

# Special investment contracts

The number of challenges faced by foreign investors in Russia should be reduced through the conclusion of special investment contracts that secure a stable legal environment for the investor and can ensure his treatment as a Russian producer. The main idea of this paper is to provide guidelines to foreign investors on such special investment contracts. Specifically, the scope of this paper will be confined to an explanation of how to apply for a special investment contract and tips to assist investors in its negotiation and conclusion to the benefit of the investor.



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## **Why a special investment contract?**

A special investment contract is an investment agreement between the Russian government and the investor<sup>1</sup>. Under the contract the investor shall establish or upgrade its production facilities in Russia, and the Russian government shall grant the investor certain benefits. These benefits may include tax incentives or the securing of set tax and legal frameworks for the investors for the entire duration of the special investment contract<sup>2</sup>. However, from the investor's perspective, the most important benefit arising from the special investment contract is the "Made in Russia" certificate which is issued for the products manufactured by the investor in Russia, provided that the products are covered by the special investment contract.

The "Made in Russia" certificate is important due to the Russian government's recent policy of import substitution, and enables the investor to participate in state procurements as well as in procurements performed by state-owned companies in those cases when Russian-made products will be

privileged. The issue is that many companies with production facilities in Russia are unable to receive a "Made in Russia" certificate for their products, especially if they only have knockdown assembly facilities. An assembly plant in Russia is not sufficient to receive a "Made in Russia" certificate. Moreover, the requirements on local content and technology transfer must be met. However, the requirements established by law cannot usually be met within the established timeframes. Therefore, investors need a grace period. At present this grace period can only be provided by a special investment contract. Thus, a special investment contract empowers the investor to start production and to immediately receive a "Made in Russia" certificate for the first three years, even if the manufactured products do not meet the localisation requirements. After the grace period, the required degree of localisation must be achieved.

## **Application for a special investment contract**

Once the investor has decided to apply for a special investment contract, it will submit an application. The

<sup>1</sup> For the purposes of this paper, we consider in particular those special investment contracts that are concluded on the federal and not regional level.

<sup>2</sup> Special investment contracts will be concluded for a maximum period of ten years.

consideration of the application and conclusion of a special investment contract is within the competence of the Russian Ministry of Industry and Trade.

A well-conceived application for a special investment contract has particular relevance not only for the approval of the investment project by the Russian Ministry of Industry and Trade, but also for the further negotiation of the special investment contract.

The application form and the documents to be attached thereto are stipulated by law<sup>3</sup>. One of the key documents to which the investor should pay special attention is the business plan of the project, including its financial model. When drafting the business plan, it is recommended that the UNIDO or EBRD international business planning

targets, tax withholdings, risks, etc., where both economic indicators and established legal requirements must be taken into account. Otherwise, the business plan will not meet the requirements and may be rejected.

When preparing the business plan, it is also important to understand that the investment under a special investment contract must amount to at least RUB 750 million. That being said, the investor is basically allowed to independently determine what the indicated investments will be used for under the localisation project and by which deadlines. In principle, the investments can be performed throughout the entire effective term of the special investment contract. True, the specific amount to be spent on each individual investment target must already be indicated when submitting the application. In order to

application, while maintaining the overall amount of investments.

It is also important to note that the investor will have to resolve a fair number of practical issues that usually arise in order to properly draft the documents: in particular, how to account for investments already made, how to separate products manufactured under the special investment contract from the investor's current business activity, how to report the profit for the period when the project begins to generate operating profit, taking into account the established degree of localisation of certain products, etc. The answers to these questions will make it possible to duly draft the application. Therefore, once you know what key questions need to be answered, you have to act and find a solution. This is not an easy task, particularly if you do not have extensive experience. In any case, you will need to resolve the key issues before you begin negotiations with the Russian Ministry of Industry and Trade. While having a solution is essential, it is also important to maintain some flexibility at this stage. The negotiations with the Russian Ministry of Industry and Trade may introduce new ideas that need to be incorporated into the application. This is an important stage, because it helps to ensure that the documents are arranged in a logical and legally compliant way. Please also note that the special provisions of the special investment contract must already be included in the application.

Once the application is prepared, it is first sent by the investor with all attached documents to the Industrial Development Fund. The Industrial

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standards or the Vnesheconombank recommendations on drafting a business plan be used as guidelines. Regardless, the business plan should contain special sections on localisation of production (in particular, a localisation schedule), local content, investment

give the investor the required flexibility, considering the long-term nature of the project, it is possible to introduce a special provision in the application granting the investor the right to change the amount of investment and the investment targets indicated in the

<sup>3</sup> Resolution No. 708 of the Government of the Russian Federation dated 16 July 2015 "On Special Investment Contracts for Certain Industrial Sectors".



## Drafting and negotiating a special investment contract

Since the Interdepartmental Commission also approves the essential terms of the special investment contract, the draft special investment contract should be prepared prior to the final approval of the investment project. When drafting of the special investment contract, the following issues must be considered directly.

Special investment contracts are governed by Russian law, with the State Commercial Court of the City of Moscow having jurisdiction. The template of a special investment contract is established by law<sup>4</sup>. However, the provisions of the contract can and will be amended proceeding from the specifics of the investment project.

The obligations of the investor under a special investment contract will be covered, first of all, by the business plan submitted in the application. On the approval of the investment project, the business plan will be attached to the contract as an integral part thereof. Despite the fact that the business plan is usually considered merely a possibility, it turns into an obligation of the investor under the special investment contract. From this standpoint, the best course of action is to focus not only on scrutinising the drafting of the business plan, but also on the negotiation of a “legal buffer” for those cases when business expectations are not met for reasons beyond the investor’s control.

The template of the special investment contract shall be amended in line with the regulation on local content and the

Development Fund is an intermediary between the investor and the government, and gives preliminary approval and provides its comments on and recommendations for the application. A number of questions that arise during the preparation of the documents may also be promptly discussed with the Industrial Development Fund, which can apply its experience in approving special investment contracts with other investors to help the investor to find solutions to certain issues.

After the preliminary approval of the investor’s application by the Industrial Development Fund, the application and all attached documents are sent to the Russian Ministry of Industry and Trade. This is considered the official submission of the documents. The considera-

tion of the documents in the Russian Ministry of Industry and Trade generally takes several months (even up to six months) and requires regular working meetings. Based on the results of the consideration of the application and the documents, the Russian Ministry of Industry and Trade issues a preliminary decision to approve or reject the investment project.

The final approval of the investment project and the special investment contract is in the competence of the so-called Interdepartmental Commission. This commission includes the representatives of nearly all key ministries (the Ministry of Economic Development, Ministry of Finance, Ministry of Energy, etc.), as well as representatives of professional associations and public organisations.

<sup>4</sup> Resolution No. 708 of the Government of the Russian Federation dated 16 July 2015 “On Special Investment Contracts for Certain Industrial Sectors”.

timeline for localisation. This is a government regulation<sup>5</sup>, but also involves a fair amount of initiative on the part of the investor. The investor's primary obligation is to comply with the mandatory regulations on the percentage of local content and the technical processes to be performed in Russia. At the same time, however, the investor decides on the product portfolio and is not ultimately prevented from modifying, updating and replacing the products under a long-term investment project based on research and development or due to market conditions. However, it is important to identify such issues at the

Trade might propose that a penalty be introduced to the special investment contract for the breach of the localisation clause, even if such a penalty is not explicitly stipulated by the law on special investment contracts. In particular, a penalty may be established for those cases when an investor fails to meet the established percentage of local content. Should this be the case, the penalty will be calculated proceeding from the investor's turnover from the sale of products manufactured under the special investment contract that do not meet the local content requirement. It is particularly critical for investors to ensure that

points from the beginning. There are always differing positions followed in the end by a compromise between the parties. When negotiating a special investment contract, the negotiating process is made more difficult by the fact that the investor is working with the state, represented by the Russian Ministry of Industry and Trade. A number of Ministry departments are involved in the approval process: the sectoral department (for example, for the automotive industry, the machine tool industry, etc.), the legal department, the strategic development department, etc. Each department considers the draft special investment contract from the standpoint of its own competence. Furthermore, the essential terms of a special investment contract must also be approved by an Interdepartmental Commission made up of the representatives of various ministries and sectoral organisations that have their own positions and competence on key issues. As a result, the approval process is conducted in several rounds, and requires, at the very least, intensive legal work, negotiation and coordination skills.

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very beginning and stipulate special provisions in this regard in the special investment contract.

To ensure that the investor duly performs its obligations under the special investment contract, the Russian Ministry of Industry and Trade puts the investor under surveillance. This is usually performed on an annual basis, with the investor submitting annual reports and supporting documents to the Russian Ministry of Industry and Trade. Therefore, investors must also be aware that the Russian Ministry of Industry and

the penalty clause is negotiated in good faith, in order to make it feasible for the investor. Generally speaking, the liability and termination clauses lead to the most discussion. An in-depth substantiation of the investor's position from the legal and economic standpoint is required in order to reach a compromise.

The drafting and approval of a special investment contract takes time. On the one hand, a special investment contract, like any other agreement, must be negotiated. In B2B practice, the parties probably never agree on all

In summary, a special investment contract will establish stable frameworks for the investor in the Russian market, and shield him for a long period from the unpredictable measures taken by the government. It can apply to the entire range of the investor's activities, and serve as a foundation for successful cooperation between the business and the state. At the same time, the investor must first manage to conclude the special investment contract on conditions that enable him to implement the project in an economically reasonably and legally precise way. ■

<sup>5</sup> Resolution No. 719 of the Government of the Russian Federation dated 17 July 2015 "On the Criteria for Classifying Industrial Products as Industrial Products that do not have Russian-Made Equivalents".