

NEW AMENDMENTS TO RUSSIA'S PRIVATIZATION LEGISLATION: COSMETIC MEASURES OR FURTHER DEREGULATION?

N.Malginov, A.Radygin

Analysis of recent updates to the Russian privatization legislation in 2015 allows saying that the 2015 amendments as a whole aim to boost the process of privatization. The suggested enhancements for the information system of privatization of government-owned and municipal property and for the mechanism of selling such property are intended to render the entire privatization process more transparent while counteracting occurrences of corruption and criminality. It has not gone unnoticed that the practice of narrowing the scope of the privatization legislation continues. Since the legislation came into force late in 2001, the number of property categories whose disposal goes beyond the scope of the provisions thereof has nearly doubled (to 20 from 11), some of which have been given a broader interpretation. The next few years will show what kind of effect the potential of the foregoing amendments has on the effectiveness of this process, bearing in mind the contribution to meeting the federal budget deficit and generating budget revenues at other levels of public authority.

Russia has recently laid a solid ground for the advancement towards establishing an efficient system of managing public property and privatization.

The key policy documents in regard thereto are a forecast plan (program) of the privatization of federal property and the main guidelines for the privatization of federal property in 2014–2016, which was approved by the Russian government executive order No. 1111-p of 1 July 2013, and the State Program “Federal Property Management” until 2018, which was approved by the Russian government executive order No. 327 of 15 April 2014¹.

In practice, this implies that the list of strategic entities will shrink more than half its original size, approximate dates and custom-tailored privatization schemes for a few largest companies and banks will be set, federal state unitary enterprises will begin to prepare their development strategies, public employees will be gradually replaced with professional directors of management and supervision bodies of companies with state participation, and state-run corporations will face a tighter operating regime.

Many practical measures basically aim to enhance the privatization regulation pursuant to the amendments to the Privatization of Federal and Municipal Property Act of 21 December 2001 (No. 178-FZ). As a reminder, the major package of amendments to the Act was introduced in 2010², which, among other things, extended the period of the forecast privatization plan (program) to three years, allowed taking individual decisions at the Russian government level on the terms of privatization of specific assets, allowed legal entities to act as the seller, permitted electronic sales, reduced the amount of the deposit required for bidding at auction and tender sales, promoted

1 In replacement for the similarly titled state program approved by the Russian government executive order of 16 February 2013, No. 191-p, which stood in force for about 14 months.

2 No essential amendments were introduced to the applicable Privatization Act in the period between its effective date (26 April 2002) and the spring of 2010.

the development of a public offering sales scheme (the so-called Dutch auction), expanded the transparency requirements to privatization procedures by posting respective information on official websites in addition to official printed media publication and via some other media¹.

In 2011–2014, amendments to the Act were less critical. They extended the list of methods whereby federal state unitary enterprises may be transformed into limited liability companies (LLC) and non-profit organizations (NPO)), set specific terms and conditions for privatizing certain categories of assets (socio-cultural and utility facilities, concessionary agreement and cultural heritage), updated some provisions that govern the sales mechanism of auctions, tenders and public offering, clarified the requirements to the privatization information system and transparency, including the presentation of documents by bidders, a refund procedure for invalid transactions, and the protection of public ownership, etc.².

Active enhancement of the privatization legislation continued last year. Five federal acts, which were adopted in April, June, July and December 2015, introduced an array of new updates and amendments to the applicable Privatization Act 2001.

First, the term “open joint-stock companies” was replaced with “joint-stock companies” across the entire text thereof. The replacement was necessitated after amendments to Part 1 of the Civil Code of Russia came into force on 1 September 2014. The amendments, which were introduced by the Act of 5 May 2014 (No. 99-FZ), abolished the differentiation of closed and open joint-stock companies, defined public joint-stock companies whose shares and convertible securities are offered publicly (by public subscription) or publicly traded under the provisions set forth in securities acts³. The old version of the Act provided a privatization method whereby federal state unitary enterprises may be transformed (go private) only into open joint-stock companies (OJSC) and later – since 2011 – into limited liability companies (LLC).

Another update to the basic conceptual framework was clarification of the definition of the fee basis as a basic concept of privatization (Article 2). The old version interpreted this as disposal by paying a fee or by transferring the stockholding in JSCs to the federal government state or municipalities whose property is contributed to the charter capital of JSCs. The new updated version contains a new provision on the transfer of shares, interest in the charter capital of business entities that were established by incorporating federal state and municipal unitary enterprises. The exact reason behind this is obscure because, after all, the same practice was in place before the update was introduced. Perhaps the goal was to link the incorporation of federal state unitary enterprises to the legal framework and the mechanism of the privatization process as a whole.

1 For more details, please refer to Kuzyk M., Malginov, Radygin A., Simachev Y., Shmeleva N. Public sector and a new privatization policy // Russian economy in 2010. Trends and Outlooks (Issue 32). M., Gaidar Institute 2011, pp. 436–445.

2 For more details, please refer to Malginov, Radygin A. The state of the public sector and privatization // Russian economy in 2011. Trends and Outlooks (Issue 33). M., Gaidar Institute 2012, pp. 423–430; Malginov, Radygin A. The state of the public sector and privatization // Russian economy in 2013. Trends and Outlooks (Issue 35). M., Gaidar Institute 2014, pp. 403–404; Malginov, Radygin A. The state of the public sector and privatization // Russian economy in 2014. Trends and Outlooks (Issue 36). M., Gaidar Institute 2015, pp. 389–393.

3 The public company rules are also applied to joint-stock companies whose charter and trade name indicate that they are public companies.

Second, 20 more categories were added to the segment of property that goes beyond the scope of the Privatization Act (Article 3).

In 2015, the segment was extended with securities that are traded on-exchange under the Act of 21 November 2011 (No. 325-FZ) and on the basis of the decisions of the Russian government. As a result, on-exchange trading of shares in OJSCs was removed from the set of eligible methods of privatization (the original version reads “through the securities market operator”). It is appropriate at this point to recall that the previous removal, late in 2014, was applied to the property whose title is transferred to the management company as government’s asset contribution (also at the regional and municipal levels) as set forth in the Act of 29 December 2014 (No. 473-FZ), “On the territories of advanced socio-economic development in the Russian Federation”.

Additionally, the Act provides a broad definition of three other categories of property that go beyond the scope of the Framework Privatization Act.

Other NPOs were added to state-run corporations (SRC) and non-profit organizations (NPO) that are established by transformation of federal state unitary enterprises and agencies. Regions and municipalities, besides the Russian Federation, were specifically defined as agents eligible for making asset contributions thereto.

The category of joint-stock company (JSC), as well as securities convertible into JSC shares if repurchased under the Joint-Stock Companies Act 1995 (Article 84.8), was updated by adding stocks and securities that are governed by two other provisions thereof (Articles 84.2 and 84.7).

The former deals with the compulsory offer to purchase shares as well as other issue-grade securities convertible into the shares in a public company by a person who acquires more than 30% of the equity (including affiliated persons). The latter requires that the person who acquires more than 95% of the public company’s equity repurchase from other shareholders the rest of the shares as well as the issue-grade securities convertible into the shares in the public company, as requested by their shareholders.

A federal property that is disposed by Russian government’s decisions in order to create conditions for attracting investment, promoting the stock market development as well as modernization and techno-economic development, was updated by adding a property that is disposed in order to develop small and medium-sized entrepreneurship, which includes the activity carried out by JSC Federal Corporation for the Development of Small and Medium-Sized Enterprises under a special-purpose Act 2007 (No. 209-FZ) as institution for the development of small and medium-sized entrepreneurship. This becomes a second provision which links it with the Privatization Act. In 2008, it was updated by adding a provision which describes the procedure whereby small and medium-sized business entities may be involved in the privatization of leased immovable property owned by regions and municipalities.

Additionally, a new provision was introduced within the jurisdiction of the Privatization Act, which leaves room in the Fundamentals of Notary Legislation of the Russian Federation 1993 for setting specific terms for the involvement of notaries and notarial chambers in the privatization of regional and municipal property by auction or tender.

The provisions thereof that govern the terms of privatization of various government-owned assets due to the establishment of ROSCOSMOS Russian

Federal Space Agency, a new state-run corporation, under the respective special-purpose Act of 13 July 2015 (No. 215-FZ) are similar to those removed from the Privatization Act. Here one can see a similarity to the previous updates to the Privatization Act, which concern the incorporation of railroad transport (2003), the establishment of ROSATOM State Atomic Energy Corporation and Rostec Corporation (2007).

Third, the information system of privatization (Article 15) saw important updates.

The information system of privatization is now reduced to posting on official websites privatization programs and progress reports at all levels of public authority, decisions on the terms of privatization of government-owned and municipal property, property sales announcements and final results of such sales.

All reference to other information channels (mass media publications including official print media publications, and public domain information systems including info-communication networks) were deleted from the text thereof. Accordingly, the term “publications” was replaced with “posting information on websites” across the entire text thereof, and all reference to official media publication were deleted from the text thereof.

Posting a privatized property sales announcement (not less than 30 days before the scheduled sales date) was updated by adding a requirement for posting the decision on the terms of privatization within 10 days after the date of such decision.

The information which must be included into the privatization decision was updated by adding document execution requirements and the data on all the previous tender/auction sales at which such property was tendered, which were announced during the year preceding the sales thereof, and of the results of such tender/auction sales.

The following information was added to the former 5-point set of information required for selling shares in a joint-stock company and stakes in a limited liability company: (1) the URL of the website which contains annual and progress accounting (financial) reports of a business entity as set forth in newly introduced Article 10.1 thereof, (2) the size of the land plot/plots on which the immovable property of a business entity is located, (3) business entity's staff headcount, (4) the size and the list of business entity's objects of immovable property, including all the existing encumbrances and the encumbrances established during the privatization of such objects of immovable property, (5) information of the tender/auction sales of such property within a year preceding the sales date, which failed, were cancelled, held invalid, including a respective reason (lack of bids, a single bidder, other reasons). Such information was previously available in a special clause thereof, which contained the requirements to the announcement of sales of tendered government-owned and municipal property, which is posted on websites.

Second, the deadline for posting information on the results of privatization transactions on websites was shortened (to 10 from 30 days), and the format of presenting such information changed too.

The relevant information (description of the property and seller's name, tender/auction date and location, price of the deal, buyer's name (the successful bidder)) was updated by adding the tender/auction time, as well as the name of a natural person or a legal entity – the highest bidder, except the successful bid (in the case of sealed bidding) or the second to last bid (in the

case of open bidding). The latter replaces the data on the quantity of bids and eligible bidders, which was removed from the list.

Fourth, an array of legislative amendments concerned the privatization planning and procedure, with most of them being related to the development of technological support of management processes.

The scope of the government's competence (Article 6) was enlarged by allowing it to approve a list of legal persons for the purpose of electronic sales of government-owned and municipal property.

A direct reference to electronic sales was introduced on page 15 (Article 32.1), which concerns the privatization information system. Furthermore, the provision which stipulates that records shall be taken of electronic sales no longer requires posting the results on the official website which was used for such sales during the day which follows the date of such records.

The provision thereof which requires that the government submit to the State Duma (the lower house of parliament) a report on the past year results of the privatization of federal property was extended by adding the requirement that the report be simultaneously posted on the official website (Article 9).

The Act was updated by introducing a new article (Article 10.1) which requires that federal state unitary enterprises, JSCs and LLCs eligible for privatization programs present authorized agencies at all levels of public authority with annual and progress accounting (financial) reports within 30 days of the final date of the accounting period and post the information provided in such reports on the official websites designated by public authorities.

An essential update was introduced with regard to the pricing of privatized property (Article 12). The wording which reads that the starting price shall be set subject to Russia's appraisal legislation is now limited to the duration of the period between the date of property appraisal report and the date of posting on the website the announcement of sales of government-owned or municipal property (within six months).

Fifth, the mechanism of a series of privatization methods was updated.

Regarding auction sales, the period for accepting bidder applications for participation in auction sales remained unchanged (at least 25 days) and a period between the final date of accepting such applications and the date of qualifying applicants as bidders were set (within 5 working days). The period between the auction date and the date of qualifying applicants as bidders was reduced by more than three times (not later than on the third working day, whereas the old version reads "not sooner than 10 working days"). The amount of the deposit required for participation in auction sales doubled (from 10% to 20% of the starting price).

The successful bidder notice shall be delivered by hand against acknowledgement to the successful bidder or its authorized agent on the date when the auction final results are released (the old version required that such notice be delivered within 5 days from the day when the auction final results are released), ruling out the possibility of delivering the same by registered mail. And the period required for concluding a purchase and sale agreement with the successful bidder was reduced by three times (15 to 5 working days from the day when the auction final results are released).

The foregoing updates to auction sales are fully applicable to tender sales and sales by public offering to the extent to which they concern a period

within which applicants must be eligible for bidding at such privatization procedures, their execution, the increase in the amount of the deposit applicants must pay for being eligible for bidding (10% to 20% of the starting price), the delivery of a successful bidder notice and conclusion of a purchase and sale agreement with successful bidders.

Accordingly, the Act was updated by removing the provision which prohibits an agreement to be concluded based on the results of auction sales, public offering, sales at which the price is not announced within 10 working days from the date when the protocol with the results of sale of government-owned and municipal property is published on websites.

On top of all the aforesaid, the regulation for executing privatized property purchase and sale transactions (Article 32) was updated by adding a provision which stipulates that failure to observe the procedure for selling government-owned and municipal property, including unreasonable non-recognition of the applicant as bidder, shall bring about invalidation of a transaction that is based on the results of selling such property.

A provision in Article 43 ceased to be in force, which stipulates that upon revealing a property which is to be contributed to the charter capital of a joint-stock company and was not recognized as privatized property when such property was established, the joint-stock company shall be granted priority for purchasing such property at market price, and the assets which the joint-stock company has not repurchased are subject to privatization in the manner prescribed by law.

Overall, the above reviewed amendments (2015) should help boost the privatization process. The suggested enhancements for the information system of privatization of government-owned and municipal property and for the mechanism of selling such property are intended to render the entire privatization process more transparent while counteracting occurrences of corruption and criminality.

For this purpose, it is essential to compile a list of legal entities for electronic sales of government-owned and municipal property. The need to use electronic platforms for public procurement was discussed long ago. The reasons behind choosing such platforms is their great experience in various types of sales and high-quality infrastructure that meets the information security requirements.

Pursuant to the Russian government executive order of 4 December 2015, No. 2488-p, the foregoing list of e-sales platforms was updated by adding six companies including OJSC Russian Auction House (RAH), the key non-government platform which for three years has been engaged in selling privatized property. The company was commissioned to sell shares in about 200 government-owned joint-stock companies and more than 80 state treasury items. Besides RAH, the list of legal entities authorized for e-sales also comprises five organizations including two joint-stock companies, ZAO Sberbank – Computer Assisted Trading System, LLC RTS – Tender and the State Unitary Enterprise Agency for State Orders, Investment Activities and Interregional Relations of the Republic of Tatarstan¹.

Enhancing the mechanism of sales by auction, tender and public offering should help sell non-liquid assets while also supporting and stimulating small and medium-sized enterprises. However, addressing the issues of taxation

1 www.economy.gov.ru, 8 December 2015

and administrative barriers appears to be more important for such enterprises.

At the same time, it is worth noting that the requirements to the amount of deposit are the same as those prior to 2010, when the deposit was down from 20% to 10% of the starting price specified in the property sales announcement. Similarly, the term of concluding agreements with successful bidders and of sales by public offering is the same as was previously set (within 5 working days)¹.

It hasn't gone unnoticed that the practice of narrowing the scope of the privatization legislation continues. Since the legislation came into force late in 2001, the number of property categories whose disposal goes beyond the scope of the provisions thereof has nearly doubled (from 11 to 20), some of which have been given a broader interpretation.

The next few years will show what kind of effect the potential of the foregoing amendments has on the effectiveness of this process, bearing in mind the contribution to meeting the federal budget deficit and generating budget revenues at other levels of public authority. ●

¹ However, simply days, not working days, were referred to in the initial version of the law (as was set by the amendments in 2011). The 10-day term of concluding an agreement was initially set for tender sales.