

## THE PROGRESS OF PRIVATIZATION AND THE SITUATION IN REGARD OF OWNERSHIP RELATIONS IN 2013

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*The most important event of 2013 was the approval of the Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016. Its most significant distinctive feature, in which it differs from the previously issued document of the same type, was the introduction of some serious alterations to the privatization plans for biggest companies. The list of assets earmarked for privatization remained essentially the same as before. However, in contrast to the privatization program for the period of 2011–2013, the reduction of state participation in the capital of many biggest companies will by no means imply that the government is going to lose the right of corporate control, or at least the possibility to influence corporate governance procedures. The aggregate volume of federal budget revenue generated by privatization (or sale) transactions and use of state property in 2013 will drop on the previous year by nearly one-third, and by more than half when adjusted by the amount of revenue generated in 2012 by the RF Central Bank (the Bank of Russia) from the sale of a stake in Sberbank. Nevertheless, the revenue figure for 2012 in this budget item was the third highest since the early 2000s following the record high of 2012 and the 2011 indices.*

The year 2013 saw the sales of blocks of shares (or stakes in charter capital) in a total of 148 economic societies (less two sales of shares with the aid of investment consultants) (vs. 265 units in 2012); 33 federal state unitary enterprises (FSUEs) were reorganized into open-end joint-stock companies (OJSCs) (vs. 103 units in 2012).

On the whole, over the period of implementation of the first three-year privatization program, the number of sold stakes in companies' capital (or equity shares) (730 units) increased more than 1.8 times on the crisis period 2008–2010. At the same time, that number turned out to be roughly equivalent to the aggregate index for the two pre-crisis years (2006–2007), while falling short of the corresponding indices for the mid-2000s, when blocks of shares were being sold at a rate above 500 units per annum. The results achieved in the framework of the privatization program with regard to unitary enterprises appear to be more modest: the number of FSUEs, in respect of which the RF Federal Agency for State Property Management (*Rosimushchestvo*) over the period 2011–2013 issued regulations concerning the terms of their privatization via reorganization into open-end joint-stock companies (216 units, of which a total of 182 OJSCs were registered: in 2011 – 46 units; in 2012 – 103 units; in 2013 – 33 units), amounts to approximately one-third of the corresponding index's value for the period 2008–2010.

The distinctive feature of the privatization deals that took place last year, as well as of all those completed over the course of the three-year privatization program, was the sale of federal blocks of shares through private sellers appointed by the government

(in the main investment banks) in accordance with the alterations introduced to the existing privatization law in the spring of 2010. Throughout the course of 2013, a total of 6 transactions with shares in biggest joint-stock companies, to the total value of Rb 286bn, were completed with the aid of investment consultants in accordance with the RF Government's decisions, whereas in the government program '*Federal Property Management*', approved by the RF Government's Regulation of 16 February 2013, No 191-r, it is stated that no less than 4 sales of big entities with high investment potential should be completed every year via public offers of shares; these entities are to be picked out from among those earmarked for sale in the course of that year on the basis of the RF President's or the RF Government's decisions (stock exchange transactions and strategic sales).

The most significant in their scope (to the value of more than Rb 100bn) were the following 2 quasi-privatization deals:

- the sale of 5.66% of shares in OJSC 'Oil Company Rosneft', to the total value of Rb 148.1bn, in favor of *BP* in the framework of purchase of shares in *TNK-BP*, as a result of which the monies generated by the privatization of shares in OJSC 'Oil Company Rosneft' were entered into the balance sheet of OJSC *Rosneftegaz*, whose sole founder is the Russian Federation (the consultants in this transaction being *Citigroup*, *Bank of America Merrill Lynch*);

- the placement, through an open subscription, of an additional issue of shares in OJSC *VTB Bank* to the total value of Rb 102.5bn, as a result of which the government's share in its capital shrank from 75.5% to 60.93% (the organizers of that transaction being *Close-*

end Joint-Stock Company (CJSC) *VTB Capital, Citigroup, J.P. Morgan, and Bank of America Merrill Lynch*.

The placement that deserves special mention is that of shares in Joint-stock Company *Alrosa* carried out by means of a public offer to a broad range of potential investors in accordance with international standards (the organizer of that transaction being *Goldman Sachs, Inc.*). In the course of trading on the MICEX, the offer included 7% of shares in JSC *Alrosa* (in federal ownership), 7% of shares owned by the Republic of Sakha (Yakutia), and 2% of quasi-treasury shares controlled by the company itself (a total of 16%), to the total value of Rb 41.3bn, including Rb 18bn paid for the alienation of federal right of ownership to the 7%-stake.

A more standard procedure was also applied to the sale of federal stakes in the following companies:

– OJSC *Vanino Commercial Sea Port* (55% in the company's charter capital, to the total value of Rb 15.5bn, the organizer of the transaction was CJSC *VTB Capital*, the buyer was LLC *Mechel-Trans*<sup>1</sup>);

– OJSC *Siberia Airlines* (25.5% in the company's charter capital, to the value of Rb 1,133bn, the organizer of the transaction was OJSC Alfa Bank, the buyer – CJSC C 7 Group);

– OJSC *Territorial Generating Company No 5 (TGK-5)* (25.1% in the company's charter capital to the value of Rb 1,080bn, the organizer of the transaction was CJSC *VTB Capital*, the buyer – OJSC *TGK-9*).

By way of a general overview of the transactions with stakes in biggest companies completed in 2013 it can be noted that, in contrast to the two previous years, their structure was dominated, in terms of volume, by those deals that yielded nothing directly to the budget (an additional issue of shares in *VTB*; the sale of block of shares in *Rosneft* as part of a deal with *TNK-BP*), whereas only one such deal out of a total of seven was concluded in 2011–2012 (an additional issue of shares in the *United Grain Company* (UGC) in 2012 to the value of Rb 5.951bn). The proportional distribution of proceeds from privatization deals had also changed. While in the period 2011–2012 only about 2% out of the total sum of Rb 299bn was yielded by deals that had no direct effect on the budget, in 2013 their share amounted to 87.5%. As a result, over the entire three-year period (2011–2013) deals of that type accounted for about 44% of the aggregate volume of all the 13 deals with shares in biggest Russian companies with state participation.

The process of sale of state-owned blocks of shares was joined, in 2013, by the OJSC 'Auction House of the Russian Federation' (OJSC *RAD*) which, in accordance with the regulation of the RF Government of 31 January 2013, No 101-r and in the framework of the agency agreement concluded with *Rosimushchestvo* performs the functions of seller of stakes in 36 OJSCs listed in last year's privatization program. Of these, the RAH has successfully completed 15 sales, which will yield a total of Rb 1,967.8m in the form of federal budget revenues – a sum comparable with the aggregate value of sales of blocking stakes in *TGK-5* and OJSC *Siberia Airlines* (Rb 2,213.5m), concluded with the aid of investment consultants. As for the use of traditional privatization instruments, the biggest deal where these were applied was the auction held by *Rosimushchestvo* in order to sell the entire stake (100%) held by the State in JSC *MOSKINAP* to the total value of Rb 935m.

The aggregate volume of federal budget revenue generated by privatization (or sale) and use of state property in 2013 shrank on the previous year by nearly third, and by more than half including the proceeds received in 2012 by the RF Central Bank from the sale of a stake in *Sberbank* (Table 1). Nevertheless, in absolute terms, this index (approximately Rb 209bn) was third highest since the early 2000s after the record high of 2012 and the index for 2011.

The ratio between non-renewable and renewable sources in the structure of aggregate revenues generated by privatization (or sale) and use of state property in 2013 is roughly comparable with the corresponding indices for 2012, if the proceeds from sale of a stake in *Sberbank* are not taken into account.

However, if we look at the results of that deal, it will become evident that the share of non-renewable sources in the structure of aggregate revenues yielded by privatization (or sale) and use of state property in 2013 nearly halved on 2012 (shrinking to 26.4%), thus reaching its 2001 level – which is still somewhat above the index for 2010. The share of revenues generated by the use of state property, on the contrary, increased from nearly 49% to 73.6% in 2012. In absolute terms this result falls short only of the yield of the year 2012, being 1.5 times higher than the index for 2011, while the amount of revenues from property privatization (or sale) turned out to be approximately 2.5 times lower than in 2011, falling also below the indices for 2003–2004.

Beside privatization, the ownership relations in this country were rather strongly influenced, over the course of last year, by the transactions on the corporate control market involving *Rosneft* (the finalization of the already mentioned purchase of *THK-BP*; the takeover of the gas company *Itera*; the agreement on

1 As a matter of fact, the official conclusion of that deal (which soon evolved into an open scandal because the buyer of the former state stake – LLC *Mechel-Trans* – resold almost the entire stake to offshore companies) falls within the timeframe of the calendar year 2013.

Table 1

## THE STRUCTURE OF PROPERTY-GENERATED FEDERAL BUDGET REVENUES FROM VARIOUS SOURCES, 2000–2013

| Year | Aggregate revenue generated by privatization (or sale) and use of state property |            | Privatization-generated revenues (non-renewable sources) |                | Revenues generated by use of state property (renewable sources) |                |
|------|--|------------|--|----------------|---|----------------|
|      | millions of rubles   | % of total | millions of rubles                                       | % of total     | millions of rubles  | % of total     |
| 2000 | 50,412.3   | 100.0      | 27,167.8   | 53.9           | 23,244.5  | 46.1           |
| 2001 | 39,549.8   | 100.0      | 10,307.9   | 26.1           | 29,241.9  | 73.9           |
| 2002 | 46,811.3   | 100.0      | 10,448.9   | 22.3           | 36,362.4  | 77.7           |
| 2003 | 135,338.7  | 100.0      | 94,077.6   | 69.5           | 41,261.1  | 30.5           |
| 2004 | 120,798.0  | 100.0      | 70,548.1   | 58.4           | 50,249.9  | 41.6           |
| 2005 | 97,357.4   | 100.0      | 41,254.2   | 42.4           | 56,103.2  | 57.6           |
| 2006 | 93,899.8   | 100.0      | 24,726.4   | 26.3           | 69,173.4  | 73.7           |
| 2007 | 105,761.25   | 100.0      | 25,429.4   | 24.0           | 80,331.85   | 76.0           |
| 2008 | 88,661.7   | 100.0      | 12,395.0   | 14.0           | 76,266.7  | 86.0           |
| 2009 | 36,393.7   | 100.0      | 4,544.1  | 12.5           | 31,849.6  | 87.5           |
| 2010 | 88,406.4   | 100.0      | 18,677.6   | 21.1           | 69,728.8  | 78.9           |
| 2011 | 240,964.1  | 100.0      | 136,660.1  | 56.7           | 104,304.0   | 43.3           |
| 2012 | 309,943.2/<br>469,243.2*   | 100.0      | 80,978.7/<br>240,278.7*                                  | 26.1/<br>51.2* | 228,964.5   | 73.9/<br>48.8* |
| 2013 | 208,974.05   | 100.0      | 55,198.5   | 26.4           | 153,775.55  | 73.6           |

\* including the proceeds received by the RF Central Bank as a result of sale of a stake in *Sberbank* (Rb 159.3bn), which is probably an overestimation of the actual aggregate share of non-renewable sources, as the budget did not receive that sum in full but minus those sources' balance sheet value and the costs of the sale of that stake. Consequently, the share of renewable sources is, on the contrary, somewhat underestimated.

Source: Laws on the federal budget execution adopted in 2000–2012; *Report on the Execution of the Federal Budget As of 1 January 2014*, www.roskazna.ru; authors' calculations.

the exchange of gas assets with *Novatek*), as well as the decisions pertaining to restructuring the aerospace industry similarly to the scenarios previously applied in the aircraft-building and shipbuilding industries – that is, by means of establishing the '*United Aerospace Corporation*'. One notable development in the power engineering industry was the permission granted to OJSC *ROSSETI*, or Russian Grids<sup>1</sup> to increase its charter capital by means of an additional issue of shares; at the same time, the government corporate control threshold (which had been fixed for that company because it is on the list of strategic joint-stock companies) was to be raised to 61.7% (previously – 54.5%). However, the size of the block of shares in OJSC *Federal Grid Company of the Unified Energy System (FSK UES)* earmarked for inclusion in the charter capital of *Russian Grids* was increased by only 0.09% (from 79.55% to 79.64%). Generally speaking, the formation of vertically integrated structures (VIS) remained one of important directions of government policy in the sphere of ownership relations. Over the period 2011–2013, this aspect of the three-year privatization program's implementation involved decisions with regard to the terms of privatization of 148 FSUEs and stakes in 85 OJSCs;

1 Formerly the Interregional Distribution Grid Companies Holding (IDGC Holding).

and finalization of the measures designed to establish 34 vertically integrated structures (or more than 3/4 of the total number of those mapped in accordance with the government's decisions).

Many activities were under way in connection with the implementation of the Government Program *Federal Property Management*, approved by regulation of the RF Government, of 16 February 2013, No 191-r.

Among notable developments relating to the program's normative backing, we should point out the approval of the Methodological Recommendations for determining the targeted uses, by institutions operating under the jurisdiction of federal bodies of state authority, of federal property entities consolidated by right of economic jurisdiction or operative management to federal state unitary enterprises (FSUEs), federal treasury enterprises (FTE), federal budget-funded institutions (FBI), federal treasury institutions (FTI), federal autonomous institutions (FAIs); the development of a Methodology for determining the specific categories of assets owned by state-owned companies depending on their core types of activity; the development of Methodological Recommendations for organizing the operation of the board of directors of a joint-stock company with a state stake, as well as for organizing the auditing activity of the audit (or revisi-

sion) commission of such a company. The Methodological instructions for state-owned companies as to how to apply the key performance indicators in estimating their operation are still in the phase of elaboration. In the managerial bodies of joint-stock companies with state stakes, civil servants continued to be replaced by professional managers. Thus, the number of this type of personnel in the boards of directors of the OJSC entered on the special list declined from 141 to 122.

According to data released by *Rosimushchestvo*, almost all of the targets for 2013 set by the aforesaid Government Program had been met by the year's end; and the results achieved with regard to the functions of federal property entities as applied to FSUEs, economic societies with state stakes, and treasury-owned entities were significantly higher than the planned targets. The same is true of the indices describing achievements in the fields of information technologies, record-keeping and monitoring. Thus, the share of government services rendered electronically surged to 40% vs. the target of 10% set for the year 2013; and the share of federal property entities entered in the State register (as a percentage of the total number of entities that have been identified as those to be entered in the register) rose above 96% vs. the target of 70%.

According to *Rosimushchestvo*, as of 15 April 2014 in the Government Program's framework, a total of 1,618,067 property entities were entered into registers, which represents a rise of 10% (or by 146.3 thousand) on 1 January 2013 (1,471,782 property entities). State property owned at the federal level is represented by 2,049 economic societies (OJSCs, CJSCs, LLCs) and 1,785 FSUEs (including treasury enterprises) vs. 2,337 JSCs and 1,795 unitary enterprises as of early 2013, as stated in the new privatization program for 2014–2016.

The approval of the *Forecast Plan (Program) of Federal Property Privatization and the Main Directions of Federal Property Privatization for 2014–2016* by the RF Government's regulation No 1111-r of 1 July 2013 was one of last year's most important events.

The most significant feature in which the content of the current program differs from its predecessor is the fundamental change in the privatization plans of biggest companies. The list of assets earmarked for privatization has remained essentially the same. It no longer contains OJSC *Rosselkhozbank*, OJSC *Rosagroleasing* and OJSC *FGC UES*, and it has been augmented by OJSC *Rosnano*, *Rosspirtprom*, *Rostelecom*, the State Transport Leasing Company, and two Moscow airports. However, in contrast to the privatization program for 2011–2013 as amended in 2012, the reduction of the State's participation in the capital of many biggest

companies implies that the State will still retain the function of corporate control, or at least the possibility to influence the corporate governance procedures.

For JSC *Alrosa*, OJSC *Aeroflot – Russian Airlines*, and *Sovcomflot (Seaborne Energy Solutions)*, the floor for state participation is set at 25% + 1 share; for 'Rusgidro', Bank VTB, Zarubezhneft, the United Aircraft-building Corporation – at 50% + 1 share; for *Russian Railways*, *Transneft*, *Uralvagonzavod*, the State Transport Leasing Company, and the United Shipbuilding Corporation – at 75% + 1 share. In some cases, the period for reducing the size of state stakes to match these floor indices extends far beyond 2016.

It is planned that the participation of OJSC *Rosneftegaz* in the charter capital of *Rosneft* should be reduced to 50% + 1 share by 2016. As for the possible shrinkage of the government's stake in OJSC *Bank VTB* to less than 50% + 1 share, the program proclaims that this will be done in coordination with the measures designed to likewise reduce the government's stake in OJSC *Sberbank of Russia*, although the new head of the RF Central Bank, Elvira Nabiullina, later said that the Bank was not planning to reduce the State's participation in the charter capital of *Sberbank*.

The government declared its plans to withdraw, in 2014–2016, from the capital of 7 companies (*Rosspirtprom*, *United Grain Company (UGC)*, *Rosnano*, *Rostelecom*, *Sheremetyevo International Airport*, *Vnukovo Airport*, and *Vnukovo International Airport*). Such prospects are bound to raise some questions for every one of these companies. Questions will be even more likely because the privatization program offers no basic quantitative targets for the proceeds from privatization of stakes in biggest companies with high investment attractiveness indexes.

The previous privatization program did contain an estimated target of Rb 1 trillion, to result from potential revenues generated in an event of sale of shares in biggest companies by special decisions adopted by the RF Government. However, as evident from the budgetary documentation for those three years whilst the privatization program for 2011–2013 was being implemented, the total sum of federal budget revenue generated by sales of shares and other forms of participation in companies' capital turns out to be 2.7 times less than the said planned target (approximately Rb 371bn<sup>1</sup>). At the same time, this figure many times over exceeds the revenue estimates put forth in the programme for 2011–2013 (which did not include the main proceeds from privatization of stakes in big-

1 Including the proceeds received by the RF Central Bank from the sale of shares in *Sberbank* in 2012. Naturally, when revenues from the sale of other assets (land and other property) are added to the privatization revenues, their sum increases.



gest companies with high investment attractiveness indexes: Rb 6bn for 2011, Rb 5bn for 2012 and Rb 5bn for 2013, which yields a total of Rb 16bn. In the new privatization program for 2014–2016 the target for this type of revenue is set at Rb 3bn per annum. The possibilities for its actual implementation will strongly depend on the macroeconomic situation in this country (consider, for example, the threat of recession) and the situation on the stock market, especially in view of the economic and political background observed in Q1 2014.

Among practical solutions, we may note the RF Government's decision, made in January 2014, to sell its stakes in OJSC Inter RAO EES (13.76% of shares) and OJSC *Arkhangelsk Trawl Fleet* (100% of shares) to the total value of more than Rb 21bn. The preparatory work for the effectuation of these deals was completed in 2012–2013.

The buyer in the first deal will be OJSC *Rosneftegaz* which may, in accordance with the norms stipulated in the previous and current privatization programs, until 2015 act as an investor in those companies in the fuel and energy complex, whose blocks of shares have been earmarked for privatization, on condition that OJSC *Rosneftegaz* supplied a proper program for the financial backing of such transactions provided by dividends paid on the shares in commercial companies held by OJSC *Rosneftegaz*.

The second deal may serve as the first example of a non-standard approach realized in the framework of the privatization process in its contemporary phase. Its distinctive feature is the special format of interaction between the new owner (LLC *Virma*) and regional authorities on the basis of an agreement whereby a gratis transfer of 1 share into the ownership of Arkhan-

gelsk Oblast is envisaged. All key decisions, including the preservation of existing jobs, the OJSC's registration in the region's territory in order to maintain the inflow of tax-generated revenues into the regional budget, are to be coordinated with the Arkhangelsk Oblast's government, whose representative will be assigned a seat in the OJSC's board of directors.

The conclusion of a shareholder agreement between Arkhangelsk Oblast and LLC *Virma* is a unique example of the post-privatization control mechanism in operation, whereby it becomes possible, among other things, to ensure a proper balance of interests between the State represented by Arkhangelsk Oblast, on the one hand, and the new asset owner on the other, in the field of social liabilities and business promotion.

At the same time, the situation has inevitably given rise to questions as to the possible incompatibility of such instruments with the existing broader legal norms, in particular with corporate legislation (the role of the single share transferred to the oblast's government in comparison with the powers embodied in the special right to participate in a company's management granted by 'golden share'); or the sufficiency of the existing agreement for avoiding possible conflicts in the future, for example in the event of resale, by LLC *Virma*, of its stake in *Arkhangelsk Trawl Fleet*, in full or in part to a third party; and also on how well the lessons from the negative experiences from the calamitous investment tenders of the 1990s have been learned and incorporated in the agreement's provisions. Same is true of the lessons from the commercial tenders with mandatory social orientation held in accordance with the existing privatization law (third) in the 2000s. ●