

## UPDATE: FOREIGN INVESTMENTS SAFETY ALERT

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

July 19, 2022

## Summary

**On July 15, 2022**, the State Duma (lower house of parliament) held an extraordinary meeting. Earlier, on July 6, the lower house already said to hold its last scheduled plenary in this spring session, officially ending in late July. The rest of the month was considered to be the “regional work” when State Duma members work in their home regions. However, on July 10, State Duma Speaker Vyacheslav Volodin, unexpectedly for many, announced the extraordinary meeting.

In the practice of the State Duma, the decision to hold an extraordinary session is not typical. The detailed agenda for the extraordinary meeting was not known in advance. It was expected that an extraordinary session would be convened, inter alia, to consider important bills that had not been considered in the standard time frame of the spring session (including the bill on external administration), but this did not happen.

The key issues of the extraordinary meeting were personnel decisions:

- › The State Duma approved the appointment of Denis Manturov as Deputy Prime Minister. Earlier, President Putin, by his decree, provided for the combination of the posts of Minister of Industrial Policy and Trade (MIT) and Deputy PM:
  - According to the 2020 update of the Constitution, the powers of the State Duma include the approval of civil ministers and deputy PMs, as well as the head of government.
- › Besides, on July 15, President Putin dismissed Deputy PM Yury Borisov (in further appointed head of Roscosmos). The powers of Y. Borisov in the sphere of the military-industrial complex were transferred to D. Manturov.

The fact of holding the extraordinary session, as well as promotion of D. Manturov, mean the following:

- › Issues supervised by D. Manturov (first of all, import substitution – including in the military-industrial complex segment, parallel imports, etc.) received the highest priority. Without an extraordinary meeting, the State Duma could return to consideration of this issues only on September 12, with the beginning of the autumn parliamentary session.
- › D. Manturov received additional powers to speed up the resolution of the aforementioned issues. The position of Deputy PM will allow him to use platform not only of the Ministry of Industry and Trade, but also the broader possibilities of the government office, including in interdepartmental discussions.



- › The promotion of D. Manturov could have logically meant strengthening of the position of head of “Rostec” (oversees the work of a wide range of state-owned industrial and defense enterprises) Sergey Chemezov, belonging to inner circle of President Putin. However, on July 18 President Putin mentioned Rostec with a public criticism of the company’s results of work which could be considered as a counterweight to the desired increase of power and sent a clear message to the Rostec’s leadership that no special treatment will be allowed.
- › With the expansion of Mr. Manturov’s powers to the sphere of the military-industrial complex, Chemezov actually got access to the simultaneous regulatory and production capabilities in this area.
- › During his speech in State Duma, D. Manturov stated the need for a turn from “an absolutely market-oriented industrial policy to a policy of ensuring technological sovereignty”. In this regard, we can expect a transition to “manual management” in Russian industrial policy, and, as a result, an increase in uncertainty and risks for foreign business. Manturov also mentioned the preparation of counter-sanctions in a number of industries.
- › At the same time, the Manturov’s promotion may indicate refusal of the government to take drastic steps (the widespread introduction of external management of Russian assets of foreign companies, the nationalization of property, etc.) in favor of softer approaches and selective actions that have so far been characteristic of the work of the Ministry of Industry and Trade.

In this memo, we will outline the current status of the key initiatives affecting the activities of foreign businesses in Russia, the nature of discussions and prospects for key bills including those directly related to the Ministry of Industry and Trade and taking into account the Mr. Manturov’s promotion. Please also note that the possibility of new extraordinary sessions until September, if necessary, remains.

These initiatives include:

- › Parallel imports issues.
- › Introduction of external management to the assets of foreign companies in Russia.
- › Parameters for approving transactions for the sale of assets by foreign businesses in the Russian Federation.
- › Updated legislation on foreign agents and foreign influence.
- › Government mobilization initiatives and related risks for foreign businesses

### ***Parallel Import***

*Legislative status: the relevant law came into force, a list of goods for parallel imports was formed*

**On June 28, 2022**, President Putin signed a [law](#) abolishing liability for the importation of goods from the special list without the permission of the right holder. Such a [list](#) was formed by the Ministry of Industry and Trade in May. At the moment, it includes several dozen commodity items and product groups (including brands).

The MIT announced a quarterly revision of the list. Thus, on July 4, the ministry [made](#) changes to the list, adding and excluding certain positions.



Despite the fact that the regulator has well advanced in the legislation for parallel imports, at the moment the discussion continues about the goals of parallel imports and the possibility of its expansion to all goods.

Two main approaches to regulating parallel imports currently dominate:

1. Implementing parallel imports in “manual mode”.
2. Extending parallel imports to all goods.

The first approach is now used by the Ministry of Industry and Trade. The main problem of this approach is the blurring of the criteria for adjusting the list.

The ministry notes that the criteria for excluding goods from the list is ensuring supplies of those to retail chains. That is, the supply of goods to retail chains (and not just the presence of a dealership or even production in Russia) is of key importance. In addition, when making a decision, the MIT uses such a vague criterion as “the interests of Russian citizens”, which adds uncertainty:

- › Amending the list is one of the ways to put pressure on foreign companies that have announced their withdrawal from the Russian market or are planning to do so. Considering this, the presence or absence of certain goods in the list of the Ministry does not always seem justified.
- › In early July, the Association of Producers of Branded Trademarks “Rusbrand” sent a letter to the MIT proposing to exclude cosmetics and household chemicals from the list. Part of the goods allowed for parallel imports continue to be supplied to Russia directly by manufacturers (there has been no reaction from the ministry yet).
- › Additionally, manual parallel imports do not resolve the issue of potential shipments of counterfeit products. At the moment, verification of the origin of products is partially assigned to retail chains and marketplaces (the largest of them are Ozon, Yandex.Market, Wildberries). It is assumed that later this problem should be solved by the Track&Trace mechanism.

The Federal Antimonopoly Service (FAS) announced the need to extend parallel imports to all goods. The FAS advocates the transition from national to international principle of the exhaustion of intellectual property rights (if the product was sold once – no matter in which country – the right holder loses the right to control the subsequent circulation of products):

- › This approach, in addition to solving the problem of saturating the market with goods and increasing competition, also claims to solve the problem of stimulating domestic demand. In this regard, the position of the FAS can potentially be supported by the financial and economic bloc of the government responsible for budget execution (primarily the Ministry of Finance):
  - The expected budget deficit (1.2% according to the forecasts of the Ministry of Finance) in 2022 is primarily due to a significant trade surplus (excess of exports over imports), and as a result, a surplus of foreign currency and a deficit of the ruble. In this context, full-fledged parallel imports can be considered by the government as one of the tools for exchange rate and budgetary balancing.

Which of the described approaches will prevail, as well as the nature of the further discussion on parallel imports, will largely determine the dynamics of the exit of foreign companies from Russia, which, in



turn, depends on the escalation / de-escalation of relations between Russia and Western countries in the coming months.

### ***External management***

*Legislative status: the bill was adopted in the first reading; it is expected to be significantly improved during the second reading*

The External Administration Bill was passed in the first reading on May 24, 2022. Amendments to the second reading were expected before June 22, but the bill was not considered at spring plenary meetings of the State Duma.

The sponsors of the bill are State Duma members of the ruling “United Russia” party. The tough wording of the bill was originally intended to prevent or slow down the withdrawal of foreign business from Russian assets. But given the uncertain prospects for Russia’s special military operation in Ukraine, neither the government nor the State Duma forced the adoption of the bill; the very possibility of its adoption served as an instrument of pressure on foreign businesses that risked losing control of their assets in Russia.

At the same time, the continuation of hostilities in Ukraine, new sanctions by Western states against Russia, as well as individual cases of expropriation of Russian property abroad (including the assets of Gazprom Germany, the German section of the Nord Stream-2 gas pipeline) may put forward the adoption of the bill of the future autumn.

The current version of the bill defines:

- › The range of assets in respect of which external management can be introduced (are important for ensuring the stability of the economy), as well as the criteria that make external management possible (termination of operating activities, sabotage of the asset’s management, etc.).
- › Procedure for introduction of external control. The relevant ministries, as well as the heads of the regions of the Russian Federation where the companies operate, can initiate the introduction of external management. The decision is made by the interdepartmental commission under the Ministry of Economic Development. In case of a positive decision, the Federal Antimonopoly Service files a claim with the Moscow Arbitration Court, which must decide on the introduction of external administration within 5-7 days.

The wording of the bill provoked criticism from business representatives, in particular, the Russian Union of Industrialists and Entrepreneurs (RSPP), which saw the risks of excessive pressure on business. Earlier, the chairman of the RSPP, Aleksandr Shokhin, said that the bill would be redrafted for the second reading, taking into account the interests of business.

It can be expected that the main changes will include:

1. Expansion of possible options list for influencing the assets of foreign companies, where the mechanism of external administration will be only one of them:



- RSPP underlined that external management can be resorted to in an exceptional case, if other measures of influence (including trust management, sale, option schemes, etc.) do not work.
  - VEB.RF State Corporation (appointed as an external manager by default, if there are no other proposals from ministries and regions) can take over the management of the asset (management of a block of shares in a foreign company or acting as the general director of a company).
2. Elimination of redundant and vague criteria when introducing external management, including:
- Raising the participation threshold for a foreign company in an entity from 25% to 50% as one of the basic conditions for the introduction of external administration.
  - Elimination of criteria for reducing production and sales volumes by 30% or more as one of the grounds for the introduction of external administration (the reduction may occur due to objective circumstances).

Consideration of the bill in the second reading is expected in the autumn parliamentary session of the State Duma. It is possible, however, that the bill will be considered earlier during an extraordinary meeting of the lower house of parliament in the event of further aggravation of relations between Russia and the West (including the nationalization or the expropriation of Russian property abroad).

### ***Risks when selling a business by foreign companies in the Russian Federation***

**On June 29**, the head of the RSPP, Aleksandr Shokhin, announced that the discount on the sale of the business of companies leaving Russia exceeded 50% of the last official estimate. Shokhin's statement was based on the practice of recent transactions for the sale of shares in Russian entities by foreign companies.

Minister of Finance Anton Siluanov went further, saying that the subcommittee of the Government Commission for the Control of Foreign Investments, when approving transactions involving foreign companies, is guided by two criteria:

1. Approval of the transaction by the relevant ministry.
2. A discount in the transaction price of at least 50% of the appraised value of the share in the company.

Shokhin's and Siluanov's statements may indicate a possible formalization of more stringent requirements for foreign companies when selling their Russian entities, which can be implemented through amending the following legal acts:

1. Presidential [decree](#) regulating a special procedure for approving transactions between Russian residents and residents of "unfriendly countries".
2. Government [executive order](#) regulating the work of the Government Commission for the Control over Foreign Investments, which has the authority.



Potentially, we can talk about both the formalization of strict criteria for approving the sale of a share in the Russian business of a foreign company, as well as expanding the range of foreign companies, transactions with which are subject to approval by the Government Commission. Russian companies, potential buyers of foreign companies' assets, can act as lobbyists for these decisions.

Also, it could be about the informal requirement of a discount to the transaction price by special Sub-Commission of the Government Commission for Foreign Investments Control (the Sub-Commission, specially created for the transactions coordination, is chaired by the Minister of Finance) in the context of the dominance of manual management in the industrial policy segment. The Ministry of Industry and Trade, headed by Denis Manturov, has a deciding vote during approval of transactions involving foreign companies. Thus, "informal formalization" of the practice of approving transactions at a discount in favor of the buyer of foreign assets in the Russian Federation can take place.

### *Law on Foreign Agents*

**On July 14**, President Putin signed into law the [law](#) on foreign agents and foreign influence, which will come into force on December 1, 2022.

The law will allow to recognize as foreign agents any Russian and foreign organizations and individuals who receive support from abroad or are under "foreign influence" and conduct political activities.

A number of restrictions are imposed on persons recognized as foreign agents, including those that may affect the interests of foreign companies and their management, in particular:

- › Being a member of consultative, advisory, expert public authorities and gaining access to state secrets (may be significant in terms of participation of representatives of foreign companies in commissions, committees and expert groups at ministries and departments).
- › Teaching, educational activities for minors; producing information products for minors.
- › Nominating candidates for public oversight commissions.
- › Holding public events (can be interpreted broadly).
- › Participating in public procurement, receiving state support.
- › Conducting expertise in the field of legislation and ecology.
- › Applying a simplified taxation system.
- › Etc.

In comparison with the previous legislation on foreign agents, the new law tightens a number of rules that carry additional risks for foreign companies and their management, including:

- › Introduces the concept of a "person affiliated with a foreign agent". A separate register will be provided for such persons.
- › Such a register may include employees or management of an organization designated as a foreign agent, or politically active persons funded or otherwise encouraged by foreign agents.

Please also note that the law at the same time expands the list of organizations that cannot be recognized as foreign agents. Those are:



- › Employers' associations (including business associations).
- › Officially registered chambers of commerce and industry.
- › Employees of international organizations and diplomatic personnel of foreign embassies.

### ***Law on special measures in the economy***

On July 14, President Putin signed a [law](#) giving the government the right to introduce special measures in the economy in the context of “counter-terrorism and other” operations.

In particular, the law allows:

- › To introduce a ban on the refusal of state contracts for enterprises of any form of ownership:
  - First of all, we are talking about enterprises of the military-industrial complex. However, the wording of the law potentially allows any enterprise to be involved in the execution of the state order.
- › State customers from among law enforcement and security agencies – the Ministry of Defense, the Ministry of Emergency Situations, the Russian Guard, the Federal Security Service and the Federal Security Service – to unilaterally increase or decrease the volume of goods and services under the concluded contracts.

The law is not limited to regulating the work of Russian companies, equally extending to the assets of foreign companies in Russia.

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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*

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