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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.

Over the last few days, a number of these initiatives have progressed significantly:

- The State Duma adopted the draft law on appointment of external administration in foreign companies suspending business activity in Russia was adopted in the first reading
- Amendments to the Criminal Code introducing criminal liability for compliance with international sanctions were also passed in the first reading.
- The Government submitted to the State Duma a bill cancelling the responsibility for importing goods from the list of products allowed for parallel imports

This alert covers the following areas and issues:

External administration draft law

Legislative status: the bill passed in the first reading

On May 24, the State Duma adopted in the first reading the bill, authorizing the procedure of external management appointment to manage the assets of foreign companies that have announced their withdrawal from the Russian market.

The deadline for submission of amendments to the second reading of the bill is scheduled on June 22. Earlier State Duma Chairman Vyacheslav Volodin said that this draft law could be finally adopted before the end of the parliament spring session (July 31).

The same date, on May 24, the Ministry of Economic Development stated that it considers the bill to be "balanced", which means that the overall structure of the document could remain unchanged. The Ministry also claims that the future law will be applied in a targeted manner and only in “critical situations” (the key is to keep businesses working and prevent mass layoffs of employees).

It should be noted that so far, the Government and the State Duma tended not to speed up the adoption of the bill, using it mainly as a tool of pressure on foreign business in Russia. This scenario was broken by the open-ended extension of Russia's military operation in Ukraine and, as a result, further tightening of sanctions. Foreign companies continued to leave the Russian market, increasing the risks of stopping production, shortage of goods and mass layoffs of employees. Apparently, this prompted the Government to proceed with an alternative scenario and start the procedure for passing the bill.

In this context, the importance of the second reading of the draft law, during which significant amendments can be made, is increasing. Two scenarios are also possible here:

1. Adoption of the draft law in tight wording that allows for an accelerated introduction of external management, bankruptcy or liquidation of companies.
2. Softening the wording of the draft law (clarification of the criteria for enforcement, preserving the possibility for foreign companies to regain control over the asset).

Below is a quick summary of the bill as adopted in the first reading: what kind of assets and under what circumstances are subject to external management, as well as the procedure for its appointment and termination.

Companies in which 25% or more of the shares are owned by persons from "unfriendly countries" can fall under external management. At the same time, companies must be "essential for the economy" *(produce essential goods; occupy a significant share in the market segment; manufacture products that have no Russian analogues, etc.).*

The grounds for introducing external administration are as follow:

- The activity of the company is suspended (partially suspended);
- The management has withdrawn from its duties or its actions lead to the company shutdown, bankruptcy etc.;
- The production or sales of the company's goods decreased by 30% or more in three months.

The initiative to introduce external management belongs to the relevant ministries and heads of the Russian regions in which the respective companies operate. The procedure for introducing external administration is as follows:

- Initiators apply to the interagency commission under the Ministry of Economic Development (Commission).
- If the Commission decides positively, the Federal Tax Service submits an application to the Moscow Court of Arbitration, which within 5-7 working days makes a decision on appointment of an external administration.

External administration functions are performed by default by the state corporation VEB.RF or another entity (proposed by the Commission and agreed upon by the head of the respective Russian region). External management is introduced for a period of 18 months and may be terminated early (if the circumstances of the introduction of external management, sale or bankruptcy of the company are eliminated). At the same time, the external administration can either manage the foreign shares or act as the general director of the company. Only in the latter case can the liquidation or bankruptcy of the entity be initiated.

The owner of 50% or more of the company's shares may initiate early termination of external management (if the circumstances that led to its introduction are eliminated).

The bill is likely to be amended during the second readings. Earlier, the Russian Union of Industrialists and Entrepreneurs (RSPP) stated that the final version of the law would be prepared jointly by business representatives and MPs of the ruling United Russia party. It can be expected that during the next readings, the RSPP and other business associations will insist on a number of amendments to the bill, including, in particular:

- Raising the threshold for foreign participation in the entity from 25% to 50% to correspond the conditions the external administration to be introduced;
- Eliminating the criterion for reducing production and sales volumes by 30% or more, as one of the grounds for the introduction of external management (changes in these indicators may be of an objective market nature).

Draft law on criminal liability for compliance with sanctions imposed on Russia

Legislative status: the bill was supported by the relevant committee of the State Duma

On May 23, the State Duma Committee on State Building and Legislation recommended for adoption in the first reading of a bill that would introduce criminal liability for compliance with international sanctions imposed on Russia. The bill amends the Criminal Code.

The following types of punishment are provided for compliance with sanctions:

- Imprisonment for up to 10 years with deprivation of the right to hold certain positions;
- Fine in the amount of 1 million rubles (about $17 thousand) or 5 years in prison;
- Forced labor for up to 5 years.

One of the sponsors of the bill, Chairman of the State Duma Committee on state building and legislation Pavel Krasheninnikov, stated that the amendments will be mostly applied to prevent cases of refusal by Russian companies (including state-owned) to fulfill their obligations to banks and other companies subject to Western sanctions (because of the secondary sanctions threat).

On April 20, the Government, in its official opinion, pointed out the shortcomings of the bill, including:

- Excessive punishment of ten years' imprisonment;
- Inconsistency of enforcement of sanctions with the concept of “abuse of authority” (by complying with sanctions, companies may try to minimize the damage, which is what the provisions on “abuse of authority” are aimed to prevent).

RSPP also opposed the bill, pointing out that it contradicts the statements of the President Putin to waive excessive criminal liability.

Taking into account the Government’s opinion on the bill, Deputy Chairperson of the State Duma committee on state building and legislation, Irina Pankina, stated that the State Duma would not rush with adoption the bill. It is expected that its wording will be significantly changed by the second reading.

The further process of the bill adjustment will probably follow the same logic as with the bill on external administration (*toughening or softening of the wording depending on the dynamics of the exodus of foreign business from Russia*).

Parallel import

Legislative status: the order of the Ministry of Industry and Trade has come into force; the necessary legal framework is being finalized

On May 19, the Government submitted to the State Duma a bill cancelling the responsibility for parallel import of goods from the list of products earlier allowed for parallel imports by the Order of the Ministry of Industry and Trade. Consideration of the bill is scheduled for June.

The adoption of the bill is necessary from the point of view of the legal formalization of the Government's actions to launch parallel imports. On May 7, the Order of the Ministry of Industry and Trade came into force, approving the list of goods allowed for parallel imports. A number of large Russian online and offline retailers (M.Video, Yandex.Market, Wildberries) have already announced that they are ready to sell goods imported to Russia without the approval of the rightsholder. According to the media, the first deliveries of consumer electronics to Russia under the parallel import scheme have already started.

At the moment, the Government is using an approach that assesses parallel imports as a temporary measure to be used to saturate the market by particular categories of goods (in particular, the products of foreign companies that have left Russia). On May 18, the Ministry of Industry and Trade announced that the list of such goods would be revised quarterly.

In the future, the parallel imports practice can be extended to new product groups and brands. Third countries (both members of the Eurasian Economic Union and beyond) can also be involved in the process of systemic establishment of parallel imports in Russia. In this case, there is a risk that the parallel import scheme will be implemented on a permanent basis.

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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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