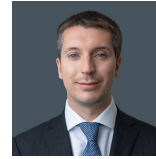


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Russia update: Exodus from extractive industries and latest measures against foreign investors



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Foreign investors in Russia may find themselves on the horns of a dilemma. Following the invasion of Ukraine and Russian countersanctions, many investors have found it necessary to wind down their business operations in Russia. Yet recent decrees by the Russian government can block those same investors from selling their assets and achieving a clean break. In short, investors may be unable to stay in Russia but unable to leave in a commercially viable manner and on their own terms.

This note considers the impact on investors' abilities to divest or repatriate their profits as a result of recent measures by the Russian government, with a focus on investors from so-called "unfriendly" countries or in the energy and natural resources sectors. It considers how affected investors can enforce legal rights against the Russian State under international investment treaties, as well as in contract and national law against State entities and third parties.

1. Recent restrictions in the energy and natural resources sectors

1.1 Recent market developments and restrictions on energy and natural resources investors

In recent weeks, several European oil and gas majors have divested, or been forced to divest, their Russian assets, following their previous announcements that they would exit their businesses in Russia:

- On 1 September 2022, it was reported that Shell had lost its 27.5% stake in the Sakhalin-2 LNG project after the Russian government transferred the project to a new holding company. Japan's Mitsui & Co and Mitsubishi agreed to take shares in the new holding company, retaining their minority stakes in Sakhalin-2. Shell had previously written off the USD 1.6 billion value of its shareholding in the project.^[1]
- On 2 September 2022, Norway's Equinor finalised its divestment from the Kharyaga project in northern Russia, completing its exit from the country.^[2] Equinor had previously transferred its interests in four joint ventures to Rosneft, writing down over USD 1 billion in assets.^[3]
- On 5 September 2022, the Russian government approved the transfer of TotalEnergies' 49% stake in the Termokarstovoye gas field in Siberia to Novatek, TotalEnergies' joint venture partner.^[4]

The divestment process has been complicated by Decree No. 520, signed by President Putin on 5 August 2022. The decree prohibits, among other things, foreign investors of "unfriendly" States from restructuring or selling their interests in Russian strategic enterprises, banks, or certain energy and mining projects and companies. The restrictions apply to investors from 48 so-called "unfriendly" countries (including all EU members, the USA, the UK, Japan, South Korea, Switzerland, Canada and Australia). The decree currently lasts until 31 December 2022 but may be extended.

Unless approved by the President, any transaction falling foul of Decree No. 520 is null and void. In practice, therefore, the government can control the terms on which an investor can restructure or sell its assets – and force the investor to pay, or walk away with nothing, in order to exit its investment.

Moreover, the Russian government has reportedly used Decree No. 520 to block ExxonMobil's efforts to divest its 30% stake in Sakhalin-1, an offshore project in Russia's Far East. On 30 August 2022, it was reported that ExxonMobil had notified Russian officials of a dispute under its contract. Should ExxonMobil be unable to resolve the dispute by negotiation, it intends to file for arbitration.^[5]

Foreign investors that remain in Russia's natural resources sector will face new restrictions. On 1 July 2022, an amendment to the Russian Subsurface Law came into effect forbidding foreign companies from holding exploration and development licences; foreign companies must transfer their licences to locally incorporated vehicles. *Rosnedra* (the Russian Federal Agency for Subsoil Use) sought to notify all foreign investors by 31 July 2022, following which investors have 90 days from the date of notification to transfer their licences to local corporate vehicles. Should they fail to do so within a 90-day deadline, the licences will be revoked without compensation.^[6] In practical terms, this means that all foreign investors will need to comply with the new Russian Subsurface Law, or surrender their licences, by late October at the latest.

1.2 Potential recourse for foreign investors

For investors that hold contracts with Russian State entities (as appears to be the case with ExxonMobil in its dispute), the latest restrictions on divesting or restructuring their assets, as well as the revisions to the Russian Subsurface Law, may entitle them to contractual remedies. Investors which do not have such a contract, or where their contract only provides for litigation before the Russian courts (rather than, e.g., arbitration in a neutral forum), should consider their rights under applicable bilateral investment treaties (“**BITs**”).

Many of Russia's BITs contain protections against unlawful expropriation as well as non-impairment or non-discrimination clauses, prohibiting measures which interfere with foreign investors' rights to manage or dispose of their investments. Several of these treaties, such as Russia's BITs with the Netherlands, France, Italy, Japan and Ukraine, allow investors to claim compensation from the Russian State for breach of their rights before an international arbitral tribunal if they are unable to resolve their dispute amicably. Other BITs, such as those with the UK, Germany, Luxembourg, Switzerland and South Korea also provide for investor-State arbitration but limit it to disputes over expropriation or restrictions on the free transfer of capital.

For energy companies (including oil and gas), the Energy Charter Treaty (“**ECT**”) protects investors against unlawful expropriation or discriminatory interference and enables investors to bring claims in arbitration. Russia signed but did not ratify the ECT; nevertheless, the *Yukos* arbitral tribunal and the Dutch Supreme Court have upheld the provisional application of the treaty in relation to Russia. Investments made in Russia before 2009 (when Russia announced its intention not to ratify the ECT) should therefore benefit from protection under the ECT until 2029.

2 Revised capital controls

2.1 Restrictions on dividend payments to foreign shareholders

Starting from 4 May 2022, Presidential Decree No. 254 extends restrictions on the payment of dividends, which already applied to Russian joint stock companies, to limited liability companies. The decree provides that, for shareholders in Russian companies associated with “unfriendly” States (or shareholders under their control), dividends must be paid in roubles into blocked accounts. Funds may only be withdrawn from these accounts for specified purposes, such as to pay taxes or to buy Russian government bonds, or as otherwise authorised by the Russian Ministry of Finance.^[7]

Although Russia announced the relaxation of certain other controls in May of this year, even investors from “neutral” countries may face difficulties repatriating their earnings as a result of exchange controls. Oil India has reported that around 8 billion roubles (USD 130 million) of its dividends are left in Russia due to restrictions on exchanging them into dollars.^[8]

2.2 Potential recourse for foreign investors

Restrictions on dividend payments may run counter to investment treaty protections safeguarding investors’ rights to repatriate profits. As an illustrative example, Article 5 of the Russia-Germany BIT protects investors’ rights to the free transfer of capital, including returns from their investments, into a convertible currency without undue delay. As noted above, several BITs between Russia and “unfriendly” States allow for compensation claims by investors unable to repatriate the proceeds of their investments.

3 Draft law on external administrators

3.1 Current legislative status of draft law on external administrators

The draft law “On external administration on governing an organization” continues its way through the legislative process, although recent statements by Russia’s business lobby group suggest that lawmakers may have cooled on the proposed law. The draft law is intended as a reaction to multinationals such as Ikea, McDonalds, Apple, Marriott, IBM, H&M and many others, which have shuttered their stores or otherwise reduced their business in Russia for compliance, ethical and/or reputational reasons.

In particular, the draft law targets companies in which investors of “unfriendly” States have at least a 25% stake and which have closed, suspended or significantly reduced their business since 24 February 2022. A 30% drop in sales over a three-month period is regarded as a “significant” decrease.^[9] The draft law provides that, unless the company’s shareholders or management commit to resume business, or transfer the company to another person or trustee, the Moscow *Arbitrazh* Court may appoint an external administrator of the company on the application of the Russian tax authorities. The administrator then takes over management of the company, to the exclusion of the previous management and shareholders; in particular, the administrator may restructure the company, sell its assets and spin off the business, and/or liquidate the company.

On 24 May 2022, the draft law passed its first reading in the *Duma*. Whilst progress on the bill was paused during the summer recess, the *Duma* restarted plenary sessions on 13 September 2022. However, recent statements by the head of the Russian Union of Industrialists and Entrepreneurs (RSPP), who is a member of the ruling United Russia party, suggest that the government may put the bill on the back burner. According to the head of the RSPP, the draft law has largely accomplished its original goal in that it has already led investors to decide to transfer their Russian assets to new owners. Accordingly, the bill is reportedly “not among the government’s priorities” for the autumn session of the *Duma*.^[10]

3.2 Potential recourse for foreign investors

Nevertheless, if the government decides to continue work on the bill, it will need to pass its second and third reading in the *Duma* and be considered by the upper house (the Federation Council) before it can be signed into law. Investors who may be affected by the proposed law should consider their rights under applicable BITs. In previous cases, such as those before the Iran-US Claims Tribunal, tribunals have considered the appointment of a government supervisor to be an expropriation under international law entitling the investor

to compensation. Investors faced with the replacement of their management and forced asset sales may also rely on protections such as “non-impairment” or “fair and equitable treatment” present in many investment treaties.

4 Key considerations for investors

Investors impacted by the Russian government’s decrees and laws should seek advice on their remedies in contract, where applicable, as well as under investment treaties with Russia. Recent measures ousting foreign investors from strategic industries, restricting the payment of dividends and taking over the management of local branches may constitute unlawful expropriation and violations of other investment treaty protections. Even investors not yet affected should consider taking advice on whether their investment structure provides protection under investment treaties, as waiting until a dispute arises may prove too late to benefit from treaty protection.

An arbitral award against the Russian State (or State-owned entities) would be enforceable in accordance with the New York Convention. Investors could therefore seek to enforce against Russian assets located abroad, in any of the 169 countries which are party to the New York Convention. Although many State assets are immune from enforcement, many legal systems allow for exceptions to the doctrine of sovereign immunity, for example, by allowing enforcement against State assets which are used for commercial purposes.

The Russian government hopes that countries such as Japan and South Korea (despite their “unfriendly” designation), China, India, and Saudi Arabia will fill the gap left by Western investors.^[11] Nevertheless, if an investor is forcibly replaced with a new investor in breach of an existing contract (such as a production sharing or joint venture agreement), it may have claims against the new investor for tortious interference or to invalidate the offending new contract.^[12] It may be possible to bring such tort claims outside Russia, for example, in other jurisdictions where the new investor has a physical presence. Some legal systems – such as the US, as a result of the Second Hickenlooper Amendment – may also allow investors which have been unlawfully expropriated potentially to recover their property from State organs or third parties. Litigation in jurisdictions outside Russia may therefore provide a further, alternative means of redress for investors alongside investment treaty claims.

For further information, see LALIVE’s [previous newsflash on possible claims against Russia for expropriation of foreign investments](#).

If you have further questions or require advice about any of the issues raised in this article, please contact the authors.

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