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FINANCIAL SERVICES

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Russia Moves Closer to Nationalizing Businesses Intending to Exit Russia

Since Russia's invasion of Ukraine, some 300 large international companies have announced intentions to scale back or shut down operations within Russia. On March 7, Russia's ruling party reacted to the exodus by announcing that it was drafting legislation to penalize businesses leaving Russia. Two days later, the government announced that it had completed a draft law. The draft was not immediately published, but a summary by United Russia, parliament's dominant political party, suggests that the law constitutes a step toward nationalization of assets of foreign-owned companies that join the rush to quit Russia.

According to the summary published on United Russia's website, the new law will apply to Russian companies with foreign shareholders (25 percent or greater ownership) based in "unfriendly" jurisdictions.[1] If the "unfriendly" parent decides to cease operations in Russia, members of the Russian company's board, or certain government officials, may apply to a local commercial court for "external administration" of the Russian company. "External administration," a process under Russia's bankruptcy law, is a reorganization (similar to Chapter 11 in the United States), with an external manager immediately displacing current management. The court supervises the restructuring, and may prohibit layoffs, control company assets, or prohibit rejection of contracts.

If, within five days, the foreign owners withdraw their decision to leave Russia (or agree to continue operations pending a sale to a buyer that will continue running the business), the external administration proceedings may be withdrawn. If the foreign owner does not reverse its decision, the company's assets will be transferred to a new company, and the new company's shares will be sold at auction.

At this time, key elements of the proposed law remain vague. For instance, what constitutes "ceasing operations" is an open question for companies that temporarily suspend operations or continue them in a scaled-down manner. One metric that may drive the answer to this threshold question is the number of employees who would be laid off if the corporation stops operating, as mass worker layoffs are a hot-button issue for the Russian regime. Other questions, such as the commencement date of the five-day "repentance" period, await clarification from the government.

It is also unclear when the Russian government will make this proposed law effective. Russian president Vladimir Putin's office has informally announced his support for the measure. However, Russia has previously been hit with arbitration awards for nationalizing foreign-owned subsidiaries, and may delay implementing the law and use the recent announcements as a warning to curb the current wave of business closures. It also may be deliberating how to structure the takeover of business assets to more resemble a commercial bankruptcy restructuring that avoids the toxic term “nationalization.” These legislative responses are in a highly fluid state, and invite careful attention from companies with operations in Russia.

[1] A list of “unfriendly” jurisdictions was introduced by the Russian government in response to recent foreign sanctions. The list currently includes the US, Canada, UK and EU, as well as Albania, Andorra, Australia, Iceland, Japan, Lichtenstein, Micronesia, Monaco, Montenegro, New Zealand, North Macedonia, Norway, San Marino, Singapore, South Korea, Switzerland, Taiwan and Ukraine. As other nations impose sanctions, the list presumably will grow.