

# Foreign Ownership of Gazprom Shares

*Linklaters. Central & Eastern European Legal Update*

*Gazprom is the world's largest gas company and supplies 26 per cent of all the gas used in Europe. This article gives an overview of the rules governing foreign ownership of Gazprom "local" shares, and comments on the features and risks inherent in those holdings.*

## Restrictions on foreign ownership

Currently there is a 14 percent threshold on the number of Gazprom shares that can be held by "foreign participants" (excluding shares acquired by foreigners before the restrictions on non-residents were first established in May 1997). If a non-resident purchaser acquires shares in excess of this 14 percent threshold, the purchase can be invalidated through court proceedings in Russia and the shares returned to the seller.

Gazprom domestic shares are traded in Russia on the Moscow Stock Exchange, the St. Petersburg Stock Exchange, the Yekaterinburg Stock Exchange and the Siberian Stock Exchange. A non-resident cannot buy shares on these exchanges on its own; it has to use a broker who is a member of the exchange. Outside Russia, Gazprom shares are traded only in the form of American Depositary Shares on the London, Berlin and Frankfurt Stock Exchanges.

Under Presidential Decree No. 529 of 28 May 1997 and Government Resolution No. 654 of 30 May 1998, until such time as the privatisation of Gazprom is completed and the state disposes of all its shares in Gazprom (currently set at a minimum of 35 percent), foreign equity participation in Gazprom is limited to 9 percent of Gazprom shares. Shares acquired by foreign participants before the Decree came into force are not included in the aggregate amount of shares held by foreign participants. Those foreign participants who acquired Gazprom shares prior to Decree No. 529 hold and dispose of the shares on terms and conditions set for Russian legal persons. Presidential Decree No. 943 of 10 August 1998 authorised the sale of a further 5 percent of Gazprom shares to foreign shareholders, raising the total limit for foreign shareholdings to 14 per-

cent. Though there is no officially published information, it appears that foreign shareholdings (not including local shares held by foreign investors) currently account for around 11.5 percent of Gazprom shares.

Since the threshold on foreign participation emanates from presidential decree, it may only be raised by special Presidential Decree or by the passing of a new federal law.

Also Article 7 of the Federal Law on Gas Supply of 31 March 1999 No. 69- FZ states the share of Gazprom's equity held by foreign natural persons or legal entities should not exceed 20 percent of the charter capital of Gazprom. We consider that this limit is additional to, and not in substitution of, the 14 percent limit set by Presidential Decree No. 943.

Decree No. 529 states that "foreign participants" includes (i) "foreign nonresident participants" and (ii) "resident foreign participants", defined as follows:

- ! "Foreign non-resident participants" include inter alia, foreign citizens, legal entities created under foreign legislation state and subsidiaries and representative offices of such persons/entities;
- ! "Resident foreign participants" include commercial organizations created under Russian law in which at least 50 percent of the charter capital is owned by non-resident foreign participants; public associations and non-profit organizations on whose management or supervisory bodies more than one-third of its members are non-resident foreign participants; various investment funds and non-state pension funds whose management companies are at least 50 percent owned by nonresident foreign participants; and commercial organizations created under Russian law in which at least 50 percent of the charter capital is owned by resident foreign participants as well as subsidiaries and representative offices of resident foreign participants.

In order to acquire Gazprom shares or securities and other financial instruments whose underlying asset is Gazprom shares on Russian stock ex-

changes, resident and non-resident foreign participants must obtain permission from the Federal Securities Commission which may only be issued in accordance with a corresponding decision of the Government. We understand that very few such permissions have been granted.

In addition, permission of the Federal Securities Commission, issued in accordance with a Government decision is required for the "export" outside Russia of Gazprom shares or securities and other financial instruments whose underlying asset is Gazprom shares, or to transfer Gazprom shares into the trust of resident or non-resident foreign participants, or to use Gazprom shares as an underlying asset for the issue and placing of securities and other financial instruments to resident or non-resident foreign participants.

Finally, Gazprom shares acquired by resident or non-resident foreign participants or by Russian legal entities can be held only by organizations in which resident or non-resident foreign participants own less than 50 percent of the charter capital and which have a depositary license issued by the Federal Securities Commission.

Any transactions performed contrary to any of the above requirements are void.

There are a number of schemes which seek to avoid the restrictions on foreign ownership (commonly referred to as the "ring fence") by using a chain of Russian companies. Gazprom has in the past "attacked" certain investment structures implemented by foreign investors. In certain instances, schemes have been successfully defended against such attacks, though certain intermediaries have also been forced to withdraw plans to launch schemes facilitating investment by foreigners in "local" shares.

### **Prospects for reform**

President Putin has recently instituted a number of high-level changes in Gazprom. Following on from an election commitment to reform the natural monopolies, in 2001 he replaced the incumbent CEO with Alexei Miller, a move which was generally considered positive by investors. On Putin's instruction, in April 2001 a working group was established to develop proposals for the liberalisation of the trade in Gazprom "local" shares, to include the abolition of the ring-fencing of trade

in domestic shares. The immediate consequence was a sharp rise in the value of domestic shares.

The working group has not published its recommendations, however reports in the media suggest that reforms may be implemented in stages as follows:

- ! Full liberalisation of the domestic trade in Gazprom shares, removing current restrictions on the number of authorised depositaries and exchanges;
- ! The creation of a designated depositary for foreign participants in Gazprom shares and a procedure for purchase. This would include the removal of requirements for permission, except in relation to derivative instruments based on Gazprom shares. An upper limit of 20 percent on the number of shares to be held by foreigners, would, however, remain.
- ! Finally, there would be a total removal of restrictions on foreign ownership of Gazprom shares. □