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Review of Amendments to the Law of the Russian Federation "On Subsoil"

On April 16, 2008 the Federation Council, the upper chamber of the Russian parliament, passed new Federal Law "On Procedures for Foreign Investments in Companies of Strategic Significance for National Defense and Security" (the "**Law**") imposing restrictions on foreign investors seeking to buy shares or acquire control over Russian companies that are deemed strategic. The new law as well as Federal Law "On the Introduction of Amendments to Certain Provisions of Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law "On Procedures for Foreign Investments in Companies of Strategic Significance for National Defense and Security" shall come into effect after they are signed by the President, which is expected to happen in a few weeks time. The latter law introduces amendments to Law of the Russian Federation No. 2395-I "On Subsoil" dated February 21, 1992 (the "**Amendments to the Subsoil Law**").

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Purpose of the Laws

The adopted laws are aimed at imposing limitations on foreign investors and groups of persons that include foreign investors ("group of persons") upon their acquisitions of shares and participatory interests in the capital of and/or control over companies that are deemed strategic, including companies that have a right to use subsoil plots of federal significance. Furthermore, the laws establish a number of restrictions on the use of subsoil plots of federal significance.

From the date of the laws' coming into effect, such transactions will require the preliminary consent of a government commission.

Restrictions on Transactions

Subsoil Plots of Federal Significance

Pursuant to the Amendments to the Subsoil Law subsoil plots of federal significance include the following:

- 1) subsoil plots containing deposits and showings of uranium, diamonds, high-purity quartz, the yttrium group of rare earths, nickel, cobalt, tantalum, niobium, beryllium, lithium, or the platinum group of metals (irrespective of the size of the deposits);

- 2) subsoil plots containing the following reserves, as evidenced by the State Register of Reserves, as of January 1, 2006:
 - recoverable oil reserves above 70 million tons;
 - gas reserves above 50 billion cubic meters;
 - hard-rock gold reserves above 50 tons; or
 - copper reserves above 500 thousand tons;
- 3) subsoil plots located in the inland sea waters, territorial sea waters, or on the continental shelf of the Russian Federation;
- 4) subsoil plots that can only be developed using land used for defense and security.

The list of subsoil plots of federal significance will be published by the Federal Agency of Subsoil Use.

Transactions Subject to Preliminary Consent

In accordance with the Law, transactions involving the acquisition of shares and participatory interests in the charter capital of a company that has a right to use subsoil plots of federal significance, as well as acquisition of control over such a company, include the following:

- 1) transactions with shares (participatory interests) of such a company if as a result of such transactions a foreign investor or group of persons acquires:
 - a) the right to direct or indirect disposal of ten or more percent of the total number of votes at shareholder level;
 - b) the right to appoint a chief executive officer and/or ten or more percent of the members of a collective executive body of such a company and/or the unconditional ability to elect ten or more percent of the members of the board of directors (supervisory council) or another collective governing body of such company;
- 2) transactions aimed at the acquisition by a foreign investor or group of persons of shares (participatory interests), if the foreign investor or group of persons already has the right to direct or indirect disposal of ten or more percent of the total number of votes at shareholder level;
- 3) agreements resulting in the acquisition by a foreign investor or by a group of persons of rights to perform the functions of a management company;
- 4) other transactions aimed at the acquisition by a foreign investor or group of persons of the right to determine the decisions of the governing bodies of such a company, including the rights to determine its business activities;
- 5) transactions aimed at the acquisition by a foreign state, international organization or organization controlled by them, of the right to dispose directly or indirectly of more than five percent of the total number of votes at shareholder level.

Timing for Obtaining Consent

The transactions listed above require the preliminary consent of a governmental commission. The overall time for taking a decision by the governmental commission is three months. However, in exceptional cases this term may be extended to six months.

Restrictions on Subsoil Rights

Discovery of a Deposit

If in the process of a geological survey a foreign investor (or a legal entity with participation of foreign investors) discovers a mineral deposit that comes under one of the categories of subsoil plots of federal significance, the Government of the Russian Federation may refuse to grant the entity that discovered the deposit the right for exploration and production of mineral resources on that plot.

If the deposit was discovered in the course of a geological survey on the basis of a combined license (for geological survey, exploration and production) the Government of the Russian Federation may decide to terminate the right to use this subsoil plot.

In either of the above cases, the Amendments to the Subsoil Law provide for compensation of expenditures related to prospecting and appraisal, and repayment of a bonus for the grant of rights. Moreover, such entities may be entitled to a premium payable by the Russian State.

Right to Use Subsoil Plots of Federal Significance

The users of subsoil plots of federal significance, with the exception of those located on the Russian continental shelf, may be legal entities registered in the Russian Federation. The Government may impose additional limitations on Russian legal entities with the participation of foreign investors on their participation in tenders and auctions for the right to use such plots.

The users of subsoil plots located on the Russian continental shelf may be legal entities:

- 1) that were established in the Russian Federation;
- 2) that have at least five years' experience in developing subsoil plots located on the Russian continental shelf; and
- 3) in whose charter capital the Russian State has a share of more than 50 percent, and/or in relation to which entity the State holds the right to direct or indirect disposal of more than 50 percent of the total number of votes at shareholder level.

Transfer of Subsoil Rights

As a general rule, it is forbidden to transfer the right to use subsoil plots of federal significance to a company with the participation of a foreign investor or a group of persons, which:

- 1) has the right to dispose directly or indirectly of more than ten percent of the total number of votes at shareholder level;
- 2) has the right to determine the decisions of the governing bodies of such a company, including the rights to control the business activities of the strategic company; or
- 3) has the right to appoint the chief executive body and/or more than ten percent of the members of the collective executive body and/or has the unconditional ability to elect more than ten percent of the members of the board of directors (supervisory council) or other collective body of such a company.

Such a transfer is permitted in exceptional cases only upon a decision by the Government of the Russian Federation.

Entry into Force

The Law will apply to transactions executed after its effective date, i.e., after its publication. However, if transactions are entered into prior to the effective date, the Law will apply to such transactions to the extent that the rights and obligations under such transactions arise after the effective date. Thus, the restrictions imposed by the Law are likely to apply to executed but not yet completed transactions.

The provisions of the Amendments to the Subsoil Law relating to the discovery of deposits will apply to discoveries made after the effective date. They will not apply to subsoil plots that have been granted under a combined license in respect of which the license holder has completed geological surveys and begun exploration and production prior to the effective date.