

Russian Federal Service for the Financial Markets to Relax Regulation on Depositary Receipts Programs

On July 21, 2011, the Russian Federal Service for the Financial Markets (the “FSFM”) published on its website a draft order introducing amendments (the “Amendments”) to the existing FSFM rules on issuance of permits for depositary receipt (“DR”) programs over shares of Russian issuers (“DR Permits”). For the Amendments to become effective, the FSFM will need to issue an adoptive order signed by the FSFM Chairman, the Ministry of Justice will need to register that FSFM order, and the official FSFM print media will need to publish the text of the Amendments. There is no current indication as to when the Amendments would be adopted, or whether they would be adopted in the form currently proposed.

The proposed changes under the Amendments are summarized in the table below:

Principal Limitations	Before the Amendments	After the Amendments
Requirement for prior FSFM permission?	Yes	Yes
Overall FSFM cap on a DR program	Generally 25% of the relevant share class	100% of the relevant share class
Mandatory tender offer rules for acquisitions above 30% relevant?	Yes	Yes
Special treatment of “strategic companies”?	Yes	Yes
Effective cap on a DR program	25% of share capital as a result of the FSFM cap or 5% if strategic subsoil company	30% of share capital as a result of the 30% mandatory tender offer rules or 25% if simple strategic company or 5% if strategic subsoil company

Principal Limitations	Before the Amendments	After the Amendments
Requirement for prior Russian listing of underlying shares?	Yes	Yes
Requirement for offering of shares in Russia?	Yes	No
Requisite ratio for shares offered in Russia v. shares sold outside Russia (in the form of DRs)	Yes, 50:50	None
Requirement for DR allocation report to FSFM?	Yes, within 30 days of closing of the offering	Yes, within 30 days of the first anniversary of the FSFM permission

It should be noted, as highlighted in bold in the table above, that even if the Amendments are implemented, each new DR program of a Russian issuer with any particular depository will be effectively capped at 30% until Russian state authorities issue clear guidance that depositories (who as a matter of Russian law are treated as shareholders of Russian companies) would not be required to extend a mandatory tender offer to all other shareholders as a result of acquiring more than 30% of the shares in a Russian company, as would otherwise be required under Russian corporate law.

We understand that the Amendments were developed by the FSFM in response to President Medvedev's proposal during the St. Petersburg Economic Forum in June this year to remove the existing limitations on Russian securities trading outside Russia. These proposals were later encapsulated in instructions from the President to the Russian Government, published on the President's website on July 1, 2011, to procure the removal, prior to September 1, 2011, of restrictions against Russian issuers placing securities outside Russia.

If adopted, the Amendments would streamline Russian regulation of DR programs for Russian issuers.

Key Elements of the Current Position

Currently the establishment of DR programs over shares of Russian issuers is subject to the following principal limitations:

1. to set up a DR program, the issuer and the DR depository first require a special permission from the FSFM;

2. there is a cap on the percentage of shares of a Russian issuer that can be deposited into a DR program (25% in practice for IPOs¹, and even lower limits for so-called “strategic” companies discussed below and in certain other cases²); and

3. an international offering of DRs must be accompanied by an offering of the underlying shares in Russia, and no more than half of the number of shares offered in Russia can be sold outside Russia in the form of DRs.

These last two restrictions have proven to be the most problematic in practice. Many public Russian companies would currently find themselves constrained if they tried to raise further capital in the equity markets because they have already reached the FSFM-imposed DR cap. They would therefore be limited to raising capital on the Russian domestic market in the underlying shares. The requirements described in paragraph (3) above have posed challenges particularly when demand for the DRs has exceeded the demand for the local shares, since Russian companies are not permitted by the current rules to reallocate any of the local share tranche into the DR tranche, potentially compromising the deal size.

As mentioned above, Russian legislation governing investments in strategic sectors (the “Foreign Strategic Investment Law” or “FSIL”) adopted in the spring of 2008 also needs to be taken into account. While there is no effective impact of being a simple strategic company³, the current cap on the percentage of shares of a Russian issuer that develops subsoil on “land plots of federal importance” (a “strategic subsoil company”) which can be deposited into a DR program is 5% and if a prior approval by the special commission of the Russian Government chaired by the Prime Minister (the “Special Commission”) is obtained, the cap can be increased to 25%. The procedure under the FSIL to increase the cap in this way requires the proposed foreign investor to submit an application to the Russian Federal Anti-Monopoly Service (the “FAS”), which acts as the administrator for the FSIL approval process. Given that a foreign investor in a capital markets context is unlikely to undertake

¹ The current cap on the percentage of shares of a Russian issuer that can be deposited into a DR program is 25% of the total issued shares of the same class of a Russian company if either: (i) its shares are included in the A list of a Russian stock exchange, or (ii) its shares are included in the B, V or I list of a Russian stock exchange and the depositary is incorporated in a country whose financial regulator has entered into a co-operation agreement with the FSFM.

² If the depositary is incorporated in a country whose financial regulator has not entered into an agreement with the FSFM (for example, the United States or the United Kingdom), the current cap on the percentage of shares of a Russian issuer that can be deposited into the DR program is: (i) 15%, if its shares are included in the B list of a Russian stock exchange, or (ii) 5%, if its shares are included on the V or I list of a Russian stock exchange. To date, the FSFM has entered into approximately 16 co-operation agreements, including with the BaFin in France, the AMF in France, the SEC in Cyprus, the CSSF in Luxembourg, the SEB in India and the CVM in Brazil.

³ By “simple strategic company”, we mean a strategic company other than a strategic subsoil company subject to more stringent requirements.

this application process, the FSIL imposes an effective limit on the size of DR programs for strategic subsoil companies of 5%.

Some commentators believe that the existing rules on foreign placements of securities have lead to Russian businesses establishing non-Russian holding companies, bypassing not only these rules but also complex Russian corporate laws.

Position if Amendments are Implemented

The Amendments represent a significant potential liberalization of rules applicable to offerings by Russian issuers and are described in more detail below.

1. Cap on Future DR Permits Generally Increased to 100%. If the Amendments are implemented, the general cap on the percentage of shares of a Russian issuer that can be deposited into a DR program would be increased to 100%, regardless of the level of listing obtained on the relevant Russian stock exchange, and regardless of where the DR depositary is incorporated⁴. Companies would therefore have greater flexibility to raise capital outside Russia and depositaries would be able to revert to the use of entities incorporated in jurisdictions most convenient to them.

The Amendments would retain the general cap of 5% for strategic subsoil companies and the 25% cap for other Russian companies deemed to be strategic to Russian interests under the FSIL would become relevant, unless in each case the Special Commission separately establishes a higher cap of 100% to match the FSFM cap. There have, however, been no announcements of changes that would allow such a strategic company or strategic subsoil company (rather than the foreign investor) to make the relevant FSIL application to the Special Commission. Furthermore, the broad definition of a “strategic company” under the FSIL has resulted in the probably inadvertent inclusion of companies that would not ordinarily be considered to be strategic to Russian interests, for example, dairy companies and cosmetics companies, which effectively extends the cases in which the 25% cap would continue to apply.

In addition, it is unclear what interplay between the two regulatory regimes is envisaged or what the procedure for seeking a higher cap on the DR program for a strategic company would be. Finally, we do not believe that the proposed amendments would automatically raise DR limits already granted by the FSFM for existing public companies. It is conceivable that, following adoption of the Amendments, the FSFM would be flooded by applications from Russian issuers with existing DR programs to increase the relevant limits.

2. No More Requirement for Local Share Tranche. The Amendments would remove the following key requirements relating to the mandatory offering of local shares in

⁴ It is unclear whether the FSFM would issue DR Permits for less than the 100% cap under the proposed regime.

Russia: (a) the general requirement for international offerings of DRs to be accompanied by offerings of the underlying shares in Russia; and (b) the requirement to involve a Russian stock exchange or a Russian broker in an offering that has a DR tranche.

3. No More 50 / 50 Rule in Allocation of DRs. The Amendments would remove the requirement that no more than half of the number of shares offered in Russia can be sold outside Russia in the form of DRs, as well as corresponding limitations on the pricing, payment and delivery requirements for the local shares. While Russian law requires that all primary shares be sold at the same price, following the adoption of the Amendments, there would be no such limitations for secondary shares. Given that local shares sometimes trade at significant discounts to DRs over those shares, selling shareholders may wish to reflect these differences in their offerings of shares and DRs. The Amendments would seem to allow secondary shares to be sold in Russia at a discount to the price of DRs sold internationally.

4. Relaxed Requirements for DR Allocation Report. The Amendments would require the report on the creation of the DR program to be submitted within 30 days of the first anniversary of the date of issuance of the DR permit by the FSFM, rather than within 30 days from the closing of the offering, as is currently the case. The Amendments would not require the issuers to indicate the amount of local shares made available in the offering but would largely be limited to reporting the size of the DR program established following the offering.

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Please feel free to contact your usual contacts at Cleary Gottlieb, or any of the authors of this memorandum – Raj S. Panasar, Murat N. Akuyev and Ekaterina A. Abrossimova, should you have any questions in connection with the above.

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