

Buybacks of Russian Securities

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Given the economic uncertainties and in light of recent geopolitical events, Russian companies may consider their securities to be undervalued and may desire to explore potential buyback scenarios for their securities. Buybacks can serve a variety of purposes:

- Distributing excess cash to shareholders
- Providing a liquidity event to dissenting shareholders in connection with significant corporate events (including delistings)
- Allowing a company to acquire liquid securities at an attractive valuation for use in future M&A transactions or employee option programs.

A buyback can be launched relatively quickly, with lead times varying from a couple of weeks to two or three months, depending on the type of buyback. As with any other public transaction involving a large number of shareholders, it should be carefully executed to reduce the legal risks for the company and its management. Apart from Russian law requirements, a Russian company with U.S. or EU investors or a listing of depositary receipts (“DRs”) on a European exchange should also be mindful of U.S. and EU regulations related to buybacks.

In this note we summarize some of the key legal considerations for a buyback, with a particular focus on a company with a DR listing on the London Stock Exchange (the “LSE”).

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Types of Buybacks

Buybacks are usually conducted in one of two manners:

- **Tender offers**, where the company offers to buy from its shareholders a specified number of shares and/or DRs at a set price, which is announced at the outset of the buyback. In order to sell securities, a security holder needs to accept the offer by the end of a set period, which is also announced at the beginning of the transaction. The

company is required to buy all tendered securities, subject to potential proration and other terms and conditions.

- **Open market purchases (“OMPs”)**, where the company announces its intention to repurchase, usually through a broker, its securities on the stock exchange or over-the-counter market over a specified time period, which is usually longer than the acceptance period for tender offers.

For practical purposes, buybacks of Russian shares or DRs representing such shares are made by a non-Russian subsidiary of the issuer rather than by the issuer itself. There are a number of legal reasons for this approach:

- Russian law sets forth limited circumstances under which Russian companies may purchase their own shares, and such purchases are subject to very strict restrictions
- A Russian company can only purchase DRs if it has “qualified investor” status under Russian law and engages a Russian broker
- Recent changes to the Russian legislation make it very difficult for DR holders to participate in buybacks conducted by Russian issuers
- There is no prohibition under Russian law for a subsidiary holding shares of its Russian parent

Inside Information and Market Manipulation

Under Russian, UK and U.S. law, a company or any insider may not acquire securities while in possession of “inside information”—generally, material, nonpublic information about the company and its subsidiaries. As a rule, this means that a buyback should be commenced at a time when the company is not in possession of inside information; typically, it is safest to launch shortly following the company’s announcement of its annual or interim results.

In addition, purchases may not be made while in possession of inside information. If the company has any inside information at any time during a buyback, the company must disclose it or, in the case of an OMP, suspend purchases if a material event does arise that the company does not wish to disclose. In the case of an OMP that is being carried out by a broker under a binding contract entered into at a time when the purchaser was not in possession of inside information, giving the broker discretionary powers over the purchases, the buyback could proceed even if the purchaser is in possession of inside

information. In such a case, the purchases under the OMP program would be made within fixed parameters established by the purchaser and set forth in the trading plan entered into with the broker appointed, but with trading decisions within those parameters made independently of, and without influence by, the purchaser with regard to the timing and amount of the purchases.

In addition to insider trading considerations, purchases under a buyback program should be structured so as to ensure that they are not considered as manipulating the market for the shares or DRs being purchased. This is particularly relevant for OMPs that may include purchases on stock exchanges. For example, the EU Market Abuse Regulation (the “MAR”)¹ provides a safe harbor for buybacks of listed shares from certain market abuse offences, such as manipulating transactions. While this safe harbor is not strictly applicable to buybacks of DRs, companies with a DR listing on the LSE may want to look to the safe harbor requirements (which include price and volume limitations, as well as transaction announcement requirements) to reduce the risk that the buyback would violate the market abuse prohibitions on market manipulations.

Under Russian law, there is no specific safe harbor for OMPs carried out on stock exchanges. To reduce Russian risks of market manipulation, limiting the OMP to only over-the-counter purchases or including explicit instructions to the broker executing the buyback not to undertake any actions that may constitute market manipulation is recommended.

Disclosure

If the company’s DRs are listed on the LSE or another European market, the company is under an obligation under MAR to disclose all inside information promptly to the market. In addition, under the general anti-fraud requirements of Rule 10b-5 of the U.S. Securities Exchange Act of 1934 (“Rule 10b-5”), the purchaser and any person acting on its behalf must not trade on the basis of material, nonpublic information. Tender offers are usually made on the basis of a Tender Offer Memorandum at a time when all material information has been disclosed to the market. While an OMP is not typically carried out through a specific disclosure document such as this, disclosure of the authorization of the OMP and of purchases made thereunder is typically made.

In an OMP, the purchaser typically provides at least every seven days a report on the aggregate number of securities purchased back and the weighted average price per day and a breakdown per trading venue.

¹ Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014.

Russian disclosure rules are more detailed and include a long list of disclosable events. For example, if the buyback is carried out by a company's subsidiary, the company will be required to disclose, in the form of a material information announcement, information regarding: (i) the entry by the subsidiary into any agreement providing for the acquisition of shares or DRs; (ii) any acquisition by the subsidiary of shares or DRs; (iii) the acquisition by the subsidiary of 5, 10, 15, 20, 25, 30, 50, 75 or 95 % of the voting rights in the company (taken together with any other voting rights held by the company and its other controlled or otherwise connected persons); and (iv) the entry by the subsidiary into a transaction that would be considered a major transaction under Russian law (if the subsidiary is considered to be "material" in relation to the company).

Other Regulatory Matters

Depending on the number of securities to be acquired by the company, a number of other Russian regulatory requirements may also need to be considered, including antimonopoly requirements, strategic law requirements (if the issuer is a strategic company) and mandatory tender offer requirements (if the company seeks to acquire more than 30% of the issuer's share capital taking into account shareholdings of the company's affiliates).

U.S. Tender Offer Rules

If the Russian issuer has U.S. security holders, a buyback that is extended to such holders may be subject to additional U.S. legal requirements applicable to "tender offers" under U.S. law. There is no bright line for determining whether or not a buyback constitutes a "tender offer" under U.S. law; instead, this depends on such factors as the way the solicitation is being conducted, the amount of securities being bought back, the purchase price in relation to the market price, the terms of the offer (whether firm or negotiable) and the period during which the offer is open. An OMP would not typically be considered a tender offer subject to the U.S. requirements.

Tender offers involving purchases of securities that are not listed in the United States are subject to Regulation 14E under the Securities Exchange Act. The minimum requirements of Regulation 14E include:

- A requirement that the tender offer be open for no less than 20 U.S. business days from the date the tender offer is first published or sent to security holders, and no less than an additional 10 U.S. business days if there is an increase or decrease in the

percentage of securities being sought or the consideration offered or if the dealer's soliciting fee is changed (five U.S. business days for other material changes)

- Restrictions on transactions on the basis of material, nonpublic information
- A requirement that an acquirer must pay promptly following the expiration of the tender offer
- Prohibitions on the purchase of securities subject to the tender offer outside the tender offer from the date of the public announcement of the tender offer to its completion

The Exchange Act provides exemptions from some of these requirements depending on whether the Russian issuer qualifies for the so-called Tier I or Tier II exemptions, which are based on the number of shares or DRs held by U.S. shareholders in proportion to the total number of shares outstanding. Tender offers are exempt from most U.S. tender offer rules if 10% or less of the class of securities subject to the tender offer is owned by "U.S. persons" (Tier I), while more limited relief is provided if 40% or less of the class of securities subject to the tender offer is owned by "U.S. persons" (Tier II). In certain circumstances, a company may decide to comply fully with the requirements of Rule 14E and not calculate the number of U.S. holders of its securities. Any tender offer that is open to U.S. security holders is subject to the requirement that the offeror disclose all information to investors that may be material to their decision to sell the securities.

If, instead of complying with the U.S. tender offer requirements, the company prefers to exclude U.S. securityholders from the buyback, the company will need to make sure that strict guidelines are implemented to avoid triggering U.S. jurisdictional requirements.

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Please do not hesitate to contact us with any questions.

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