

## Competition Aspects of Foreign Investment in Russia

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The clarification of antitrust aspects of forms of foreign investment can have crucial meaning when the final decision on investing is made. In Russia, antitrust legislation has been significantly amended during the past few years. Today, if a foreign citizen or company decides to invest in a company located in or connected in any other way with Russia, the antitrust aspects of such deal should be certainly analyzed. This article aims at bringing to the attention of potential investors the main practical issues arising when one of the forms of investments described below is chosen.

In the past few years the Russian Government has been arranging favorable conditions to encourage foreign investment. Along with investment incentives, the legal framework for foreign investments has also been determined. This framework encompasses a range of procedures that a foreign investor should be concerned with and undertake while planning and structuring investment activity. In this article we would like to emphasise the competition issues of foreign investment to Russia as competition regulation is one of the most essential aspects in this area.

Federal Law №160-FZ of July 9, 1999 “On Foreign Investments in the Russian Federation” (the “Law on Foreign Investments”) defines “foreign investors” as:

- (A) individuals or legal entities, the legal capacity of which is determined by the laws of the jurisdiction of its incorporation, including those controlled by foreign investors and incorporated in the Russian Federation, ie, *private foreign investors*;
- (B) foreign states or international organizations and the legal entities under their control, incorporated inside or outside the Russian Federation, ie, *public foreign investors*.

As a general rule, a foreign investor is entitled to invest in Russia in any form not forbidden by Russian law. In practice a wide range of forms of foreign investment to the national economy is used, but in analyzing the competition aspects we will specify only three principal forms:

1. Acquisition of stocks/shares or control over a target company (the “Target”);
2. Establishment of a joint venture; and
3. Business operations on the basis of a joint venture agreement.

Antitrust regulation and control (including merger control, etc), in particular, control over the activity of natural monopolies, observance of antitrust requirements in tenders, enforcement of laws on advertising and control over foreign investments in companies having strategic importance for the national security and defense of Russia, is exercised by the **Federal Antimonopoly Service** (“FAS”).

All of the above listed forms of investment are under governmental antitrust control. The principal law regulating antitrust control in Russia is Federal Law № 135-FZ “On Protection of Competition” (the

“Competition Law”). The Competition Law has been developed during the past two years to provide the most efficient measures for competition protection in Russia. Currently, the Competition Law has the most notable influence on foreign investment regulation than ever before. The Competition Law applies to agreements between Russian and foreign persons or companies outside Russia, as well as actions performed by them if such agreements are concluded and include the fixed production of tangible and/or intangible assets located in Russia or shares of commercial organisations operating in Russia and rights regarding their activity, or have other effects on competition in Russia. This means that the Competition Law is currently broadly applied to completely foreign transactions if they affect competition in Russia.

The following transactions between foreign companies will be subject to antitrust control in Russia under the Competition Law:

- Acquisition of shares of a company operating in Russia;
- Acquisition of tangible and/or intangible assets located in Russia; or
- Transactions having any other effect on the state of competition in Russia.

In practice, a foreign company is recognised by the FAS Russia as operating in Russia if:

1. it has a representative office in Russia (a separate subdivision of the legal entity which represents and protects its interests);
2. it has a branch conducting business of the parent company in Russia; or
3. it legally supplies goods produced beyond the boundaries of Russia in Russia in any way (regardless of the supply rate).

It should also be noted that the definition of “effect on competition” is not provided by the Competition Law. Therefore, “effect on competition” can be interpreted broadly and depends on such factors as the increase of the market share of one market participant, reduction in the number of participants on a particular commodity market or any other factors that may also affect the state of competition in Russia. Therefore, the FAS determines the effect on competition based on market data analysis and other methods available.

FAS Russia has not issued any official guidelines related to the application of the current edition of the Competition law and the practice is still forming. Therefore, we assume that at present the FAS considers the applicability of the Competition Law on a case-by-case basis. This implicates possible difficulties requiring a thorough and timely planning and structuring of the investment activity and support of experienced lawyers.

The main antitrust regulation requirements applied to the principal forms of foreign investing to Russia are described below.

### Acquisition of Stocks/Shares or Control of a Target

According to the Competition Law, the following transactions are subject to antitrust control:

1. acquisition of more than 25 per cent, 50 per cent and 75 per cent of voting stocks (applicable to joint stock companies);
2. acquisition of more than 1/3, 1/2 and 2/3 of the shares in the authorised capital (applicable to limited liability companies);
3. obtaining fixed production assets (except for land plots and non-industrial buildings, structures, installations, premises and parts of premises, incomplete construction facilities) and (or) non-material assets if certain conditions exist; and
4. acquisition of rights enabling the determination of the conditions of activity of the Target (so called indirect control) or exercise of the functions of its executive body.

One of the most widely applicable ways that a foreign investment will be subject to antitrust control is the acquisition of the majority of stocks of a Target holding a Russian subsidiary directly or indirectly. According to current antitrust laws, transactions based on the acquisition of shares of a foreign company operating in the territory of Russia are also subject to antitrust control.

It should be taken into consideration that for the purposes of antitrust control, *turnover and assets of the parties of a transaction should be calculated on a worldwide basis including all the companies from the group*. Therefore, the acquisition of stocks/shares of a foreign company that conducts business in Russia can become subject to antitrust control irrespective of the volume of sales or value of assets of a Target in Russia if the worldwide thresholds are met. The thresholds concerning financial organisations differ and are calculated in accordance with the Government Decree.<sup>1</sup>

Additionally, the Shareholders' Agreement (the "SHA"), which often accompany M&A deals and contain the additional rights and obligations of the shareholders regarding the Target, should be analyzed by the FAS together with the deals accomplished. Thus, for example, the acquisition of a minor interest in a Target may be followed by an assignment of rights to block decisions on basic issues of business activity, to appoint the majority of the members of the Board of Directors, etc. These provisions of the SHA may also become a ground requiring an antitrust filing in Russia.

While structuring acquisition transactions, a possible foreign investor often does not take into consideration, important aspects such as the sphere of the business activity of a Target. However, according to Russian laws the access of foreign investors to specific spheres of business activity is limited.

For example, Art 7 of Federal law No 69-FZ of March 31, 1999 "On Gas Supply in the Russian Federation" stipulates that in the case of a purchase and sale of shares held by the owners of the regional gas supply systems and gas distribution systems, the stake of foreign citizens or foreign organisations shall not exceed 20 per cent of the total amount of the ordinary shares of the said systems. Similar restrictions are settled in the spheres of banking, insurance, mass media, communication, agriculture, etc. The control over enforcement of these requirements is exercised by a number of state authorities including the FAS.

Federal Law No 57-FZ of April 29, 2008 "On Procedure for Foreign investments in Companies Having Strategic Importance for National Defense and State Security" (the "Strategic Investments Law") identifies 42 spheres of business activity that are of strategic importance for the national security and defense of Russia. These are activities related to the:

1. *national defense* sector (eg, working with nuclear materials, activities related to weapons and other military equipment, aviation and space, coding and encryption equipment);
2. *natural resources* sector (eg, exploitation of subsoil areas of federal importance);
3. activity of *natural monopolies* (eg, energy sector);
4. *mass media* sector (eg, television, radio broadcasting and print media if it complies with the conditions specified in the Law); and
5. *telecommunications* (eg, activities of the major telecom providers).

If a company is involved in one or more of the following activities:

1. The acquisition of shares (stocks) resulting in the direct or indirect control of more than 50 per cent of the total voting shares (stocks) of a business entity of strategic importance; or
2. The acquisition of shares (stocks) of a business entity of strategic importance that exploits subsurface areas with federal status, if the right to control directly or indirectly 10 per cent or more of the total voting shares (stock) of such a business entity is acquired,

the proposed activity will require the preliminary approval of the Governmental Committee headed by the Prime Minister. Generally, consideration of the filing in accordance with the Strategic Investments Law takes approximately six to nine months because the Committee holds its sessions on an irregular basis.

FAS Russia is one of the bodies authorised to exercise control over foreign investments in strategic economic areas, its functions include, *inter alia*, the receipt of filings, review of the transactions with regard to a determination of control (direct or indirect) over the company having strategic importance and requests for information from the state authorities, transfer of the applications to the Governmental Commission for resolution.

As the FAS is responsible for the consideration of the transaction in accordance with the Competition Law and Strategic Investments Law, it has the right to suspend the consideration of an antitrust filing until the Governmental Committee approves the transaction. Therefore, revising the transaction to comply with the Strategic Investments Law is recommended. In most cases the conclusion of whether the Target is of strategic importance or not can be made based on an analysis of the internal documents of the Target (eg, certificates, licenses, etc).

## Establishment of a Joint Venture

Establishment of a joint venture company itself is a separate reason that may require obtaining clearance in Russia. However, it rarely becomes a ground for an antitrust filing due to the latest amendments to the Competition Law. Antitrust clearance in Russia may be required for a foreign investor if the authorised capital of a new company is paid by stocks (shares) and/or property, including trademarks, of another commercial organisation located in Russia. The merger and takeover of companies are also subject to antitrust control if certain thresholds are met.

Therefore, the incorporation of a joint venture company outside Russia without a transfer of Russian assets will be excluded from antitrust control. The contribution to a JV (joint venture) by way of transfer of shares in Russian companies is considered in the order described above (please see “Acquisition of stocks/shares or control of a Target”).

### *Liability for Violation of Antitrust Laws*

Acquisition of stocks/shares or control of a Target and establishment of a JV are considered **deals of economic concentration**. The liability for violation of antitrust laws while implementing these deals is the same and is specified in a number of legal acts.

Violation of a duty to submit a filing (such as by submitting misleading information to the FAS, failure to notify within the required time limits, failure to provide required information and failure to comply with a FAS ruling) as well as closing the transaction without a requisite FAS clearance may result in the imposition of an administrative fine in an amount up to RUR 500 000 (approximately USD 16,700) on the acquirer. The CEO of the acquirer is also subject to administrative liability in the form of a fine (from RUR 5 000 (approximately USD 180) to RUR 50 000 (approximately USD 1,700)) or disqualification from holding the position of CEO in the subject or other companies for a certain period of time (up to three years). The limitation period is one year from the date the violation is committed (namely, signing of an agreement between the parties to the transaction).

If the FAS establishes that a transaction was implemented without the FAS approval and that it has resulted or may result in the restriction of competition in Russia, the FAS may file a lawsuit to declare the transaction void and as a result “reverse” it. The limitation period is one year from the moment the FAS finds out, or should have found out about the transaction. However, the practice of invalidation of the transactions by Russian courts is rare. Taking into account that global transactions are implemented abroad, the problem of execution of Russian court decisions in the territory of another country can arise.

Therefore, the consequences of a breach of antitrust laws are quite severe. However, to date, the mechanism of their assignment to a foreign person or legal entity is not adequately developed. Yet, the FAS is actively involved in cooperating with antitrust authorities of other countries aimed at the development of an efficient system for the execution of their decisions.

## Business Operations on the Basis of a Joint Venture Agreement

One of the popular forms for foreign investment to Russia is via business operations based on a joint venture agreement without an incorporation of a JV. In particular, the agreements concluded for the purposes of the promotion and sale of new products (services or works) by a combination of economic and/or technical capacities of the parties are widely used. The Competition Law is applied to agreements concluded outside of Russia if they affect the state of competition in Russia. Therefore, the FAS can recognise them as an anticompetitive collaboration if these agreements contain provisions prohibited by Russian antitrust laws.

Thus, an agreement between competitive foreign and/or Russian companies aimed at cooperation in the form of market-sharing according to territorial principles, volume of sales/purchases, range of products or types of sellers or buyers, price-fixing, etc, in Russia is prohibited as **restrictive**. The list of prohibited conditions is determined by the Competition Law and includes, *inter alia*, economically or technologically unjustified refusals to conclude a contract with a particular buyer or seller, fixing different prices on the same commodity where it is not economically or technologically justifiable, creating barriers to the entry to a commodity market or exit from a commodity market. Once the aforementioned conditions are established, an irrefutable presumption of a restriction on competition will arise and agreements creating such conditions will be prohibited *per se*. The FAS does not have to prove the negative consequences of the execution of such agreements or the affect on competition in Russia as the inclusion of such conditions in the agreements itself is a violation of the Competition Law.

“Vertical” agreements do not fall under prohibitions *per se* except (i) agreements that lead to fixing of the price for resale and/or (ii) agreements that prohibit selling competitor’s goods. The above provision related to price-fixing is interpreted by the FAS broadly and includes, *inter alia*, the setting of minimum/maximum prices and recommended prices. Even providing distributors with informational materials where resale prices are indicated can be considered price-fixing if the FAS reveals that most of the distributors follow such prices. Depending on the market share of the legal entities participating in the agreement certain legal entities may be exempt from provisions (i) and (ii).

### *Liability for Violation of Antitrust Laws*

The liability for violation of antitrust laws regulating anticompetitive agreements differs from the liability for deals of economic concentration. A company which entered into an agreement prohibited under antitrust laws in force is subject to administrative liability; its CEO will also be liable for the offence. The “*turnover fines*” in the amount of 0,003 per cent to 15 per cent of the violator’s turnover on the market where the violation occurred may be imposed on the company-wrongdoer. The amount of the fine cannot be less than RUR 100 000 (approximately USD 3300). The limitation period is one year from the issuance of the FAS decision on the matter upon a result of an investigation. At the same time, the FAS has the right to initiate an investigation within three years from the date a violation is committed or the time at which the FAS finds out that the violation is continuing (namely, conducting the business in accordance with agreements). Therefore, the limitations period for liability based on anticompetitive agreements is rather long.

Further, since October 2009, the CEO of a company-wrongdoer can be subject to criminal liability for certain violations. The Criminal Code of Russia has introduced fines in the amount of up to RUR 1 million (approximately USD 34,000) and/or imprisonment up to seven years. In cooperation with the FAS the law enforcement authorities determine the *corpus delicti* and grounds for initiation of a criminal case in respect of

the CEO, regardless of the CEO's citizenship. However, if the CEO is a foreign citizen and does not have income and/or assets in Russia, the execution of the sentence seems to be complicated.

## **Conclusion**

Today, Russian antitrust laws are one of the most dynamic branches of Russian law. Thus, provisions regulating foreign investments are constantly being developed. This is caused by the necessity to provide foreign investment regulation that encourages the development of a competitive market and at the same time allows for exercise of control over its participants, without a negative impact on competition.

For the past several years, foreign investors did not pay attention to the antitrust aspects of investing in Russian companies or companies owning assets in Russia. However, current laws and practice will force them to take into account the antitrust aspects of their investments to avoid possible negative consequences arising from the powers bestowed on the Russian authorities.

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## *Notes*

1 Decree of the Government of the Russian Federation No. 334 of May 30, 2007 on Establishment of the Values of the Assets of Financial Organizations (Except for Credit Organizations) and of the Aggregate Share of Financial Organizations (Except for Credit Organizations) on the Commodity Market for the Purpose of Exercising Antitrust Control; Decree of the Government of the Russian Federation No. 335 of May 30, 2007 on Establishment of the Values of the Assets of Credit Organizations for the Purpose of Exercising Antitrust Control.