoms providers having "dominant position" (and included as such in the official register) under the Competition Law
  - telecoms *(not including Internet*)
  - fixed phone providers covering (i) five or more RF regions, or (ii) Moscow or St. Pete
- certain TV, radio, print media (having defined reach/circulation)
- fishing

II. Industries / Enterprises Covered (General – FSIL, *cont'd*)

- And these recent-development caveats
  - Schlumberger / Eurasian Drilling Co. (EDC) proposed acquisitions: Commission resists / establishes conditions; deal eventually dies; basis is RF Gov't surprising position that oil filed drilling services = E&P for FSIL strategic activity purposes, now seems to apply to other service co. acquisitions
  - For media industry, beyond FSIL the new Mass Media Law (effective Jan. 1, 2016), with its 20% foreign shareholding restrictions, creates whole new layer of control
- And some technical notes:
  - see the list of "critical technologies" in 44 described categories, issued to assist in review of approval applications (see FSIL art. 10.1(9)), per Gov't Directive No. 1273-r, July 14, 2012 (updated as of June 2013)
  - and see the separate / unrelated Presidential Edict No. 1009 of August 4, 2004 (as amended many times to date) confirming the list of State-Owned Strategic Enterprises and Stock Companies (relating to restrictions on privatization)
  - FSIL is triggered even if strategic activity isn't primary for the target enterprise – unless exempted – e.g. by amendments of 2011 (re radioactive materials) and 2014 (re food products)
  - de facto simplified FAS review process … may continue in areas not yet covered
  - another issue: FSIL strategic sectors list designation names doesn't always match general-law licensed activity designation names

II. Industries / Enterprises Covered (Mineral Fields Investments)

Note: Readers not involved / interested in FSIL-related details specific to mineral resource (oil & gas, hard minerals) field investments / projects can skip the following slides 10-20, and go directly to slide 21

2. Mineral Resource Fields Investments – per FSIL, SL (and CSL and GSL) Amendments

(relevant changes were introduced by companion 2008 amendments to Subsoil Law ("SL"), Continental Shelf Law ("CSL") and Gas Supply Law ("GSL") – which must be read / applied together with the core FSIL regime – and further more recent, and pending, amendments to have in mind as well)

- Resource fields that are classified as "field of federal significance" ("FFS") – also commonly called "strategic field" herein – per amended SL art. 2.1, namely:
  - fields located on land – i.e., on RF regional territory) and confirmed reserves (per state balance figures as of January 1, 2006 (and last updated as of Aug. 2015) – as follows:
    - extractable crude oil reserves of ≥70 million tons
    - natural gas reserves of ≥50 bcm
    - gold reserves of ≥50 tons
    - copper reserves of ≥500,000 tons
  - all offshore fields (on continental shelf and/or territorial / inland seas – note issue of Caspian and Azov fields categorization … see further below)
  - all fields with uranium, nickel, pure quartz, niobium, and certain other rare-earth metals, primary deposits of diamonds and platinum group metals (incorporates July 2016 SL amend.)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- all fields, development of which requires use of lands having defense / security significance (e.g., near border area, military base)
- and note here:
  - a company is classified as SE even if it has only one FFS
  - but apparently ≠ SE if it has a number of smaller fields that only in the aggregate have reserve volume over applicable FFS threshold (e.g., RusVietPetro and Imperial Energy cases)
- there has been discussion of raising some of the above FFS reserves volume thresholds to help boost investment – but no real forward movement on this front to date
- and proposed full exemption for some (or all?) East Siberia and Far East fields
- and further complications: oilfield service company now considered SE if works on an FFS (e.g., Commission view on Schlumberger/EDC deal) or for having a water or sand extraction license on territory of an FFS?

- List of all such fields, first published by MNR in 2009 (per Gov't Decree No. 823 of Nov. 2008) and updated periodically – now contains about 180 oil & gas fields and over 1000 hard mineral fields (and plus all offshore fields qualify). Related issues:
  - intended role of list (apparently not definitive, given that thresholds / definitions make field inclusion basically self-evident – per MNR expressed view) – may be further clarified over time
  - once listed, all such specific fields will retain FFS status even if the above initially-established FFS criteria – specified minerals, reserve thresholds, etc. – are later updated / changed
  - and perhaps also if state-balance booked reserve volume decreases – per MNR expressed view
  - but alternative view that such "delisting" may be possible (practice is unclear)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- what about mixed oil/gas fields? might a combined BOE test also be used in the future to determine if meets FFS threshold? (apparently not, for now)
- any effect of Russia's new reserve classification system applied from 2016? seems no, so far

- Important special rules (and some questions) re application of FFS restriction to fields still under geological study (including under full combined E&P license) – per current SL art. 2.1 last three sub-paragraphs with FSIL-related 2008 amendments:
  - if license holder "having participation of foreign investors" (including RF subsidiary thereof) makes a commercial discovery that meets any FFS criteria, RF Gov't "may", based on national security considerations, take decision:
    - to refuse conversion to E&P license – if combined license not already in place (per Reg. issued under Gov't Decree No. 897 of Nov. 2008 – and see also corresp. amendment of related earlier-existing rule); or
    - to terminate the rights if already under combined license (per Regulation issued under Gov't Decree No. 697, Sept. 2008) – and see related new SL art. 6 point, at slide 14 below
    - with repayment (to licensee) of signing bonus; and study/appraisal expenses – plus premium payment for the discovery, per Regulation approved by Gov't Decree No. 206 of March 2009: premium payment to vary from 25% to 50% depending on region and type of mineral – unsatisfactory for IOCs
    - *Note: there has been an MNR-proposed draft SL amendment providing for "upfront" Gov't decision to allow a licensee having foreign participation to continue with project upon "strategic" commercial discovery, in "exceptional case" – but not clear if/when might ever be adopted (and see notes below on some related helpful proposals … reality of adoption also not clear)*

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- some further questions on this (beyond important financial shortcomings), absent change:
  - for now (absent an amendment), seems to mean literally *any*, and not only ≥25%, "foreign-control" investment level (including Lukoil or Novatek, and even Gazprom and Rosneft? how will it be applied?)
  - applies to SEs having only indirect foreign ownership? not so clear (as opposed to FSIL wording)
  - what about reimbursement of investor's share purchase price? expropriation remedies?
  - what if there already was one FFS-sized commercial discovery on an E&P field, and now another one is made – on different structure within the field? (note interplay with First Amending Law art. 12.2 – see slide 14)
- and further important point: this additional restriction / obstacle appears to apply literally even in cases where a Russian state-owned company holds >50% interest in the license/project, and regardless whether the foreign participant(s) is/are private or state-owned companies:
  - namely, the FSIL arts. 2.7 and 2.9 "safe harbors" (see slide 25 below) seem not to extend this far
  - e.g., this might be an issue even in various IOCs' new offshore exploration license ventures with Rosneft
- possible alternative scenario / risk mitigation in such context (no live problems yet)
  - risk that license conversion is allowed but foreign investor would be squeezed out
  - try to aim for post-closing best-efforts covenant and indemnity by (and/or a put option to) Russian partner in event of license conversion problem or squeeze-out (and possible back-in right, if…)
  - might allow conversion / retention of license with conditions (analogy to FSIL art. 12.1)? see below
  - proposed further SL amendments to buttress investors' protections – e.g., for advance approval (as noted above), and/or exemption for new offshore geol. study license where upon strategic commercial discovery the field will be controlled by RF state co. per FSIL art. 2.7 (see below); still a murky/uncertain area
- note special case of offshore fields – no new conversions at all? (see slides 15, 17 below)
  - but Rosneft's Veninneft (off Sakhalin) license (Sinopec as minority partner) was converted in May 2014
  - Lukoil's lobbying efforts: May 2015 amendments exempted Baltic Sea licenses issued before 2008; and Lukoil's ambition for general offshore field access – still a work in progress / note Lukoil-Caspian licenses too
  - Morskoye license conversion granted to foreign-controlled PetroResurs in 2015 (Caspian ≠ shelf)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- per newly amended SL art. 6 last para., E&P work on an FFS by a licensee that is (or is controlled by) a foreign investor may be carried out only on the basis of relevant RF Gov't decision
  - interplay with Gov't right to revoke license under SL art. 2.1 (see slides 12-13) is unclear; this art. 6 dicatedalso applies if licensee "completed study work and started E&P" before 2008 (exempted from art. 2.1, see below), but that might be a rare case by now
  - SL art. 6 last para. used to apply to *any* licensee, but December 2014 SL amendment narrowed application
  - no exemption for licensees de facto controlled by Russians (à la FSIL art. 2.9)
  - let's see how this will be applied in practice
- per First Amending Law art. 12.2, these new art. 2.1 license conversion restriction (and compensation) rules summarized at slides 12-13 above
  - do apply in event of commercial discovery after Amending Law entered into force in May 2008
  - but don't apply to fields already given out under full E&P combined license, and where license holder had already completed study work and started E&P work, before this law enacted
- test cases to date
  - Lukoil/Gazprom 50/50 Tsentrcaspneftegas JV: est. 170 mln. ton discovery at Tsentral'noye field in Caspian – presented issues of conversion, shelf field (or not – Caspian unique status?) and RF state control (resolved by issuance of E&P license per existing Russia-Kazakhstan treaty – and see slide 17)
  - Timan Oil & Gas (AIM-listed UK company): 100 mln. ton discovery confirmation at Nizhnechutinskoye field in Komi (but maybe E&P work had already commenced pre-FSIL? eventually became debt foreclosure sale matter – with its own evident FSIL issues)
  - offshore field – Veninneft (Rosneft / Sinopec JV) license converted in May 2014
  - Morskoye license conversion in 2015 (noted above – again, Caspian unique status?)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- Reformulated SL art. 9 as of 2008 (and as further amended since then) – re permissible subsoil users / licensees:
  - in general, foreign companies (and simple partnerships / consortia) still may be users/holders – though there have not been many cases of either (and see special provisions re PSA users)
  - new users/holders of an FFS on land may be only RF-incorp'd companies (and, in auctions for such rights, Gov't may establish further restrictions – e.g. re participation of foreign investors, or required majority Gov't ownership in such Russian companies)
  - new users/holders of an FFS that are on or extend onto the continental shelf (i.e., any field there) may be only (i) RF-incorporated companies and (ii) which further:
    - have at least 5 years experience in RF shelf project development (there are possible broad / narrow interpretations of how this requirement can be satisfied – with narrow one clearly prevailing in "official" discussions / clarifications to date)
    - have >50% shareholding (and/or direct/indirect control) by RF – presumably meaning by/through RF-controlled company such as Gazprom, Rosneft, affiliate (note basic issues on application of this rule in practice; see related points below at slides 17 and 24-25)
    - and note the problem with idea of transfer of such an existing license to a JV company in which foreigners have minority (<50%) stake – see slide 19 below
    - MNR has been proposing draft SL amendments that would clarify/allow (but Gazprom / Rosneft have opposed / blocked to date, and seems dead for now, except for the new exemption for Lukoil's Baltic exploration licenses):
      - any Russian incorp'd co. (could be Russian- or foreign-owned) to get an exploration-only license offshore
      - upon discovery, non RF-controlled licensee has to farm out majority stake to an RF-controlled co., or will lose license (with costs and premium payable) – but Lukoil would like its own "conversion right" here
      - if RF state-controlled co. discovers an offshore field, may farm out minority stake to private (incl. foreign) party
      - foreign shelf experience to count toward 5-year work requirement – would mainly just benefit state-owned Zarubezhneft (with its Vietnam shelf experience) … as long as RF state control still also required
    - but territorial sea / inland waters fields are treated as "just FFS", not limited to Rosneft / Gazprom (i.e., can/will be auctioned)
    - And Caspian fields are apparently ≠ shelf (per recent license conversion case), but not yet clearly written in law

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- per First Amending Law art. 12.3, the above SL art. 9 restrictions re permissible users of an FFS (on land or sea) don't apply to use of an FFS, rights for which were granted before that amending law's entry into force
  - but need to consider various contexts / applications of this (including for shelf fields) – unless/until the above-noted further SL art. 9 (and 10.1) amendments are adopted
  - including vis-à-vis above-noted art. 12.2 license conversion rule (and note special exception for Baltic Sea license conversion if exploration license granted before 2008 – per 2015 amendment)
  - so foreign companies still should be allowed farm-in participation in already-licensed FFS fields, per the FSIL rules/restrictions – but the Russian NOCs (particularly Rosneft, and also Gazprom) have successfully imposed interpretive and policy obstacles in practice to date
  - and there may also be questions re such participation in newly-licensed FFS shelf fields, per possible interpretation of 2008-amended SL art. 10.1 – see next slide

- A few related notes
  - FSIL art. 12.1(8) provision for possible condition / requirement of a certain level of processing / refining of mineral resources extracted by an E&P SE on strategic field
    - e.g., DeBeers / Arkhangelsk Diamonds – see slides 36-37
    - and related possibility for Gov't to impose such domestic refining requirement in subsoil use terms for an FFS – actually done in the 2010 Trebs-Titov tender won by Bashneft
  - Also note provision on "federal fund of reserve fields" – to be held back from licensing altogether until Gov't decision to release them (see SL art. 2.2 and Gov't Decree No. 552 of July 2013, with implementing rules)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- SL art. 10.1 as revised – re permissible bases of granting subsoil use rights
  - provides that only RF Gov't itself is to grant rights (i) generally on the basis of auction – for E&P or combined license (geological study plus E&P) use on an FFS, and (ii) to convert geological study rights to full E&P rights upon commercial discovery on what was already an FFS or what would become one by virtue of the new discovery
  - but note July 2008 Second Amending Law clarification here – that new licenses for (i) shelf fields, (ii) strategic fields on land that extend onto shelf, and (iii) strategic gas fields, which appear on a Gov't-approved list, are to be granted without tender or auction – and note that for now essentially this is only for Gazprom / Rosneft and affiliates, per SL art. 9 and companion amendments to CSL / GSL
    - see implementing Regulation adopted by Gov't Decree No. 4 of January 2009, and initial list of such strategic gas fields issued per Gov't Directive No. 1707-r in Nov. 2007
    - then, by several further directives to date, many individual gas and/or shelf fields have been assigned to Gazprom without tender/auction
    - and many shelf fields also assigned to Rosneft by several such directives to date
    - Gazprom able to get a few shelf license transferred to GPN-Sakhalin; more such transfers may be anticipated
    - Zarubezhneft, another state-owned (100%) oil company but without Russian shelf experience, also wants to be approved as Russian shelf licensee; not yet accomplished (see slide 15 above)
    - and note also the Rosshelf court case
    - Rosgeologia is mostly to focus on territorial seas, inland waters etc. – under special exploration license terms
  - and note apparent MNR/Gov't interpretation of combined FSIL / SL / CSL provisions to mean that shelf exploration licenses can no longer be "converted" at all
    - unless the "new" licensee is RF state-controlled and has the 5 years experience (e.g., Veninneft complies)
    - Lukoil / other projects in Caspian – should be OK for various reasons (special Caspian status, treaty, etc.)
    - and law amendments (CSL art. 7 already, and possibly SL art. 10.1) could help but maybe no longer needed – as the Veninneft conversion may be seen to set the practice pattern?

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- Revised SL art. 13.1 – re tenders/auctions for use rights provides (as now dovetailed with revised arts. 9 and 10.1 – see above) that:
  - decisions on conducting use right tenders/auctions, and related rules for such, to be taken by
    - RF Gov't for FFSs (only auctions now permitted, per 2012 SL amendment),
    - regional gov'ts for widespread minerals and other local significance fields, and
    - Rosnedra/MNR for all other fields
  - re auctions for FFSs on land (or territorial sea, inland waters): Gov't can, per defense / security considerations, restrict / prohibit entry to bidders (per revised SL art. 9) having foreign investor participation (and auction announcements are to state any such restrictions)
  - Re FFSs at sea: for now there are no more auctions, rather just direct issuance by RF Gov't (to Gazprom, Rosneft, and affiliates); and see slide 15 above re the special requirements, and see the related SL art. 14(5) re rejection of auction application where applicant doesn't fit the announced FFS auction requirements
  - tenders (winner chosen based on various factors) are preserved except for FFS context, alongside auctions (based on greatest offered bonus alone), as lawful format of granting subsoil use rights
  - but note again that "strategic" shelf, land/shelf, and gas fields can and are now being given out to Gazprom / Rosneft and affiliates (and conceivably other state-owned companies) without auction, per combined new amended SL, CSL and GSL regime and Jan. 2009 Reg. (see slide 17 for details)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- SL art. 17.1 – re transfer of use rights:
  - transfer of FFS use rights to a Russian company in which foreign investor/group has >10% ownership or other basis of right to control is prohibited
  - this prohibition is meant basically to track the FSIL re initial investment by foreigners (but questions of interpretation / "fit" arise) – and there is an MNR-proposed amendment to synchronize with the now raised FSIL 25% "control" threshold (see slide 21) … uncertain fate
  - corresponding specific wording is included into Admin. Reg. approved by MNR Order No. 315 of Sept. 2009
  - apparent literal application also to various Russian companies owned by individuals through foreign holding structures – e.g. Novatek, Lukoil? (FSIL art. 2.9 itself doesn't help here)
  - but such a rights transfer may be permitted by RF Gov't decision "in extraordinary cases" (note – seems intended roughly to dovetail with FSIL approval regime) – e.g., Gazprom / Petrovietnam (see Gov't Directive No. 1310-r of July 2012)
- SL art. 20 – re new corresponding basis for termination of use rights:
  - possible Gov't-initiated termination of E&P rights on an FFS upon commercial discovery
  - to be read in line with the related SL art. 2.1 provisions summarized at slides 12-13 above (and keep in mind the above-summarized possible further amendments that might broaden flexibility / protection against such termination risk – but seems not soon)

II. Industries / Enterprises Covered (Mineral Fields Investments, *cont'd*)

- SL art. 40 re one-time payments (bonuses)
  - requiring that minimum-bid bonus, in auction for FFS E&P rights upon Gov't-decided termination of rights of previous user (having foreign-investor participation) upon commercial discovery, be set at the previous user's exploration / appraisal costs
    - to be reimbursed to such user, per the related provisions noted above
    - but note the possible misfit here – such minimum bids should be set to include applicable premium? (see slide 12 above)
  - providing that the amount of bonus for FFS E&P or combined license rights granted without auction (per the amended SL / CSL / GSL regime) is to be set by Gov't (and, since then, payment levels for most of the already-assigned fields have been agreed between Ministry and Gazprom / Rosneft)
  - rules for this (formula based on anticipated level of extraction tax) adopted by Gov't Decree No. 94 of February 4, 2009

III. Scope of Investment Deals Covered Per the FSIL

1. Broad Direct Sphere of Application

- Foreign investment in form of purchase by foreign investor, or its "group of persons", of >50% shares/stake in Russian SE…
- or ≥25% shares/stake, for SE engaged in mineral resource E&P on an FFS (strategic field) and any further shares – but note the important exception from this still-low 25% threshold, if Russian state-owned company has >50% (see slide 25); and further exception if acquirer already holds >75% (slide 30)
  - "foreign investor" means basically foreign company / group, or Russian company controlled >50% (shares, board, etc.) by foreigners (FSIL art. 3.2) – but interpretation / application issues
- Or other transactions / agreements aimed at establishing, or otherwise entailing, foreign investor's (group's) control over a Russian SE etc. (see slide 28 below on this)
- Or acquisition of ownership, possession or use ≥25% fixed assets of any SE calculated at book value (see FSIL arts. 2.1 and 7.1.1 etc. – 2014 amendments)
- "Control" (resembles / builds on already-existing definitions in Russia's competition laws/regs)
  - generally by having rights/means to dispose over >50% (≥25% for mineral E&P in FFS) of voting shares / stake in SE, right to elect/appoint >50% (≥25%) of its Board of Directors or collective management body, or right to appoint General Director
  - by self or "group of persons", by agreement or agreed action, and includes
    - means of indirect control through third parties, etc. (see Section III.2 below)
    - in general – FSIL spins out elaborate "control" definition (art. 3) and concepts (art. 5)

III. Scope of Investment Deals Covered *(cont'd)*

- other key definitions ("group of persons", "agreement", "agreed actions") borrowed from Competition Law
  - note uncertainties, especially re "group" definition / application for FSIL purposes
  - i.e., purchase of control over an SE by a Russian parent co. that also happens to have one/more foreign subs requires approval? (now seems moot question, unless the SE is ultimately controlled by a Russian/foreign dual citizen or by multiple Russian citizens none of whom individually controls – see slide 23)
  - note the TGK-2 case (see slide 30) – and similar deals might be vulnerable
- expressly made to apply also to transactions / agreements done outside Russia with aim or result of gaining control over a Russian SE
- note that (per art 5.2) "control" can be <50% stake in SE, if dispersion of other holdings is such as to give that <50% stake effective control
  - thus, it seems <50% foreigner direct/indirect stake should not = control in other circumstances – e.g., when a Russian co. directly or indirectly owns/controls >50%
  - but note possible alternative views, involving foreigners' / Russian companies' direct/indirect shareholdings and mathematical calculations in various scenarios
- hypothetical case 1: SE JV with foreign party owning 51% of 20% participant co.
- hypothetical case 2: SE JV comprising 51% Gazprom / 49% Lukoil
- but mere "negative control" – i.e., possibility to block key board / management decisions
  - evidently ≠ prohibited control per se (but caution re negative / positive control borderline)
  - there are some helpful FAS rulings on point (under the FSIL art. 8.6 inquiry procedure)
  - compare with express prohibition on blocking rights for foreign *gov't-owned* cos. in an SE (slide 24)
  - and note FAS's apparent strict approach in this area re general (non-strategic) offshore acquisitions

III. Scope of Investment Deals Covered *(cont'd)*

- Also, possibility that foreign investors' control not present for FSIL purposes if
  - >50% (or ≥25%) total foreign participation in Russian privately-held SE but without any affiliation between / among the foreign companies (each holding < 50% / < 25%) by group of persons, agreement, agreed action, etc. (but won't work for foreign state-owned investors – see slide 24)
  - e.g., total >50% foreign portfolio (and/or mini-strategic) investment holdings in Russian publicly traded SE company (or ≥25%, for mineral resource SE — like Gazprom, Rosneft)? or 50/50 foreign/Russian JV?
  - and Novatek case – see Yamal LNG / Tambeineftegaz court decision (came out the same way)
  - and note apparent dominant view to date (including at FAS) that ADR/GDR depositary bank holder of SE shares normally should not be considered a single foreign investor/group (and per securities laws now too)
  - but again, we don't recommend reliance on any/all such possible "loopholes" (rather, could send inquiry to Authority per FSIL art. 8.6 – see Section IV.2 below)
- Important exception under FSIL art. 2.9: general SE ownership restrictions regime doesn't apply to SE transaction where buyer is foreign investor/group ultimately owned / controlled by Russian (federal or regional) state or by Russian citizen (who is an RF tax resident) except dual citizens
  - in fact most FSIL applications / approvals before then were this type – many prominent examples
  - FAS/Commission previously seemed to be using this as a "hook" to examine typical Russian/Russian complex offshore structures
    - these provisions introduced by 2011 and 2014 amendments have relieved this previously big part of the Commission's caseload (but Russian dual-citizen buyers are still controlled)
    - but such Russia-owned companies face ongoing pressure to eliminate (or at least simplify) their offshore structuring – per the current "de-offshorization" campaign/laws

III. Scope of Investment Deals Covered *(cont'd)*

- Special regime (per FSIL arts. 2.2, 2.3, 2.4, and FIL art. 6) for investments by foreign gov'ts, int'l orgs. (but note exemption for certain IFIs – see slide 26), and their controlled companies – and including their RF-incorp'd entities:
  - prohibited to obtain / have affirmative control of an SE (>50%, or now ≥25% for an FFS SE), or buy ≥25% of SE fixed assets; seems intended / applied as absolute prohibition – any possible alternative softer reading is not supported by practice (and seems even less likely now that the 10% bar has been raised to 25%)
  - approval required for (i) any SE – or *any* Russian co. – stake of >25%, or (ii) any possibility to block SE – or any Russian co. – board / management decisions (not defined as "control" per se, but regulated similarly)
  - approval required (i) for any stake >5% in an SE engaged in FFS (strategic field) mineral resource E&P (even if RF state company holds >50% – see arts. 2.3 and 2.7 – but sense of law seems to allow for ≤ 49% in such FFS SE projects where RF state company has >50% (see slide 25 just below), or (ii) for negative controls (but policy / practice still developing) – possible eventual further liberalizing amendment in this area?
  - and note possibility of foreign gov't <50% stake in a foreign "state-owned" company being considered as "control" (per arts 2.4 and 5.2) – seems that determination of such control is to be by analogy to FSIL rules for Russian SEs (see slides 21-23)
  - FSIL makes no distinction between "market oriented" and more rigidly run (often 100%-owned) state-owned companies; such possible distinction isn't developing in practice / application to date (i.e., in what is/isn't approved)
  - several approvals granted to date for such investments in SEs (now including Indian NOCs with Rosneft)
  - and note also the separate FSIL art. 2.6 carve-out for treaty-based investments (no known such examples yet) – of potential help here for important foreign state-owned companies (see slide 26)
  - FSIL art. 5.2.1 now specifically provides that a joint holding of >50% (or <50% in circumstances described in FSIL art. 5.2) in an SE by several non-affiliated foreign investors that are controlled by foreign states or int'l orgs. (other than IFIs exempt under FSIL art. 2.3) equals foreign control – codifying the earlier Megafon and Astrakhan Port court case holdings

III. Scope of Investment Deals Covered *(cont'd)*

- The above-noted general low "≥25% = restricted control" and related special thresholds for foreign investment in strategic fields E&P SEs
  - shouldn't apply (seem expressly waived – per FSIL art. 2.7) in any case where RF itself (presumably meaning through RF owned/controlled companies – e.g., Gazprom, Rosneft, Zarubezhneft, affiliates) holds >50% of shares/stake and/or otherwise directly/indirectly controls >50% stake before and after the deal
    - but note possible issues: how to calculate this for Gazprom / Rosneft? (there is sensible / helpful FAS interpretation from Yuzhno-Russkoye, Alrosa and Gazprom Neft cases and gen'l purpose Dec. 2013 clarification – in favor of "corporate control" rather than mechanistic "mathematical" approach)
    - and consider Tsentral'noye field case (separate treaty exemption); and what about a non-oil/gas RF state company as the >50% partner? seems OK – Sberbank / Urals Energy various fields… and note subsequent sale to Rosneft – with subsequent farm-out to foreign investors (mostly, Indian state cos.)
    - so the Gov't policy/position is still evolving…
    - but still runs up against Rosneft / Gazprom state-policy-driven constrained view for shelf fields (i.e., no IOC direct equity)
  - and also subject to the special art. 2.3 requirement that foreign gov'ts and their controlled cos. need Authorized Agency approval to acquire/control >5% of a strategic field E&P SE – which rule for now still applies even in such "RF has >50%" cases
    - thus in such cases a foreign gov't-owned company should be able to acquire ≥25% (up to 49%) of an FFS SE by approval (and a private foreign company up to 49% even without approval) – appears to comply with letter/spirit of law – but again, to date there is a different Gov't (Rosneft / Gazprom) policy view on offshore fields
    - the authorities seem to agree, per informal indications – but practice / rulings involving foreign state-owned companies still awaited (different from ONGC/Imperial and RusVietPetro cases – finding that no FFS/SE involved)
    - and so, it seems, private E.ON Ruhrgas / Yuzhno-Russkoye (Gazprom has 51%) was/is OK without FSIL approval

III. Scope of Investment Deals Covered *(cont'd)*

- but note – this is also subject to the related rule (per SL art. 9 now – see slide 15) that only a Russian company having >50% shareholding/control by RF (a Russian state-owned company), and with 5 years of Russian shelf experience, can be holder of any offshore field (but possible future liberalizing amendments here too?)
- there is some doubt as to whether a 51/49 equity but 50/50 voting-arrangement venture between a foreign investor and a Russian state-owned company would work in this context (without approval)
- and note likely hindrance of 5% threshold on reserves bookability

- Note: this whole FSIL regime is not applicable in cases where foreign investment is governed by a separate/special law or a treaty (see art. 2.6) – e.g., re
  - some treaty-based bi-national oil & gas field joint investments (e.g., with Kazakhstan in Caspian – but the reach of this exception is debated)
  - int'l financial orgs. (IFIs) – such as EBRD and IFC – formed by treaty to which Russia is a party, or having signed an int'l agreement with Russia (but notification still needed)
  - presumably, existing investments in the grandfathered PSAs
  - defense industry cooperation with foreign governments
  - note: this is a possible "cure" approach for foreign state-owned/controlled cos. (especially if seeking control of an SE); and note the Silk Road Fund / Yamal LNG case

III. Scope of Investment Deals Covered *(cont'd)*

- Also seems not applicable to the projects where IOC (even state-owned) gets only minority stake in risk-service OpCo with Russian NOC, and the latter alone holds the license (but some caution merited here)
- Some further scope-of-application issues:
  - the whole regime no longer applies to intra-group deals under FSIL arts. 7.1.3 (re FFS holders) and 4.4 (re other SEs) – introduced by 2014 amendments, though some wording issues remain (see slide 30)
  - application to foreign participation in existing "non-strategic" company that later develops into strategic sector activity?
    - FAS Dec. 2013 clarification opines that no FSIL approval is needed for this "at the moment"… except in case a company is established through re-org. with parallel re-issuance of the license
    - … but this clarification does not have formal force of law, so perhaps a targeted FAS inquiry might be wise in a particular case
    - possible that state is essentially relying on right/ability to exclude foreign-owned bidders from "strategic license" auctions, etc. (short-circuiting the FSIL regime?)
    - what about this variant? – "SE" has but is not using a strategic-sector license …
    - FAS has indicated particular concern re "sham" deals: giving up a strategic license before share acquisition, and then applying for it again soon after acquisition is done. (but the Dec. 2013 letter doesn't mention this)

III. Scope of Investment Deals Covered *(cont'd)*

2. Wide Scope of Transaction / Agreement Types and Contexts

(per FSIL art. 5 "indicia of control" and art. 7 "types of transactions" – amplifying on the arts. 2 and 3 basics)

- Covers sophisticated structuring possibilities – including trust, management contract, delegation / agency, other types of agreements or other actions, giving direct/indirect control over SE, and/or deals giving right to determine management decisions of SE, etc.
- Including
  - purchase/sale (including additional share issue), gift, exchange agreements, exercise of put/call options, operation of mandatory tender offer rules under Company Law, repo, etc.
  - bank's (or others') enforcement of pledge upon default (assuming that taking of pledge itself, without voting right, was not already subject to approval)
  - and what about preferred shares (given their limited voting rights)? some uncertainty here – MNR has expressed conservative view
  - and voting agreements – as highlighted by FSIL art. 3.3 (including typical E&P project operating agreement?)
- And even situation where foreign investor/group gets "control" of an SE without itself having taken any new action (see FSIL art. 7.5):
  - as result of reallocation of SE shares among other holders (by share buy-back, charter capital decrease, redistrib. among other holders, conversion of preferred to common voting shares (assuming not already counted – see above), exercise of put, operation of repo, etc.
  - in which case FSIL approval must be obtained within 3 months of having gained control by such "passive" means (and see the related disinvestment rule per art. 15.5 – slide 40 below)
  - abusive variant of this in practice: TGK tender offer cases – see slide 30 below

IV. Approval Regime, Processes, Procedures

1. Basic Regime
   - Application for approval to Authorized Agency (herein "AA")
     - FAS has this role (by Gov't Decree No. 510 of July 2008)
     - Dep't of Control over Foreign Investments established within FAS for this (current chief is Andrei Yunak, appointed in 201)
   - AA acts under, and in close coordination with, specially-created Gov't Commission for Control over Foreign Investments (the "Commission"), headed by Prime Minister Medvedev
     - basic Commission Reg. adopted by Decree No. 510, and membership (mix of Deputy Prime Ministers, and economic sectoral / security agency ministers) now set by Gov't Directive No. 888-r of June 2012
     - also direct / active role of FSB (and Ministry of Defense) in this process – to investigate and draw conclusions on potential threat to national security / defense
     - FAS rules for consideration of FSIL applications – adopted by Gov't Decree No. 838 of October 2009 (updated in 2012)
     - plus Application Review Rules per FAS Order No. 597 of August 2011 (and a few procedural regs)
   - If investment is through RF-incorporated company, that company (rather than foreign parent) should be the applicant – this is FAS expressed preference / practice to date
   - Applicants are advised by FAS to submit all possible info on the FSIL art. 10.1 listed items (though not strictly required), as well as the required art. 8.2 application info items, to help expedite review (and also see amended art. 8.5 re further invited info)
   - And FAS apparently wants separate application for each proposed SE control acquisition

IV. Approval Regime, Processes, Procedures *(cont'd)*

- Whole process supposed to take up to 3 months from receipt of proper application – and extendable up to 3 months more, for total to 6 months (art. 11.4); but should expect 6 months in most cases
- Approval for making investment will have time period/deadline of validity (based on applicant's request/proposal, but usually for 2 years)
  - and for (up to) certain number of shares – within reason, for the proposed deal (see FSIL arts. 4.3, 8.2(1))
  - Commission can grant time extension of approval validity, at its discretion (art. 11.2.1)
- Approval can have conditions – to be formalized in investor-AA agreement (see slides 36-38), and various penalties provided / possible for violation (slides 39-40)
- Approval not needed (per art. 4.4) where foreign investor/group already directly/indirectly lawfully holds >50% of an SE (except those engaged in strategic field (FFS) mineral resource E&P) and acquires more shares in same SE, or for intra-group transfers of such SE shares
- Also no approval for these investments in SEs engaged in FFS mineral resource E&P per art. 7.1.3:
  - acquisition of further shares by investor already at/above 25% "control" through SE charter capital increase where the investor's shareholding is not increasing; or
  - intra-group deals; or
  - by investor already above 75% shareholding in such SE (but some wording / interpretation issues may arise)
- Some questions
  - how would / wouldn't apply to foreign state-owned co. investment – beyond 25%? and beyond 50% (acquired pre-FSIL)?
  - and see the Onexim/TGK-4 and Kores/TGK-2 court case decisions of 2009-12 – re required approval for any post-FSIL >50% acquisition to "count" for this purpose. (And note that Dec. 2013 FAS clarification suggests that a foreign investor wishing to acquire more than 30% in an open stock company SE should file for an FSIL permission to acquire 100% such SE because of the mandatory tender offer requirement.)
- Approved acquisition can be by one or more transactions (see art. 4.3)

IV. Approval Regime, Processes, Procedures *(cont'd)*

- See also art. 14 – establishing a general requirement to notify the AA of any acquisition of ≥5% of shares/stake in an SE – per set rules (see slide 5)
  - general application to any such acquisition, even where FSIL approval not needed (e.g., by exempt IFIs)
  - art. 14 notice also needed for acquisition deals that have proceeded per FSIL approval
  - penalty for non-compliance (see Section V below)
    - seems for now limited to admin. fines, and not covered by art. 15-based invalidation or loss of voting rights, etc.
    - but a FAS-proposed FSIL amendment would apply loss of voting rights here as well; distinct from art. 16.3 retroactive-application notice provision for pre-FSIL ≥5% shares/stake acquisition in SE (here again, likely non-applicability of art. 15 penalties) – see slide 6
- And recall companion related Foreign Investment Law art. 6 approval requirement, introduced per this same FSIL-based regime
  - for >25% investment (or blocking right) by any foreign-gov't (or int'l org.) controlled company in *any* Russian company
  - possible direct application of Civil Code void-transaction consequences for non-compliance (but not other FSIL art. 15 penalties?)
  - but see slide 5 above re favorable real interpretation / practice to date

IV. Approval Regime, Processes, Procedures *(cont'd)*

2. Application Submission Basics (FSIL art. 8)

- Provision made for two types of application
  - for advance agreement/approval to enter into a transaction for direct/indirect control, etc. (per arts. 7.1 - 7.3)
  - for agreement / approval of already-established control by passive means (per art. 7.5)
- Mostly overlap of needed supporting documents, some distinctions – and
  - there still is no official form of application – even with the Oct. 2009 FAS application rules; these rules just spell out a bit what is to be submitted and how
  - application in most cases is to include "business plan" in FAS-approved form (see art. 8.2(10)) – guidelines issued by new FAS Order No. 201 of March 23, 2011 (requirements liberalized from previous version)
- Also, art. 8.6 provision for submission of foreign investor's "inquiry" to FAS, in case of possibly covered transaction by foreign investor/group where fact of establishing control "is not obvious"
  - limited intended scope for inquiries? but wider practice is well developed already
  - required document attachments specified
  - to be answered within 30 days (uneven practice on this to date)

IV. Approval Regime, Processes, Procedures *(cont'd)*

3. Application Review / Approval Basics (FSIL arts. 9-13)
   - Some basic timing points
     - generally accepted rule/practice is application and review post-signing, with approval as condition precedent to closing (like with standard FAS share-acquisition approval)
     - but again note the Megafon case decision (though may have been a fluke … see slide 2 above) – need to be careful here
     - standard FAS share-acquisition approval process is held up for completion of FAS/FSIL process (per Competition Law linked amendment of 2008)
   - Authorized Agency (FAS) coordinating role/actions (FSIL art. 9)
     - checks application for completeness; informs applicant of gaps
     - determines fact of establishment of control – by the proposed transaction, or by passive means
     - if determines will be (is) no control, informs applicant (and Commission), and no approval needed (except for case of foreign gov't / controlled co. gaining >25% (>5% for SE E&P in strategic field) – then same further process as for "control" cases, see just below & art. 10)
     - if determines will be (is) control (including by ≥25% of strategic field E&P SE), or will be foreign gov't / controlled co. gaining >25% (>5%) of SE, the application is processed/reviewed further – by FAS in coordination with FSB and Ministry of Defense ("MoD")
     - plus MNR de facto role, re SEs involving mineral resources

IV. Approval Regime, Processes, Procedures *(cont'd)*

- And recall de facto simpler approach, as noted above, in cases of
  - foreign gov't-owned company acquisition of >25% stake in non-SE, per amended FIL art. 6 (see slides 5, 31)
  - strategic activity not primary for the target "SE" (see slide 8) – or for investor...
- FAS / FSB / MoD further coordinated actions (FSIL art. 10)
  - in designated cases (i.e., all cases requiring approval under FSIL), FAS sends inquiry to FSB and MoD and, within 30 days, FSB and MoD investigate and report back to FAS re potential threat to national security / defense if control or related transaction were to be allowed (arts. 10.1, 10.3)
  - simultaneously, FAS within 30 days investigates for presence of one/more of 12 listed "risk indicia" associated with target SE (see detailed list at FSIL art. 10.1)
    - which items largely reflect specifics / sensitivities re the 45 strategic sectors listed at art. 6
    - and whether that SE has a state secret license (but note that holding such license per se ≠ SE)
  - upon FAS finding that there is state-secret licensing involvement, sends inquiry to Inter-Agency Commission on Protection of State Secrets, for confirmation whether there is an applicable bilateral treaty re state secrets

IV. Approval Regime, Processes, Procedures *(cont'd)*

- Once FAS and FSB / MoD findings are done (in case requiring approval), FAS sends all the application materials – together with FAS / FSB / MoD respective findings and FAS recommendation re approval / rejection of application – to Commission for review / approval (per arts. 11-12)
- FAS's (but evidently not the FSB's / MoD's) actions/inaction, conduct of review, and decisions may be challenged in RF court

- Commission role / actions (FSIL art. 11)
  - within 30 days, takes decision to approve, to approve with conditions (investment agreement – per. FSIL art. 12), or to reject application
    - to be promptly conveyed through FAS to applicant
    - total time from FAS's receipt / registration of application to final decision is to be ≤3 months, or ≤6 months "in extraordinary cases" – but in practice about 6 months seems the norm
  - Regulation and make-up of Commission is set by Gov't decree; detailed Commission / FAS rules for considering applications adopted
  - Commission rejection of application is appealable to RF Supreme Court
  - control applications – i.e., applications gathered / grouped for occasional Commission meetings – about 3 per year (most recent one in June 2016)

IV. Approval Regime, Processes, Procedures *(cont'd)*

- If Commission decides to approve the application on basis of conditions (FSIL art. 12):
  - decides on one or more of the conditions set out at FSIL art. 12.1, as appropriate to the case, re:
    - various measures for protection of state secrets
    - continued fulfilment of state military orders, mobilization plan, etc.
    - carrying out natural monopoly services per state-set tariffs, etc.
    - carrying out business plan submitted by applicant (per art. 8.2(10))
    - preservation of work-force level
    - carrying out appropriate level of refining / processing of produced mineral resources or fish (this jibing with general Gov't/Ministry policy priority – increase in value-added products exports)
  - note: possible awkwardness of imposing such conditions on the proposed investor, in cases where only minority interest being acquired and thus investor can't control compliance (e.g., DeBeers)
  - conditions also apparently imposed
    - on Transmashholding re Tver Rail Car plant control stake
    - on Total re Yamal LNG 20% stake
    - in Schlumberger in the proposed (then aborted) EDC acquisition – apparently including some corp. governance type conditions not stated in the law

IV. Approval Regime, Processes, Procedures *(cont'd)*

- in such cases, FAS prepares agreement ("Investment Agreement") to be signed by applicant with FAS, based on Commission conclusions re required conditions of approval
  - based on model agreement adopted / issued by AA (per FAS Order No. 357 of September 2008) – the form is quite short/simple (4 pages), with only certain blanks to be filled in; extent of negotiability to await further practice
  - must conform with Commission's required terms (see FSIL art. 12.4)
  - also to incorporate provisions on liability for violation (see arts. 12.8 and 15, and section 5 of the form Agreement)
  - to be signed within 30 days of Commission decision re required conditions (with possible 14-day extension) – per procedural FAS Regulation of March 2013 No. 115/13
- if applicant has refused one/more conditions, AA is to reject application (no provision for negotiation – but further actual practice developing)
- Investment Agreement is to remain in effect for whole term of applicant's control of / holding in the SE – and may be amended, but only:
  - by agreement of applicant and AA, and approval by Commission
  - in case of substantial change of circumstances (FSIL art. 12.7, and see Civil Code art. 451)

IV. Approval Regime, Processes, Procedures *(cont'd)*

- We keep track of AA/Commission actions on approval applications to date, and can summarize
  - majority of all FSIL applications to date have been from foreign companies controlled by Russian shareholders / beneficiaries (see slide 23 above) – many of these are now exempt from this whole FSIL regime, per art. 2.9 as amended in 2011 and 2014
  - FAS reports that only 12 rejected applications out of over 400 filed to date
  - many applications returned upon finding that target co. ≠ SE (incl. some foreign gov't-owned co. applications for non-SE stake acquisitions under FIL art. 6 – see slide 5 above)

V. Consequences of Non-Compliance (art. 15)

1. Direct Legal Consequences – For Transactions in Violation of Law
   - Considered null and void (per art. 15.1 and general Civil Code art. 168 rule)
   - Court (on application of AA or other interested party) applies consequences of void transaction (per Civil Code art. 167 etc. – e.g., possible mutual return of shares/money, etc.)
   - Per FAS, it has filed some court cases for alleged FSIL violation – most settled so far; in Astrakhan Port case brought by FAS, transaction found void by lower court in 2014 (and that judgment confirmed on appeal in 2015)
   - But note the TGK cases (2009-12) – acquirors of SE company shares using this FSIL consequence as sword (with some FAS "clarification" help) to get follow-on mandatory-offer share purchases going above 50% declared unlawful/void (to avoid having to buy at too-high price, post-crisis)
2. Possible Further / Other Consequences (FSIL arts. 15.2 - 15.4)
   - Decisions taken by shareholders / management bodies of the SE, after transaction / control etc. done in violation, may be held void by court
   - If not possible to apply other penalties / consequences for void transaction (per specific deal/SE circumstances – e.g., offshore company deal), or for failure of timely application / approval for passive-means control – court can deprive investor/group of shareholder vote (so that its vote doesn't count for quorum / general purposes) – LISSI case (2012), and Astrakhan Port (2014)
   - Cancellation of foreign investor's voting rights applied by court in the Vimpelcom case – as a preliminary injunction (later lifted, upon partners' settlement of the shareholding dispute)
   - Similar possible penalties/consequences for gross/repeated violation of FSIL art. 12 Investment Agreement

V. Consequences of Non-Compliance (art. 15)

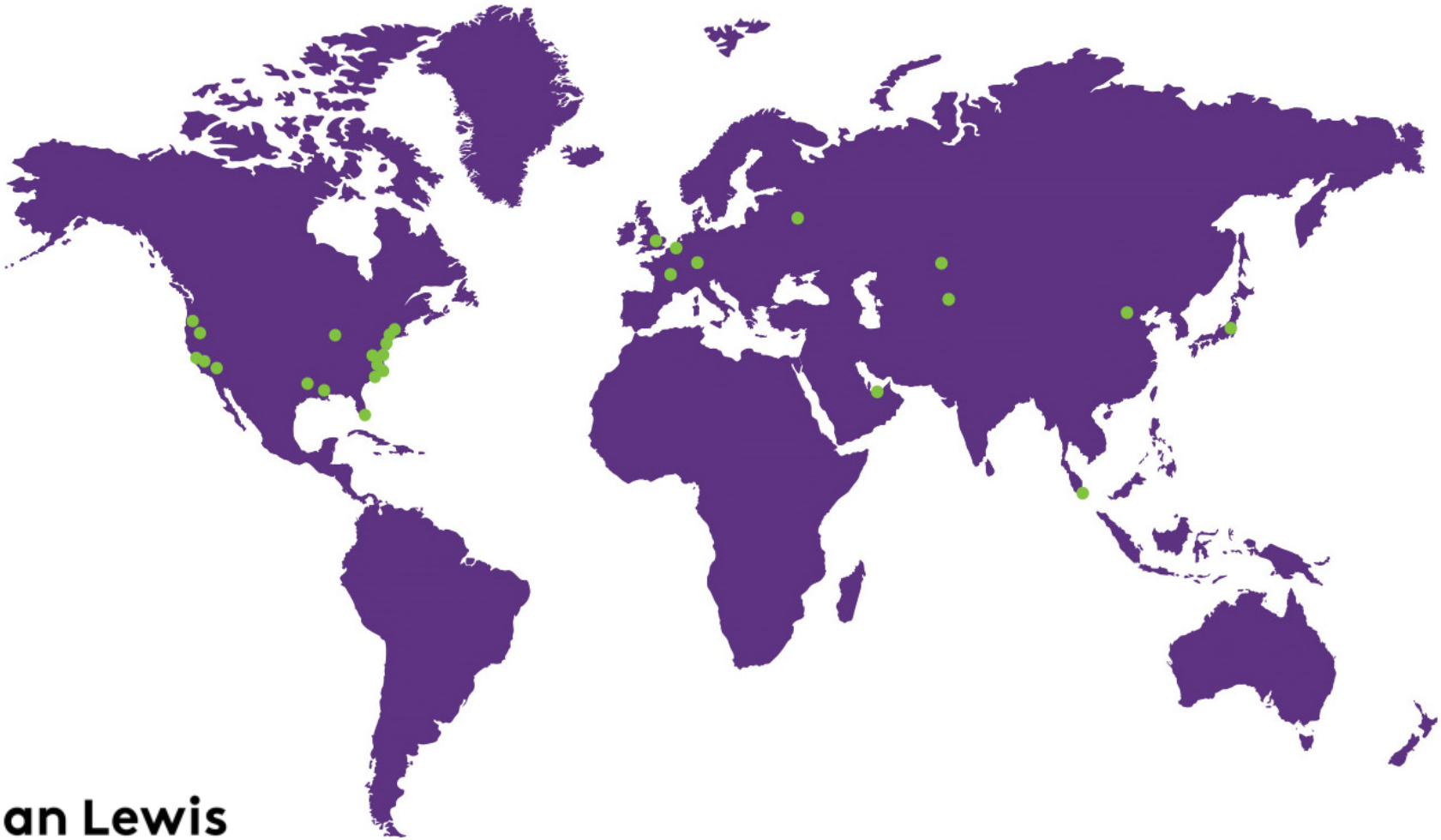
3. Required Disinvestment (FSIL art. 15.5)
   - For passively-gained-control cases (per art. 7.5)
   - Within 3 months of rejection of approval application
     - investor/group must dispose of portion of shares/stake so that remaining portion doesn't give control
     - meant to apply as well to foreign gov't/company-acquired 25% (5%) stake? – though that is not itself defined as "control"? No known practice to date; not clear
   - For non-compliance, similar penalties / consequences as above – lose vote at shareholder level, votes don't count for quorum / general purposes (plus ~$15,000 admin. fine per AVC amended provision – still seems negligible compared to other possible penalties)
4. Application of Full Art. 15 Penalties / Remedies
   - Seems not, for non-compliance only with art. 14 (future ≥5% SE stake) or art. 16.3 (pre-FSIL ≥5% SE stake) notification requirements; but a pending FSIL amendment may provide for loss of voting rights by court action
   - For now, likely only (relatively small) AVC fines – now about $8,000 (some such imposed fines reported by FAS)
   - For non-compliance only with new Foreign Investment Law art. 6 requirement of AA approval for ≥25% investment (or blocking right) by any foreign-gov't-controlled company in any (non-SE) Russian company – seems could be subject to direct Civil Code voidness consequences
   - And, for any of these, possible FAS resistance / delay on the company's next FSIL application

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Almaty
Astana
Beijing
Boston
Brussels
Chicago
Dallas
Dubai
Frankfurt
Hartford
Houston
London
Los Angeles
Miami
Moscow
New York
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Santa Monica
Silicon Valley
Singapore
Tokyo
Washington, DC
Wilmington



Morgan Lewis

THANK YOU