IT companies have been included in the list of strategic entities: implications for foreign investors

FAO foreign investors, heads and employees of IT companies

Pepeliaev Group advises of proposed amendments to Federal Law No. 57-FZ 'On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for Ensuring the Defence of the Country and Security of the State' ('Law No. 57-FZ').

The Russian Government has published a draft law proposing to add certain areas of the IT sector to the list of strategically significant activities (the 'Draft Law')[1]. The document also provides for rules applicable to existing ownership structures with foreign participation, including mandatory notification of Russia's antitrust regulator the Federal Antimonopoly Service (the 'FAS of Russia') and, in certain cases, the need to obtain approval for corporate control or to reduce the membership interest.

If the amendments are adopted, it will become significantly more difficult for IT companies to attract and retain foreign participation in their capital without complying with a special permission and notification regime.

The list of strategically significant activities is being expanded

The main initiative of the Draft Law is to expand the list of strategically significant types of activity. It is proposed to include the following:

1) licensed activities involving the technical protection of confidential information;
2) activities of marketplaces;
3) activities that involve developing (adapting, modifying) trusted software;
4) activities of data centre operators;
5) activities that relate to developing, creating, implementing, selling or circulating artificial intelligence technologies;

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[1] Draft Law 'On Amending the Federal Law "On the Procedure for Making Foreign Investments in Business Entities of Strategic Importance for Ensuring the Defence of the Country and Security of the State"' (Draft ID: 168601).

6) activities of mining infrastructure operators, mining pool organisers and operators of information systems (IS) for issuing digital financial assets (DFAs).

Pepeliaev Group's Comment

The FAS of Russia is proposing an excessively broad definition of the term 'AI technologies', under which developing virtually any technology using AI could be classified as a strategically significant activity.
In addition, the wording concerning activities relating to how AI technologies are developed and circulate effectively also covers organisations that have no influence over the technologies themselves, including electronics distributors.
We believe that the above provisions of the Draft Law need to be clarified.

Notification of ownership of interests/shares

A foreign investor or a group of persons that includes a foreign investor must notify the FAS of Russia of exercising control, directly or indirectly, over at least 5% of the votes at the general meeting (GM) of a company carrying out an activity that the Draft Law proposes to include in the list of strategically significant activities. Such notification must be submitted within 180 days from the date on which the law enters into force.

If this obligation is not met, the FAS of Russia may apply to the court seeking to deprive such persons of their voting rights.

The need to obtain approval for corporate control or dispose of shares/interests

A foreign investor or a group of persons directly or indirectly exercising control over more than 50% of the votes at the GM of a company carrying out an activity that is proposed to be included in the list of strategically significant activities must:

- either apply to the FAS of Russia to have the establishment of control approved;
- or dispose of a part of the shares (interests) such that, after they are disposed of, the foreign investor or group of persons would have the right to exercise control over no more than 50% of the votes at the company's GM.

One of these actions must be taken within 365 days from the date on which the law enters into force. Otherwise, the FAS of Russia may also apply to the court requiring that such persons be deprived of their voting rights.

If the FAS of Russia refuses to approve the establishment of control, the foreign investor or group of persons must effect a disposal of part of the shares (interests) so that, following such disposal, they would have the right to exercise control over no more than 50% of the votes at the GM of the company.

Exemption from repeated approval

Repeated approval of a foreign investor or group of persons establishing control over a company is not required if all of the following conditions are met:

- a decision approving this has previously been adopted in accordance with Law No. 57-FZ;
- the application was submitted in respect of the same type of activity as specified in a decision that was previously adopted approving the establishment of control;
- information on the beneficiaries, beneficial owners and controlling persons of the foreign investor and the company, as well as information on the characteristics of control, was submitted no later than 30 days before the application for the permission document was filed;
- the list of such persons and the grounds for classifying them as such have not changed compared with the information specified in the application further to which the decision approving control was adopted.

What to think about, what to do

IT companies whose activities may be classified as strategically significant should already be checking their ownership structure and determining whether they have foreign investors, as well as what their membership interest is, in terms of the 5% and 50% voting thresholds. Foreign investors and such companies would be advised to consider in advance whether it will be required to notify the FAS of Russia, to have the establishment of control approved, or to restructure the participation interest, taking into account the transitional periods of 180 and 365 days from the date on which the law enters into force.

Help from your adviser

Pepeliaev Group’s specialists are ready to provide legal support in assessing whether the requirements of Law No. 57-FZ are applicable to a specific ownership structure, a company's activities and planned corporate changes. We can assist in preparing notifications and applications to the FAS of Russia, provide support in interacting with competent authorities, and propose options for restructuring membership interests as well as reducing regulatory risks.

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