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UPDATE: FOREIGN INVESTMENTS SAFETY ALERT

Overview of limitations of foreign investments and consequences for foreign companies in Russia

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Summary

Due to the significant changes in the investment climate in Russia, the Russian Government has introduced a number of extraordinary measures to prevent foreign investor and capital flight, some of them directly targeting multinationals operating in Russia.

As part of our ongoing efforts to protect and support multinational investments in Russia, Kesarev has prepared a brief guide on the measures introduced by the Government of Russia that affect the operations of international companies in the country.

The described period demonstrated the dual approach of the Russian authorities in applying retaliatory measures. The key initiatives in this area – the launch of parallel imports, the introduction of external administration of foreign companies' assets, as well as the introduction of direct restrictive measures against foreign legal entities and individuals. Issues of nationalization and confiscation of foreign property in Russia are being raised at a high level (the Speaker of the State Duma), but so far, they have not received support at the final decision-making level.

This alert covers the following areas and issues:

1. Parallel imports

Legislative status: ministerial order entered into force

On May 7, the order of the Ministry of Industry and Trade (MIT) came into force, which approved the list of goods subject to parallel imports. The order is based on the Government decree authorizing parallel imports dated March 29:

- The list contains a wide range of industrial and consumer products, both in the form of brand names and product codes.
- Having products on the list the importer has no liability for infringement of intellectual property rights.

- At the same time, the importer is responsible for the quality of goods (previously, exporters from third countries were responsible for this).

MIT Minister Denis Manturov previously stated that parallel imports were a temporary solution, and the list of goods allowed for imports under this system may change. The ground for excluding goods from the list may be the decision of a foreign company, which announced the suspension or closure of its business in Russia, to return to the local market (so far, there have been no such cases) or resume supplies. The Association of European Businesses insists on the temporary nature of parallel imports, noting that it should not be allowed for those goods whose supplies continue or whose official importers are present in Russia. MIT is consolidating business offers to remove selected brands from the list.

Overall, the chosen approach complicates the systemic organization of parallel imports (the very possibility of changing the list does not allow organizing stable logistics), it can also contribute to an increase in the share of counterfeit products due to insufficient control. In this regard, product quality control can partly become the responsibility of retailers. The largest Russian marketplaces (Ozon, Yandex.Market, Wildberries) have announced their readiness to sell goods from the parallel import list if suppliers can confirm their authenticity and origin.

2. External administration

Legislative status: the bill can be passed before the end of July

On May 16, the Government's Legislative Commission supported a bill that governs the introduction of external administration for the assets of foreign companies that have announced their withdrawal from the Russian market. The bill itself was submitted to the State Duma on April 12.

Having approved the bill, the Commission proposed some amendments. In particular, it proposed to introduce external administration for manufacturers of military equipment, as well as companies involved in the implementation of projects in the fuel and energy sectors. Initially, the bill's initiators proposed to apply it to companies that meet certain criteria: produce essential products, occupy a dominant market position, are the sole manufacturers of certain goods, etc.

On May 15, State Duma Speaker Vyacheslav Volodin said that the bill could be adopted before the end of its spring session (until July 31). The first reading may take place already in May.

The bill provokes heated discussions both between state agencies and between businesses and authorities. The Government and the Parliament do not intend to speed up the adoption of the bill, using it primarily as a tool of pressure on foreign companies. **On May 17**, the head of the Russian Union of Industrialists and Entrepreneurs (RSPP), Alexander Shokhin, announced that, together with the MPs from the ruling United Russia party, they would finalize the bill. The RSPP takes a compromise position, insisting on a softer approach to the introduction of external administration and maintaining opportunities for foreign companies to return to the Russian market in the foreseeable future.

Also **on May 4,** the Chairman of the State Duma Committee on Property, Land and Property Relations, Sergei Gavrilov, made it clear that a tailored approach could be applied to foreign companies, breaking them down into three categories: 1) those continuing business in Russia; 2) those forced to suspend activities because of western sanctions; 3) those who leave the Russian market completely. The

introduction of external administration and the application of other measures will take into account both a company's position in the market and the circumstances of its exit from Russia.

3. Counter-sanctions against unfriendly countries

Legislative status: Presidential Decree signed, the Government approved the first list of designated companies

On May 3, President Putin signed a decree on retaliatory special economic measures due to the unfriendly actions of foreign states and foreign organizations. The decree prohibits the implementation of transactions with and the fulfillment of obligations (including deals already in progress) to individuals and legal entities that are included in the sanctions list (set by the Government).

The Decree is a framework one: the Ministry of Finance and the Central Bank are empowered to clarify a procedure for its application, while the Government is to set a list of designated persons.

So far, Russia has used sectoral counter-sanctions measures that do not target individual companies – this decree allows to do this. This measure was caused, first of all, by the actions of the European side to seize control of Russian assets. In particular, in April, Germany introduced external administration of Gazprom Germania, which is indirectly controlled by the Russian Gazprom.

On May 11, the Government adopted a decree to set a list of sanctioned companies. The list comprises companies belonging to the Gazprom Germania group, as well as the Polish company Europol Gaz S.A., which owns the Polish section of the Yamal-Europe gas pipeline. Companies from the list are prohibited from supplying Russian gas and carrying out any other transactions. Thus, Russia is trying to "zero out" the value of nationalized assets in the EU and prevent their further resale or nationalization. It can be expected that this logic will be applied to other Russian companies in the West subjected to external administration or nationalization.

The objectives of such sanctions against former subsidiaries of Gazprom in the EU may be:

1. To give legal grounds for stopping gas supplies to their own trading companies.
2. To prevent using its former underground storage facilities.
3. To force EU buyers to pay for gas in rubles.

4. Legislative initiatives to counter sanctions

Legislative status: statement of the Parliamentary Speaker, followed by the introduction of bills to the State Duma

On May 15, State Duma Speaker Vyacheslav Volodin announced that during the spring session, MPs would consider several bills to counteract anti-Russian sanctions. In addition to the bill on external administration, Mr. Volodin announced initiatives relating, among others, to the following issues:

- Security of personal data (regulates the cross-border transfer of personal data, provides for the possibility of interference in the processing of data of Russian citizens on the territory of other countries).

- Possibilities of restricting the activities or blocking foreign media outlets operating in Russia in response to unfriendly actions of foreign states against Russian media outlets.
- Taxation (in particular, the period of validity of reduced income tax rates will most likely be extended until January 1, 2024).

Let us also note that **on May 1**, Vyacheslav Volodin proposed confiscating the assets of unfriendly countries that decide to seize Russian assets on their territory. Volodin's populist statement is most likely provoked by statements of Western politicians requesting to confiscate Russia's foreign exchange reserves with the subsequent transfer of these funds to Ukraine. At the moment, the likelihood of a decision to confiscate foreign assets in Russia is low.

5. Discussion around the bill allowing businesses to terminate contracts because of sanctions

Legislative status: pending in the State Duma, awaiting a formal opinion of the Government

On May 11, it became known that the Ministry of Finance had sent to the Government a negative formal opinion on the bill, which allows legal entities and individuals not to fulfill their contractual obligations if this is impossible because of sanctions. The bill, initiated by the head of the Duma's Committee on State Building and Legislation Pavel Krasheninnikov, was submitted to the Parliament on March 22.

Preliminary consideration of the bill is scheduled for May, with no particular date set yet. It provides for amendments to the Civil Code, which will allow companies to avoid liability for full or partial failure to fulfill contracts if this has become "objectively impossible" amid sanctions against Russia.

The Ministry of Finance substantiates its objections by the vagueness of the criteria by which the possibility of fulfilling an obligation under contracts is determined. The Ministry notes that such law can serve as a basis for non-fulfillment of obligations to counterparties not only from "unfriendly" countries but also to Russian ones. In particular, there are risks of non-performance under state contracts.

As the Government is not unanimous on the bill, its further prospects will depend on whether some compromise on its provisions is found. Until then, the bill cannot move any further.

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If you would like to schedule a discussion of this paper and learn more details about the above listed documents, please contact Yury Panasik, Partner, y.panasik@kesarev.com

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