Chapter 5. Institutional Problem

5.1. Property relations and the role of the public sector and privatization

5.1.1. The size, integral components and main features of the public sector

Last year the Russian economy developed in a crisis situation, and this resulted in a delay in passing a successive privatization program. In 2009 this document was approved as late as the end of November while during six previous years privatization programs were usually approved late summer – early autumn[1].

The Forecast privatization plan (program) of federal property for 2010 and the main trends of federal property privatization for 2011 and 2012 approved by the respective Resolution of the RF Government of November 30, 2009 No 1805-r, as the previous similar documents contained data on the number of unitary enterprises in federal ownership (FGUPs) and joint-stock companies with the share of the Russian Federation in their capital at the beginning of the calendar year only. Therefore we do not have sufficient information yet to assess objectively the dynamics of these components of the public sector in 2009. Let us review in detail the changes that occurred in the key categories of the business entities in federal ownership.

Federal government unitary enterprises

Dynamics and the sector structure of FGUPs in 2004 – 2008 are tabled below. In 2008 the total number of unitary enterprises in federal ownership reduced by 1/3 (almost 2,000 enterprises) and amounted to 3.8 thousand entities by early 2009. Such reduction of the sector was the largest one during recent years (for comparison: the number of the unitary enterprises reduced by 1/% or by less than 1,500 from June 1, 2006 to January 1, 2008).

Table 1

Dynamics and the sector structure of the federal government unitary enterprises in 2005 – 2008

Sector	As of June 1, 2005		As of June 1, 2006		As of January 1, 2007		As of January 1, 2008.		As of January 1, 2009	
	units	%	units	%	units	%	units	%	units	%
Non-productive sectors	3617	43,6	1817	25,3	1670	25,6	1151	20,2	988	26,25
Industry	1870	22,55	1624	22,6	1539	23,55	1744*	30,5	476	12,65
Agriculture	1111	13,4	913	12,7	826	12,65	618	10,8	611	16,2
Construction	903	10,9	752	10,5	668	10,2	…	…	300	8,0
Transport & Communications	725	8,75	612	8,55	536	8,2	409	7,2	249	6,6
Forestry	67	0,8	53	0,75	49	0,75	37	0,65	…	…
Other sectors	–	–	1407	19,6	1245	19,05	1750	30,65	1141	30,3
Total	8293	100,0	7178	100,0	6533	100,0	5709	100,0	3765	100,0

* –industry plus construction .

Source: 2006 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2006 – 2008; 2007 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2007–2009; 2008 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2008 – 2010; 2009 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2010 and 2011; 2010 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2011 and 2012; calculations made by the authors.

[1] The Forecast plan (program) of federal property privatization for 2008 was the only exception as well the main trends of development of federal property privatization for 2008 – 2010 approved in spring 2007.

Early 2009 the enterprises in the category of "other sectors" that were not included in the base classification (30.3% of the total number of FGUPs) remained the most numerous category in the FGUP sector structure. The non-productive sectors (26.3%), agriculture (16.2%) and industry (12.7%) were largely represented; 8% of FGUPs represented construction and 6.6% - transport and communications.

In 2008 a sharp decline of the absolute number and share of enterprises in the industry and construction manifested a major trend of changes in the FGUP sector structure. If early 2008 30.5% of the federal unitary enterprises were in the industry and construction, a year after this figure dropped to 20.7%. The reduction of the share of the transport and communications sector was insufficient: from 7.2% down to 6.6%. The specific weight of the non-productive sector and agriculture increased by 5-6 per cent points.

The dynamics of FGUPs number by sectors illustrates well the size of the shift in the FGUP sector structure. Thus, for two years between January 1, 2007 and January 1, 2009[1] the absolute number of the unitary enterprises in the industry reduced by 3.2 times, in the construction, transport and communications sectors by 2.2 times while in the non-productive sectors by 1.7 times, in agriculture – by 1.35 times and in other sectors (outside the base classification) by 1.1 times.

Joint-stock companies (JSC) in federal ownership

It is worth noticing that by early 2009 the number of JSC which shares were owned by the federal government reduced by more than 9% (or by 337 companies) vs early 2008; thus their number was 3,3337 companies which is the lowest figure for the entire period 1999 to 2008.

Now let us review the dynamics of the number of JSC which shares were owned by the federal government for the last years, by sectors (see *Table 2*).

Table 2

Dynamics and sector structure of the joint-stock companies which shares are in federal ownership or in relation to which a special "golden share" right is used, in 2005 through 2008

Sector	As of June 1, 2005		As of June 1, 2006		As of January 1, 2007		As of January 1, 2008		As of January 1, 2009	
	unit	%	unit	%	unit	%	unit	%	unit	%
Non-productive sectors	685	18,1	356	9,6	405	10,1	638	17,4	383	11,5
Industry	2078	54,9	1772	47,6	1797	44,95	1878*	51,1	1583	47,45
Agriculture	287	7,6	380	10,2	404	10,1	…	…	234	7,0
Construction	459	12,1	396	10,6	353	8,9	397	10,8	280	8,4
Transport & Communications	229	6,1	363	9,7	534	13,35	761	20,7	522	15,65
Forestry	45	1,2	99	2,7	88	2,2	–	–	…	…
Other sectors	–	–	358	9,6	416	10,4	–	–	335	10,0
Total	3783	100,0	3724	100,0	3997	100,0	3674	100,0	3337	100,0

* – including industry and construction (695 units or 18.9%), fuel and energy complex (597 units or 16.25%) and military industrial complex (586 units or 15.95%).

Source: 2006 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2006 – 2008; 2007 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2007–2009; 2008 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2008 – 2010; 2009 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2010 and 2011; 2010

[1] The selection of the two-year interval between January 1, 2007 and January 1, 2009 was justified by that early 2008 the industry and construction were quite pronounced in the FGUP sector structure; this impedes making correct comparison of the FGUP structure as of early 2008 and early 2009. Besides in the 2009 data forestry is not segregated.

Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2011 and 2012; calculations made by the authors.

As of the beginning of 2009, in the JSC sector structure (federally owned) the largest weight was that of industrial enterprises (about 47.5% pf all the JSC). The industry was followed by agriculture (15.7%), non-productive sectors (11.5%) and other sectors (10%). The total weight of the construction, transport and communications sectors was less than 10%.

While speaking about changes in the JSC sector structure which shares are federally owned, one can notice a pronounced increase of the share of industry and agriculture (2.5 and 2.4 per cent points accordingly) in 2007-2008.[1] . The specific weight of the non-productive sectors was somewhat less pronounced (by 1.4) while the share of construction, transport and communications, and other sectors in the general JSC structure with federally owned stocks decreased; mostly in construction (by more than 3 points).

Distribution of JSC with the state participation depending on the federally owned share is another important feature of such JSC (*Table 3*).

Table 3

Dynamics and the structure of joint-stock companies with the government participation in 1999 – 2008 (including the use of the "golden share" right) with account of the government share size

Date	Total		by 25%		25 to 50%		50 to 100 %		100%		«Golden share»	
	unit	%	unit	%	unit	%	unit	%	unit	%	total	No shares
1999 г.	3316/ 3896*	100	863	26,0	1601	48,3	470	14,2	382	11,5	580 **	
January1, 2001	3524***	100	1746	49,55	1211	34,4	506	14,35	61	1,7	…	…
August 2001	3949 ****	100	1843	46,7	1393	35,3	625	15,8	88	2,2	542**	
January 1, 2002	4407	100	2270	51,5	1401	31,8	646	14,65	90	2,05	750**	
January 1, 2003	4222 *****	100	2152	51,0	1382	32,7	589	13,95	99	2,35	1076	118
June 1, 2003	4205	100	2148	51,1	1339	31,8	600	14,3	118	2,8	…	…
October 1, 2003	4035	100	2051	50,8	1308	32,4	552	13,7	124	3,1	640	148
January 1, 2004	3704	100	1769	47,75	1235	33,35	540	14,6	160	4,3	591	251
June 1, 2004	3905	100	1950	49,9	1183	30,3	499	12,8	273	7,0	…	…
March 1, 2005	4075/ 3791#	100	1697	44,8	1154	30,4	487	12,85	453	11,95	…	284
June 1, 2005	3783/ 3524##	100	1544	43,8	1093	31,0	474	13,5	413	11,7	…	259
June 1, 2006	3724/ 3481##	100	1063	30,5	885	25,4	397	11,4	1136	32,6	…	243
January 1, 2007	3997/ 3816##	100	932	24,4	814	21,3	368	9,6	1702	44,6	…	181
January 1, 2008	3674	100	771	21,0	645	17,6	269	7,3	1989	54,1	…	…
January 1, 2009	3337	100	769	23,0	510	15,3	200	6,0	1858	55,7	…	…

* – The Concept of management of the state property and privatization in 1999 mentions 3,896 business entities (including 3611 OJSC, 251 CJSC and 34 LTD and LLC), in which capital the federal government participates. 3316 units is an estimate and a result of summarizing the blocks of shares of various size mentioned in the Concept;

[1] The selection of the two-year interval between January 1, 2007 and January 1, 2009 was justified by that at the beginning of 2008 in the JSC sector structure (with federal ownership of stocks) the group of other sectors was absent; at the same time the industry and construction (jointly), fuel and energy complex and military industrial complex were quite marked. This makes difficult reasonable comparison pf the JSC structure with federal blocks of stocks as of early 2008 and early 2009. Besides forestry ceased being shown separately after 2007.

** – total number of JSC using the "golden share" special right; JSC with no government share are no shown separately;
*** – JSC without consideration of 48 interests and blocks of shares in foreign companies; data are available that Russia owns 119 interests, shares and blocks of shares in foreign companies which book value is $1.4 bln;
**** – the data from the draft Privatization program for 2002 presented by federal Ministry of Property to the federal government; according to the data of the Ministry of Property Register, 4308 blocks of JSC shares were federally owned as of September 1, 2001;
***** – only open joint-stock companies with no account of 118 OJSC where the special "golden share" right was used (no shares available), blocks of shares of 102 JSC transferred to FGUP Rosspirtprom for operational management , 75 CJSC and interests in the LLC charter capitals, transferred by the RF Government Regulation of April 2, 2002 No 454-r "On the termination of state participation in the charter capitals of credit organizations" or received in the form of succession, gift or on other grounds;
# 3791 units is an estimated number of JSC which shares are federally owned, with no account of 284 JSC where the special "golden share" right is used (with no block of shares available). The weight of a JSC with a particular share in the capital for comparison with the previous period data is calculated based on this number. For reference: as of January 1, 2005, the shares of 3767 JSC were federally owned not considering the above 284 JSC with the "golden share" and interests in the charter capitals of 24 LLC companies transferred to the treasury following the RF Government Regulation of April 2, 2002 No 454-r "On the termination of state participation in the charter capitals of credit organizations" ;
– the calculated number of JSC which shares are federally owned; with no account of the JSC where the special "golden share" right is used. The weight of a JSC with a particular share in the capital for comparison with the previous period data is calculated based on this number.
Source: www.mgi.ru; Russian economy in 2001. Trends and prospects (Edition 23) Vol. 2 M, IEPP, March 2002, p. 62; A. A. Braverman. On measures to improve efficiency of federal property management and the criteria of its evaluation. //Bulletin of the Ministry of Property of Russia. 2003. No 1, p. 13-14. Enterprises with the state participation. Institutional and legal aspects and economic efficiency. Series "Scientific reports: independent economic analysis. № 155. M.: Moscow Public Research Foundation.; Association of Researchers of the public sector economy, 2004, p. 47; 2004 Federal Property Privatization Program and main trends of federal property privatization by 2006// Bulletin of the Ministry of Property of Russia. 2003. No 3. p. 4–5. Key problems of improving management efficiency of federal property and main directions of the dividend policy of the Russian federation// Bulletin of the Ministry of Property of Russia. 2003. No 4. p. 8; V, Andrianov. Russia in global economy// Society and Economy 2003, No 11, p. 84;; 2005 Federal Property Privatization Program// Materials for the RF Government meeting on March 17, 2005 "On measures to improve management efficiency of federal property; 2006 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2006 – 2008; 2007 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2007–2009; 2008 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2008 – 2010; 2009 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2010 and 2011; 2010 Forecast plan (program) of federal property privatization and the main trends of federal property privatization for 2011 and 2012; calculations made by the authors.
The number of the FGUPs to be incorporated has been constantly growing, however the mid-2005 trend of increasing share of blocks of shares that would help the government to exercise a full-fledged corporate control due to a sharp growth of the number of full (100% shares) blocks ceased gradually and did not developed further in 2008.

As of January 1, 2009, likewise early 2008, the government was able to exercise a majority or complete control in more than 61% of all the companies. The share of the minority stakes (up to 25% of the capital) has been growing in the overall structure of the federally owned stocks while the share of blocking (25% to 50%) or majority stakes (over 50% but under 100%) was decreasing.

The absolute number of minority stakes in federal ownership has changed insignificantly while the number of blocking and majority stakes reduced obviously: by more than 1/5 and ¼ accordingly. This trend affected the full stakes to a lesser degree and the number of full stakes reduced by 6.5%.

Rosstat monitoring is another source of data about the growth of the public sector[1]. According to Rosstat, the growth dynamics of business entities in 2008 and in 1H of 2009 developed as follows (*Table 4*).

Table 4

Number of enterprises in the public sector of economy registered by territorial divisions of the Federal Property Management Agency and the Property Management Agencies of the RF subjects in 2008 – 2009

Date	Total*	GUPs -State unitary enterprises- including treasury enterprises	Government agencies	Business entities which charter capital has over 50% of shares in	
				federal ownership	in ownership of business entities that operate in the public sector of economy
As of January 1, 2008	80570	10598	64440	4111	1410
As of July 1, 2008	77461**	9864	62571	3930	1089
As of January 1, 2009	75878**	9144	61831	3795	1101
As of July 1, 2009	77082**	8706	63019	4007	1350

* – including organizations which foundation documents after registration in government authorities do not specify types of activities, but excluding joint-stock companies in which more than 50% of shares (stakes) are in joint federal and foreign ownership; the total number of public sector entities can exceed the number of GUPs, institutions and business entities;

** – federal property is registered under Resolution of the RF Government of July 16, 2007 No 447 "On improvement of registration of federal property";

Source: On the development of the public sector of economy of the Russian Federation in 2007. M., ROSSTAT, 2008, p. 123. On the development of the public sector of economy of the Russian Federation in 1H 2008, M., ROSSTAT, 2008, p. 87; On the development of the public sector of economy of the Russian Federation in 2008. M., ROSSTAT, 2009, p. 7.; On the development of the public sector of economy of the Russian Federation in 1H 2009. M., ROSSTAT, 2009, p. 7.

In general the number of organizations of the public sector of economy decreased by 5.8% in 2008; however in 1H 2008 it grew by 1.6%. As a result, as of mid-2009 this number roughly corresponded to the similar indicator a year ago – July 1, 2008.

The development dynamics varies by different sub-sectors of the public sector. The number of state unitary enterprises was going down (a stable trend): in 2008 – by 13.7%, in January-June 2009 – by 4.8% (for the year and a half - by 17.9%).

At the same time the number of state enterprises having reduced by 4% in 2008 grew up by 1.9% in 1H 2009. Those business entities in which charter capital more than 50% shares (stakes) are owned by the government demonstrated a similar trend. In 2008 this figure went down by 7.7% while in January-June 2009 it went up by 5.6%. In 2008 the number of business entities in which charter capital more than 50% shares (stakes) are owned by the public business entities dropped most dramatically as compared to other categories of companies in the public sector (almost by 22%), however in 1H 2009 it went up also dramatically by 22.6%.

[1] According to Resolution of the RF Government of January 4, 1999 No 1, Rosstat includes the following business entities of the federal and regional levels: (1) state unitary enterprises under the right of operating and economic control; (2) state institutions; (3) business entities which charter capital has over 50% (stakes) in federal ownership; (4) business entities which charter capital has over 50% of shares (stakes) in the ownership of business entities in the public sector.

5.1.2. Mid-term privatization plans

While considering the Forecast plan (program) of federal property privatization for 2010 and the main trends of federal property privatization for 2011 and 2012 approved by RF Government Resolution of November 30, 2009, No 1805-r, certain variations from the similar documents of the previous years can be noted.

Primarily this relates to the financial and economic crisis situation where a regular privatization program was approved.

The Program did not appear by the end of summer thus breaking the established tradition, and autumn announcements by the competent Russian officials of the possibility to expand 2010 Privatization program vs the initial version with the expected budget revenues from privatization of RUR7.1 bln[1] in a new context of budget deficit (the first deficit since early 2000'es) demonstrated a forced backslide to using privatization tools for recharging the budget exactly as it was done in the 1990'es.

Nevertheless, in spite of the ambitious statements on the initiation of a new wave of privatization and initial optimistic estimates (the federal budget was expected to receive RUR 100 bln from sales of the state property in 2010) 2010-2012 Privatization program does not look too radical.

The following issues should be pointed out in this document.

Firstly it has another reference to the official government document that sets development shapes for the future – Main directions of activity of the Russian Federation Government for the period ending 2012 approved by Resolution of the RF Government of November 17, 2008 No 1663-r[2] where it states that *by 2012 the public sector will reduce, the composition of the state property will conform to the authorities and functions of the state and structural changes in the respective sectors of economy; the work will be continued to reduce the list of strategic enterprises that are not subject to privatization; the process of corporatization (converting enterprises into joint-stock companies) of federal unitary enterprises that are not necessary for exercising public authorities will be completed.*

With account of the above, in 2010 – 2012 the work will continue to remove restrictions on privatization of certain types of federal property that have lost their relevance, and to reduce the number of strategic enterprises and joint-stock companies according to the decisions of the President of Russia. A most acceptable and efficient method of management of these property and enterprises including their privatization will be determined.

Secondly, among the objectives of the government policy for federal property privatization in 2010-2012, in addition to the traditional objectives there is a target to create environment for getting off-budget investments for joint-stock companies development.

This means a much broader application of the mechanism of charter capital increase in the open joint-stock companies established in the process of privatization which 25% or more shares are owned by federal or municipal authorities, while keeping the threshold limits for the state owned shares. This procedure was defined in 2006, and the effective Law on privatization was amended accordingly.

[1] M. Momot. Large clearance. V. RBK, No 11, 2009, p.46-51. .

[2] The main directions of activity of the Government of the Russian Federation for the period ending 2012 address mainly implementation of the first stage of the Concept of the long-term economic and social development of the Russian Federation for the period ending 2020.

Rosgosstrah company (the government share is 25%) is a good example of such scheme: the company was excluded from the list of strategic JSC by Decree of the President of Russia in September 2009. The Decree points out that the RF Government may well take a further decision to increase the charter capital of the company provided the government stake remains to be at least 13.1% of votes at the general shareholders meeting with a possibility to consider the use of a special right of the Russian Federation to participate in the company management ("golden share").

Thirdly, the current Privatization program mentions major facilities in federal ownership subject to privatization as it was done in the similar documents for 2007 and 2008. Such major (budget-making) facilities subject to privatization are stakes of such open joint-stock companies as TGK-5, Rosgostrah, Moscow Metrostroi, Iskitimcement (Novosibisk region), Tyretsky Solerudnik (Irkutsk region)[1].

Besides, to raise additional revenues to the federal budget, the RF Government may pass resolutions to privatize blocks of shares of companies that are highly attractive for investors. As the document suggests, such are the shares of sea and river ports, shipping and steamship companies including the stock of OJSC "Modern Commercial Fleet (not more than 25% minus 1 share from the federally owned stock), Murmansk Sea Commercial Port, Novorossiysk Sea Commercial Port, Anapa Airport (Krasnodar Krai) Koltsovo Airport (Ekaterinburg) (Tolmachevo Airport (Novosibirsk)[2].

A necessary condition for this is Resolution of Russia's President on termination or reduction of the participation share of the Russian Federation in management of the joint-stock companies included in the list of strategic enterprises and JSC.

The presence in the list of the airports, sea and river ports as potential objects for privatization[3] follows the recent trend when certain restrictions emerged to include in privatization the enterprises in traditional sectors of production (primarily in industry where integrated entities were actively built up); attempts were made to raise private capital for infrastructure development. It is enough mentioning the sale of full stakes (100%) of the Sochi and Tyumen airports, and identification of the Ufa and Salekhard airports as major targets of privatization in the 2007 Forecast plan (program) of federal property privatization and the main directions of federal property privatization for 2007-2009.

Expectations associated with allocation of budget funds for modernization and construction of airports and primarily their flying fields were a significant factor that heated up the interest of the Russian business to invest in the airports. More serious budget limitations that

[1] In the final version of the 2010 Privatization program there is no OJSC SG-Trans which is a larger railway shipper of liquid gases. It was planned to auction this company in 1H 2010 with expected revenue of RUR 8 bln.
SG-Trans privatization was planned in 2006, however it failed because a larger part of the company's property was not registered (for ownership). At the end of 2007 RFFI assessed 100% shares of the shipper owned by the government as worth RUR14.8 bln. Moscow Metrostroi was also included in the Privatization Plan earlier.

[2] Tuapse and Vanino sea commercial ports and several shipping companies (Murmansk, North-West, Volga, Enisei and Sakhalin) were also mentioned as possible facilities for privatization though they were not included in the Privatization program.

[3] An object for privatization in such cases is the airport terminal building or the property for rendering services by the sea terminal operators since the facilities used for supporting air or sea traffic, etc. are included in the property list not subject to privatization which are used by specialized government enterprises (FGUPs "State Corporation for Air Traffic Organization in the Russian Federation", "Administration of Civil Airports (Flying Fields), Rosmorport, Administrations of Sea Ports that are deemed agencies).

are expected in coming years may strongly change this motivation and complicate the government search of investors. Another incentive for inclusion of sea and river ports in the Privatization program was, possibly, the size of the government stake in the capital which in many cases does not exceed the size of control stake.

Fourthly, for the first time in recent years after the current Law on privatization was enforced in 2002, and the government began approving annual Forecasted privatization plans (programs) the document under review does not contain a nominal list of federal unitary enterprises (FGUPs) to be privatized.

As in the similar documents of some previous years, the document states that in 2010 – 2012 those FGUPs that do not support the government functions of the Russian Federation will be privatized. About 250 FGUPs are to be privatized in 2010; their privatization procedures began in 2009.

If the President of Russia takes a respective decision in 2010, FGUPs that are excluded from the list of strategic enterprises including those that are parts of vertically integrated structures in the strategic sectors of economy may be converted into joint-stock companies; moreover, newly formed JSC may be re-included in such strategic list.

Literal understanding of this aspect gives grounds to assume that in the current year the privatization process (de facto, mainly, in the form of corporatization) of unitary federal enterprises in terms of their range expansion will slow down except for the earlier initiated procedures that would be brought to their logical end.

The other parameters of the Privatization program are as follows.

In 2010–2012 the blocks of shares of joint-stock companies established in the process of conversion of federal government unitary enterprises including those incorporated under the 2009 Forecast plan (program) of federal property privatization will be offered for sale except strategic JSC that are in the list of strategic joint-stock companies or participate in the formation of integrated structures.

In 2010 the following stakes will be offered for sale:

– blocks of shares which do not exceed 50% of the charter capital of the respective joint-stock companies except blocks of shares of strategic JSC or JSC participating in the formation of integrated structures;
– blocks of shares of joint-stock companies in construction, agriculture, chemical, petrochemical and polygraphic industries, public road system, geology, water and air transport, machine engineering, etc. (except strategic companies +JSC).

The work on establishment of integrated structures in the strategic sectors of economy using as a basis joint-stock companies which shares are in federal ownership will continue in 2010–2012.

The shares of 449 JSC and 56 property facilities of the Russian Federation Treasury including real estate, sea and river vessels are included in the 2010 Forecast plan of privatization approved by the RF Government.

By comparing the data describing the 2010 Forecast plan (program) of privatization and the data results of implementation of the previous Privatization plans (*Table 5*), one can state that in general its quantitative indicators are far from their maximum values reached in the middle of 2000'es.

Table 5

Benchmarking of the privatization dynamics of the federal government unitary enterprises and federal blocks of shares in 2000 – 2008

Period	Number of privatized enterprises in federal ownership (Federal Property Management Agency data, before 2004 – RF Ministry of Property data)	
	FGUPs privatized [1]	JSC blocks of shares sold
2000	2	320
2001	5	125[2]
2002	102	112[2]
2003	571[3]	630
2004	525	596[4]
2005	741	521[5]
2006	…	356[6]
2007	377	377
2008	213	209[7]

[1] –all preparations completed and decisions on privatization terms made;
[2] – with account of stock which sale was declared in the previous year;
[3] – without FGUPs which property was contributed to OJSC RZhD share capital;
[4] – including 31 blocks of shares which sale was announced in 2004 but the sale results were summarized in 2005;
[5] – with no account of 273 blocks of shares which sale was announced in 2005 but the sale results were summarized in 2006;
[6] – estimated value based on the report data of FAUFI (Federal Agency for Federal Property Management) "On privatization of federal property in 2007;
[7] – including blocks of shares of 135 JSC which sales were announced according to the 2007 Forecast privatization plan, but without 268 blocks of shares which sales were announced in 2008 with the results summarized in 2009;
Source: www.mgi.ru; Materials for the RF Government session on March 17, 2005 "On measures to improve efficiency of federal property management"; FAUFI report "On privatization of federal property in 2005", M, 2006; FAUFI report "On privatization of federal property in 2007", M, 2008; FAUFI progress report for 2008, M, 2009.

In 2010 the federal budget expects to gain RUR18 mln of privatization proceeds (out of those, RUR12 mln from major sales of the so-called budget-forming assets); in 2011 – RUR6 bln and in 2012 – 5 bln.

The revenues from the federal property sales can be much higher if the RF Government decides to privatize shares and other property that are highly attractive for investors.

In this context the Russian officials in their announcements made in November 2009 and related to the approval of the Privatization program for 2010 – 2012, mentioned more than RUR 70 bln of aggregated revenues of the federal budget from sales of federal property. Out of them, RUR 54–55 bln can be gained from sales of the federal stock in 28 JSC provided they are excluded from the list of strategic companies.

As for the 2009 Privatization program, its implementation, as had been expected, ran against a sharp drop of the purchasing power of the population and expectation of investors related to reduction of the assets value. Officials of the Federal Agency for Federal Property Management noticed that investors' interest began growing only by the end of summer – beginning of autumn. Potential investors showed their interest for the property auctions in 10% of cases while in the previous years it was 30%.

As of November-end, the Federal Agency for Federal Property Management passed Resolutions regarding the terms of privatization of 173 blocks of shares, published 158 information notices about sales, summarized the results of 100 bids (the annual plan provided for sell-

ing shares of 287 JSC)[1]. Major deals (over RUR100 mln) of the last year included auction sales of the government's stakes of OJSC Tobolsk River Port (25.5%, RUR188.456 mln, re-tenders, Tyumen region) and Gipromyasomolagroprom (100%, RUR188.380 mln, St._Petersburg), Hydrometallurgichesky zavod (HydroSteel Plant) (100%, RUR123.7 mln, Stavropolsky Krai). All the deals took place under selling and initial price parity [2].

5.1.3. Influence of the government presence in property on the government structural policy in various sectors, issues of strengthening of the government position

After stormy events and intensive processes in 2007 and 2008, where in mergers and acquisitions companies with the government interest in their capital domineered as buyers of assets, integrated structures were actively built up, six state corporations (GK)[3] were established, and RAO EES was liquidated, all Russia's economy has been hit by the world financial and economic crisis, and special government programs of urgent assistance to some Russian companies and banks has come to the forefront. Besides the issue of sourcing such programs (the budget system, off-budget funds, and Central Bank funds) and the terms of programs delivery in terms of their influence on the property relations, of importance was whether the state would elect acting directly or using agents (such as banks and development institutions).

If to take the period before the Anti-Crisis Action Program of the RF Government for 2009 was announced early April at the State Duma, decisions on increasing charter capitals of the following JSC received the highest resonance: OJSC Agency for Mortgage Housing Crediting (by RUR60 bln, November 2008), Russian Railway Roads (by RUR41.5 bln, December 2008), Risslkhpzbank (by RUR45 bln, February 2009), Rosagroleasing (by 25 bln, February 2009)[4].

The content of the 2009 Federal Anti-Crisis Program, namely, the priority given to subsidizing interest rates and state guarantees for credits may suggest (with caution) a minimal probability of direct expansion of the government when the government stake in some problematic companies may increase at the expense of the budget funds.

However, this Program among other actions to retain and increase the industrial and technological potential proposed allocation of considerable budget funds to additional capitalization of leading companies of the defense-industrial complex; examples are the buyout by the government of additional issue of stock of OJSC RSK "Mig" for RUr150 bln, respective decisions for FGUP GKNPC named after M. V. Khrunichev for RUR8 bln, OJSC KAPO named after S. P. Gorbunov for RUR 4.128 bln, OJSC MMP named after V. V. Chernyshev for RUR2.9 bln; this follows the trend to increase share capitals. The Program provides for addi-

[1] Interview of Deputy Head of the Federal Agency for Federal Property Management E. L. Adashkin, RIA Novosti, www.rosim.ru, 25.11.2009.
[2] www.rosim.ru.
[3] Federal Foundation for Assisting Housing Construction Development created in pursuit of Federal Law of July 24, 2008 No 161-FZ formally has a restricted form of incorporation (foundation) but in reality is very close to state corporations established earlier, since the Foundation and these corporations are considered non-commercial organizations. .
[4] The assessment of the anti-crisis actions to support the producitng sector of the Russian aconomy. GU-VShE and MATs report for the 10th International scientific conference of GU-VShE on the issues of development of the economics and the society, Moscow, 7-9 April 2009. – M, GU-VShE Publishing House, 2009.

tional issue of shares and bonds of certain strategic enterprises with their further buyout by the authorized agencies for RUR52 bln.

In addition separate items reflect compensation (as the increase of the charter capital of OJSC RZhD) of under-received revenues due to reduced pace of railway tariff indexation for 2009 by 8% (against 14% in the plan) for goods and passenger traffic tariffs (privileged categories)(total of RUR52.3 bln); increase of the charter capital of the Agency for Mortgage Housing Crediting (by RUR 20 bln), an interest-free loan to OJSC AVTOVAZ from the federal funds designated for property contribution to GK Rostechnology (RUR25 bln) [1]; another contribution to this company (RUR 2 bln) was declared as a state support to the air lines.

New examples of expansion of the state business include a decision to establish a state leasing company in the transportation complex on the basis of OJSC State Transportation Leasing Company (100% voting shares belong to the government)[2], which share capital was increased by RUR10 bln, and announcement of the establishment of an integrated leasing company to support coal mining enterprises with mining equipment (in this case the status and the level of government involvement has not been announced yet).

The available and announced cases of additional capitalization refer mainly to those companies where the government is the sole shareholder (e.g. Agency for Mortgage Housing Crediting, Russian Railways, Rosselkhozbank, Rosagroleasing), and the process of mergers and acquisitions is not affected. In principle the same can be said about a possible buyout of an additional issuance of shares by separate strategic enterprises of the defense-industry complex, though private shareholders are also present in some of these enterprises.

However, regardless of the significant influence of the federal budget policy on the property relations development, banks and development institutions as agents of support of the federal government have always played a more serious role in providing support to the companies.

In the context of the absence of officially announced plans of further comprehensive expansion of the state entrepreneurship sector, the scale and the format of the government support and the selected priorities in crediting the real economy and participation in the stock exchange market transactions have proved to be decisive factors.

The most urgent issue was that of the policy of Vnesheconombank (VEB) which began refinancing the external debts of the major Russian private companies in autumn 2008. Since VEB granted mainly short-term loans (for one year), in 4Q 2009 the issue of repayment of the granted loans emerged, and if no repayment, the issue of choice between granting new loans, restructuring the debts (de-facto it was renewal of the granted loans), initiation of bankruptcy procedures or obtaining property rights on the pledged assets. Formally this should not be deemed nationalization since the federal treasury is not going to receive any additional property, and VEB as a state corporation is a non-commercial entity.

Major banks with government stakes that received the government financial support face a similar choice. Mechel company, e.g. that was attacked by the federal government officials in

[1] Late 2009 MinPromTorg approved the Rules for granting subsidies from the federal budget to GK RosTechnologies in the form of a property contribution to provide financial support to OJSC AVTOVAZ by way of an interest-free loan for AVTOVAZ to execute the obligations before the suppliers, intermediary entities, crediting companies and other agents with a following increase of the GK RosTechnologies share in the AVTOVAZ charter capital.

[2] Converted from CJSC Leasing Company of Civil Aviation in 2006

July 2008 who were displeased by the company's failure to pay taxes in full volume and the use of transfer pricing mechanism disrupted the terms of 78.9% credit agreements (the loan value) in 2008 and early 2009. Among the Mechel creditors were: Gazprombank (under a $1.5 bln loan 35% of shares of the coal mining companies Yakutugol and Yuzhny Kuzbass were pledged); VTB (under a RUR15 bln loan part of the assets of Yuzhny Kuzbass and Chelyabinsk metal works were pledged) and Sberbank (RUR3.3 bln loan)[1]. The latter is also a creditor of the united chemical company Uralkhim having received for security against $700 mln loan the control stakes of OJSC Azot (Berezniki city, Perm region) and OJSC Kirovo-Chepetsk khimcombinat (chemical plant) (Kirov region).

Possible transition of the property rights to the state-owned companies and major banks with government stakes would have obviously marked a new stage of the state property expansion.

In real life, however, the government would tend to meet the business interests by following the previous practice of debt restructuring. In the first half of October 2009 the VEB Supervisory Board extended for another year the loans issues for repayment of external debts to such companies as Gazpromneft, Citroniks, Evraz Group, Rusal, GK PIK and Altimo. The prolongation was made without revision of the main parameters of the deals earlier recorded in the loan agreements (including the size of the security) except interest rates [2].

If such approach continues to be followed, the potential of possible expansion of the public sector would remain unrealized in large; however such situation would imply a certain revision of the principles of financial accountability, refusal from "soft" budget limitations in business entities' activities and consistency in application of the bankruptcy procedures which was implemented in the Russian economy from early 90'es with great difficulties and tremendous cost efforts.

The preliminary data for 2009-end results allows us making a cautious conclusion that the state has been less active in implementing the policy of integration of separate state-owned assets into holdings. An indirect sign of this is the lower number of clarifications in the list of strategic unitary enterprises and joint-stock companies vs two previous years: 12 clarifications vs 22 in 2008 and 42 in 2007 (for comparison: three clarifications were made as of 2004 end results, four – in 2005 and 12 in 2006). The bigger number of the clarifications was connected with building up integrated structures where initially the enterprises and the companies to be integrated are excluded from the list and later a newly-formed holding is re-included. As a result of this, 22 unitary enterprises and 16 joint-stock companies were excluded and 4 integrated companies were included in the list.

As a reminder, in 2008, following the decisions of the President and the RF Government, Federal Property Management Agency established 26 integrated companies, OJSC Oboronservice and GK RosTechnologies among them; these two companies integrated 440 unitary enterprises and 43 joint-stock companies. Since the Russian Government issued Resolutions on their privatization in November 2008, and these companies were included in the respective program in 4Q 2008, the procedure for their integration was to be completed in 2009.

To implement the 2008 resolutions, the first stage of the establishment of an integrated company OJSC Headquarters for Reproduction of Farm Livestock was completed on the basis of the Center for Artificial Insemination of Farm Livestock; this company integrated 19 farms

[1] D. Varaskin, Banks displeased. – Vedomosti, June 24, 2009, S. B. 02.
[2] Development Bank extended the loans for one year. : RBK daily, 9 October 2009 г., No 185 (748). p. 2.

located mainly in the Povolzhie (the river Volga), the Urals and in Siberia (Bashkiria, Mordovia, Idmurtia, Ekaterinburg, Tyumen, Altai, Kemerovo, Novosibirsk, Krasnoyarsk and Krasnodar).

In the previous year under the government property policy, OJSC Agency for Regulation of the Product Market was converted into United Grain Company; its charter capital received the shares of 31 enterprises of cereal products (milling plants, grain elevators, etc.) including 17 control stakes in the form of placement of additional shares.

Likewise the charter capital of the earlier created integrated company called Concern of Radio Engineering Vega will be increased by adding federal stocks of 14 joint-stock companies including 100% minus 1 share of 7 joint-stock companies established as a result of conversion of the earlier FGUPs.

The establishment of Rosgeology Holding is under consideration which charter capital will be formed as a result of establishment of joint-stock companies from FGUPs in exploration and by including the stocks of operating servicing JSC (49 companies altogether)[1].

In 2009 inconsistency of the government policy towards state-owned corporations became obvious, the establishment of state-owned corporations has become a new direction in the federal property and structural policies during the last two years.

Early 2009 the government began discussing extensively new plans of creation of state-owned companies (GK) and expansion of businesses of the state-owned companies in operation. Thus the Central Bank had to transfer the funds of National Wealth Fund and the Reserve Fund to a new GK Russian Financial Agency while VEB – pension deposits and also the internal and external debts of the country[2]. Consolidation of communications assets of VEB and integration of 11 air lines in Rosavia under Rosoboronexport was also considered as an alternative[3]. In the last case the situation changed early 2010: the consolidation now is to begin under the auspices of Airflot; however in terms of general federal government policy, this is not a new trend but a technical correction.

Decisions were taken to transfer GK Rostechnologies as a property contribution of the federal government in addition to a large package of the federal property transferred in 2008 of shares of another 3 joint-stock companies including 18.83% of AVTOVAZ stock that had been in management of FGUP Rosoboronexport; this corporation was to act as a customer in construction of 12 federal medical centers of high technologies under the respective national project. Rostechnologies was expected to receive federal budget allocations (as property input) at the expanse of the respective reduction of the budget allocations to the Russia's Ministry of Health and Social Development for construction of the said centers while in future subsidies would be granted to complete the construction and commission these centers. In this light another initiative of Rostechnologies to enter a pharmaceutical market by way of setting a holding with the government stakes of 35 companies looks quite logical.

In summer 2009 the Law on Establishment of the State Company Russian Motor Roads (Avtodor) was passed; Avtofor will be a national operator of the federal motor road network; simultaneously a new form of legal entity's incorporation oriented at the use of federal prop-

[1] E. Korytina, The State moved to exploration// RBK daily, October 2, 2009, p. 5; E. Korytina, Sechin helped geologists//RBK daily, October 15, 2009, p. 5.
[2] I. Zinenko. New state corporation will control all financial assets of the government, 13.01.09. – http://www.rb.ru.
[3] A. Khazbiev. Indecent proposal, - Expert, 2009 No 11, p. 26-27.

erty by the state-owned company was added to the RF Civil Code and the Law on Non-Commercial Organizations.

Avtodor is to render state services and perform other funcitons in the road sector by using federal property under trust management. This company will receive for trust management the federally-owned toll motor roads or the roads in general use and federal significance that have toll areas.

Such format will inevitably cause a lot of questions starting from expediency of the new form of incorporation with a pronounced focus on commercialization of public wealth and ending with obvious restrictions in using the term "state-owned company" (public company) in the economic and political vocabulary.

The Russian Motor Roads as a non-commercial entity is very close to the state-owned companies established earlier, the only difference being the trust management; however, this form has not been widely used for other types of federal property, e.g. blocks of shares.

On the other hand, criticism of the state-owned companies that has been growing since their establishment ended in development (by summer) by the initiative of the President of Russia of the "Concept of development of the legislation on legal entities" which contained proposals on changing the legal form of all existing state-owned companies, on refusal from their use in future and on repealing a number of "specific" provisions of the law that granted these companies "special" rights.

The President's Letter to the Federal Assembly of Russia in November 2009 pointed out that in future state-owned companies should be converted to joint-stock companies under the government control, while those companies that have specified periods of their operation should be liquidated in due time. These include Olimpstroi and Foundation of Assistance to Reform the Utility and Housing Sectors. According to A. Dvorkovich. Aid to the President of Russia, the prospects of transformation of Rosatom and Federal Agency for Deposit Insurance will depend on their long-term results. Most probable candidates for corporarization are VEB, Rosnano and Rostechnologies[1]. However, there are no specific dates set for such transformation. It is not clear whether the new vision of the state-owned company status applies to Avtodor and Federal Foundation of Assistance to Housing Construction Development.

The first step in this direction may become corporatization of airlines that have been transferred earlier to Rostechnologies and have the status of unitary enterprises, and their further transfer to Airflot – this was announced in February 2010. The airlines considered are GKT Russia, Kavminvodyavia, Orenburg airlines and Saratov airlines, Vladivostock airlines and Sakhalin Airlines where Rostechnologies received federal stakes. Thus the Rostechnologies plans to establish a new integrated air company Rosavia[2] comparable with Airflot in terms of traffic volume have not been implemented. It is quite possible that Rostechnologies will receive a stake in exchange for the said assets.

As a result of the current financial and economic crisis, opportunities to act on the market of corporate control as actively as in 2004-2007 have been restricted for the majority of companies with the government stake even with account of state support granted to them under the anti-crisis program.

The emergence of this trend may refer to 2008 when in the context of $120 bln worth M&A in Russia there was no major deal with a company having a government stake that

[1] www.prime-tass.ru, 12 November 2009

[2] Initially participation in Rosavia and Atlant-Soyuz airline controlled bu the Moscow authorities was expected.

acted as a buyer. Mechanical engineering is worth mentioning with acquisition by the United Avia Engineering Corporation (OAK) of 49.4% of shares of Scientific and Production Corporation Irkut (a major exporter of military and civil aerotechnics) for $420 mln and acquisition of the entire capital of Kriogenmash and 85% of the capital of KHIMMASH (for total $290 mln) by Gazprombank which also became the owner of 8.3% of the shares of National Telecommunications for $128 mln. Two more deals could be possibly mentioned as having reference to the companies with the government interest but with greater specifics related to external capital markets. Gazpromneft acquired a control stake in Naftna Industrija Srbije (NIS) for $560 mln, while Gazprom expected to receive 49% of CJSC Gerosgaz possessing 2.93% of Gazprom from German company E. ON AG that bought 25% stock minus 1 share in Severneftegazprom [1].

In 2009 communications was the "hottest" sector. At the beginning of the year a possibility arose for VEB acquisition from investment bank KIT Finance[2] of 40% shares in Rostelecom and 25% plus 1 share in Svyazinvest (a telecommunication holding) from AFK Systema where for many years the sale of the federal control stake (75% minus 1 share) was on the agenda; the state-owned corporation could receive this control stake directly from the federal government.

AFK Systema being the third largest private shareholder of the company since the outrageous sale by the government of the blocking shareholding in 1997[3], at the end of 2008 proposed that the government buys out its block of shares for $1.9 bln. This amount exceeded by almost 2.8 times the asset value assessed by Ernst & Young in spring 2008; this encouraged the AFK Systema to buy another 25% shares from the government thus increasing its stake in Svyazinvest up to the control stake. Some time later AFK Systema offered the government a counter-deal to exchange the blocking shareholding in Svyazinvest for the write-off of the debt (RUR26 bln) to Sberbank of a Systema daughter company, Komstar-OTS, and the Svyazinvest stake in MGTS (28% of voting shares) where Systema had already a control stake. It goes without saying that if the proposed deal fails, Systema will be able to keep its stake in Svyazinvest and will hope selling it profitably after the crisis is over[4].

As for Svyazinvest, this company began considering an opportunity of merging with one of the All-Russia mobile communications operator. Minister of Communications and Mass Media of the Russian Federation I. Shchyogolev addressing the Association of European Business late June 2009 said that one of the aims of the holding restructuring was to become one of the fourth major cellular operators in Russia; this could be achieved by not only getting control in one of "Big Three" operators (e.g. in Megafon) but also by merging the cellular assets with outside regional cellular operators' assets or with one of the second tear majors (Tele2, SMARTS, Motiv and Sky Link)[5].

[1] Review of the M&A market in 2008. Ernst & Yong, 2009, p. 8, 22, 24, 32.
[2] 90 % of its capital are owned by OJSC RZhD and ALROSA from autumn 2008
[3] At that time 25% and 1 share of Svyazinvest were bought by Mustcom of J. Soros and V. Potanin for $1.87 bln in expectation of further privatization. In 2004 this block of shares was sold Access Industries of L. Blavatnik and his partner V. Vekselberg for $625 mln, and in 2006 it was bought by AFK Systema for a double price registering the acquired asset to Komstar-OTS, its daughter company.
[4] A. Klyuchkin. Back to the wood. www.lenta.ru, 14.05.2009.
[5] A. Bursak. Svyazinvest thinks about an alliance; RBK daily, 24 June 2009 , No 108 (671). p. 10.

The merge of the major Russian private companies in metal works and mining sectors (Norilsk Nickel, RUSAL and Metalloinvest) with GK Rostechnologies involvement did not occur though the information about this merge appeared at the end of 2008[1].

It is reasonable to ask how the processes triggered by the crisis affected the positions of the federal government in the economy as a producer of goods (services and works). Rosstat monitoring results partially confirm the increasing weight of the public sector in the economic performance indicators (*Table 6*).

Table 6

The weight of the public sector by various indicators in 2006 – 2009, in %

Indicator	2006	2007	2008	1H 2009
Volume of shipped goods (own production), rendered services and performed works (by own efforts):				
- production of mineral resources	6.0	12.8	13.5	13.8
- production of fuel and energy resources	3.9	11.8	13.2	14.3
- manufacturing sectors	8.2	8.4	8.5	9.3
- generation and distribution of electric energy, gas and water	10.7	11.4	13.0	10.5
Construction work scope (by own resources)	4.4	4.0	3.6	3.3
Passenger traffic (transportation companies) *	68.5	65.9	63.9**	64.9
Commercial shipments of goods made by transportation companies (without pipelines)	67.2	72.9	71.1**	72 4
Commercial traffic of transportation comp(without pipelines)	93. 9	94.6	94.3**	92.6
Services of communications***	9.8	9.8	9.9	11,6
Internal R&D costs	70,4	72,4	72.6	75.4
Volume of paid services rendered to the community	17.2	16.4	16.3	16.1
Investments to main capital from all funding sources ****	18.1/14.4	19.5/15.0	21.5/15.9	18.1/13.6
Net proceeds from sales of goods, products, services and works (less VAT, excises and other similar payments)	10.2	10.2	9.8	10.1
Average headcount	26,0	24,9	24,0	24,2

* – without city passenger transportation (electricity) organizations;
** – data for January – September 2008;
*** – Net proceeds from sales of goods, products, works and services (less VAT. Excises and other similar mandatory payments);
**** in numerator: less small businesses
Source: Development of the public sector of economy in the Russian Federation in 2005, M, Rosstat, 2006, p.. 8, 85, 92–93, 94, 103, 137, 139, 146–147, 167; Development of the public sector of economy in the Russian Federation in 2006, M, Rosstat , 2007, p.. 8, 82, 89–90, 91, 100, 134,136, 143–144, 164; Development of the public sector of economy in the Russian Federation in 2007, M, Rosstat, 2008, p. 9, 42, 90–91, 92, 103, 134, 136, 143–144, 164; Development of the public sector of economy in the Russian Federation in 2008, M, Rosstat, 2009, p. 13, 43, 45–46,47, 53, 61–63, 67–68, 88; Development of the public sector of economy in the Russian Federation in 1H of 2009 , M, Rosstat, 2009, p. 13, 42, 44–45, 46, 49, 52–54, 58–59, 79.

As seen in *Table 6,* the share of the public sector in 2008 and in the 1H of 2009 was insignificant for the bigger number of the indicators (the similar trend was observed in all 2000'es) not exceeding 10%-15%. The share of the public sector was a little greater for investments (15–20%, without small businesses) and employment (24–25%), while the traffic (over 60–90% depending on the indicator) and internal R&D costs (over 70%) are obvious exclusions.

However, the official statistics agencies reported a considerable increase of the weight of the entire public sector in 2008 – 2009 vs 2006-2007 in production of mineral resources (pri-

[1] M&A market review in 2008, Ernst I Yong, 2009, p. 17.

marily, fuel and energy), in manufacturing, communications, R&D costs and investments into main capital [1]. As a result, the 1H 2009 share of the public sector in the production of fuel and energy resources which was obviously lower than the public sector input into the production of mineral resources on the whole, surpassed this indicator.

Going into a more detailed review of the situation, we can say that according to the 2008 year and 1H 2009 results, the public sector domineered on a few positions (cargo and passenger traffic by rail, forest restoration, caustic ash). In almost all other cases the unit weight of the public sector was less than 20% except production of sodium chlorite, ethyl alcohol from food staffs, railway packers for broad gage lines, certain types of machine building products (cargo cars, tractor grain drills, radio receiving sets), all types of paid services, where the public sector share did not exceed 50%.

It should be noticed that the Rosstat data based on the definition of the public sector as stated in Resolution of the RF Government of January 4, 1999 No 1 (the current version of this document adopted by Resolution of the RF Government of December 30, 2002 No 393) do not reflect the real unit weight of the public sector in the Russian economy[2].

5.1.4. The effect of the federal government property policy on the budget revenues in 2000 – 2009

The crisis that hit the Russian economy in autumn 2008, naturally led to reduction of budget revenues on almost all budget items in 2009. The revenues received by the budget as a result of the implementation of the government property policy were no exception.

Let us remind that all federal budget revenues generated by the property owned by the state can be divided into two groups depending on their nature and the source. One group comprises revenues generated by the use of the government-owned property (renewable sources). The other group comprises revenues generated by non-recurrent/one-off sources that can not be renewed because the government having sold the property transferred the property rights to some legal entities and physical persons including by way of privatization (non-renewable sources).

Below (*Table 7 and 8*) we show data on revenues that are (with minor exceptions) contained in the Laws on the execution of the federal budget for 2000-2008 pertinent to the use of the state-owned property and property sales (tangible objects only)[3].

[1] The 1H 2009 results did not confirm this trend for the last indicator.

[2] See for detail: Russian economy in 2007. Trends and prospects (Ed. 29), M, IEPP, March 2008, p. 485-490. An additional factor that negatively affects validity of data in the formal statistical reports is establishment of several state corporations that are given assets.

[3] Have not been considered the revenues of the federal budget received as payments for the use of natural resources (including water, biological resources, revenues from the use of the forest fund and subsoil), reimbursement of agricultural losses resulted from withdrawal of agricultural lands, financial transactions losses (revenues from investment of budget funds (revenues from the federal budget balance and their investment, since 2006 – also revenues from managing funds of the federal Stabilization Fund (in 2009 the Reserve Fund and National Wealth Fund), revenues from investment of funds accumulated during auctions of stock owned by the Russian Federation); interest received on budget credits granted inside the country from the federal budget funds; interest on state loans (funds received from foreign governments and foreign legal entities in the form of interest paid on loans granted by the Russian Federation; funds received from enterprises and organizations in the form of interest and guarantees payments on loans received by the Russian Federation from the governments of foreign countries and international finance agencies); revenues from paid services or compensation of the government costs; remittance of profits to the RF Central Bank; certain payments from federal and municipal enterprises and organizations (patent and registration fees for official registration of software programs, data-

Table 7

Federal budget revenues generated by the use of the state-owned property (renewable sources) in 2000 – 2009, in mln rubles

Year	Total	Stock dividend (2000–2009) and revenues from other forms of equity participation (2005–2009)	Land lease payments for state-owned land	Revenues from leasing of state-owned property	Revenues from remitted profit that remains after FGUPs have paid taxes and other mandatory payments	Revenues from Vietsovpetro JV business
2000	23244.5	5676.5	–	588.,7	–	11687.3[1]
2001	29241.9	6478.0	3916.7[2]	5015.7[3]	209.6[4]	13621.9
2002	36362.4	10402.3	3588.1	8073.2	910.0	13388.8
2003	41261.1	12395.8		10276.8[5]	2387.6	16200.9
2004	50249.9	17228.2	908.1[6]	12374.5[7]	2539.6	17199.5
2005	56103.2	19291.9	1769.2[8]	14521.2[8]**	2445.9	18075.0
2006	69173.4	25181.8	3508.0[8]	16809.9[9]	2556.0	21117.7
2007	80331.85	43542.7	4841.4[8]	18195.2[9]	3231.7	10520.85
2008	76266.7	53155.9	6042.8	114587.7[9]	2480.3	–
2009	31849.3	10114.2	647.,5	113507.3	1757.3	–

[1] – according to the Ministry of State Property of the Russian Federation, in the 2000 Law on the execution of the federal budget there was no separate item, the total amount of payments of government enterprises (RUR9,887.1 mln) was shown (with no break down);
[2] – the rental amount for (i) lands in agricultural use and (ii) city and settlements lands;
[3] – total revenues from renting property assigned to (i) research institutions (ii) educational institutions, (iii) health institutions, (iiii) state museums, state institutions of culture and arts, (iiiii) archives, (iiiiii) RF Ministry of Defense, (iiiiiii) organizations of the RF Ministry of Railways, (iiiiiiii) organizations of scientific services for Academies of Sciences with a government status and (iiiiiiiii) other revenues from renting of state-owned property;
[4] – according to the Ministry of State Property of the Russian Federation, in the 2001 Law on the execution of the federal budget there was no separate item, the amount coincided with the amount of other revenues in payments of federal and municipal organizations;
[5] – total revenues from renting of state-owned property (land rents are not shown separately);
[6] – rent amount for (i) lands of cities and settlements and (ii) lands in federal ownership after state ownership on land was delineated;
[7] – total revenues from renting property assigned to (i) research institutions, (ii) educational institutions, (iii) health institutions, (iiii) state museums, state institutions of culture and arts, (iiiii) state archives, (iiiiii) postal offices of the federal postal communications of the RF Ministry on Communications and Information Support, (iiiiiii) organizations of scientific services for Academies of Sciences with a government status and (iiiiiiii) other revenues from renting of state-owned property;
[8] – rent payments after the federal ownership to land was delineated and proceeds from sale of the right to conclude rent contracts for lands in federal ownership (for 2008-2009 – except land sites of federal autonomous institutions);

bases and topologies of integral microchips and other revenues which before 2004 had been a part of the payments by the state-owned enterprises (except revenues from Vietsovpetro JV activity since 2001 and remittance of part of FGUPs' profits since 2002)); revenues from PSA implementation; revenues from disposal and management of confiscated and other property converted into government revenue (including property converted into government property received by way of inheritance or gift, or treasures); proceeds from lotteries, other revenues from the use of property and rights in federal ownership (revenues from disposal of rights to intellectual property results (R&D and technological works) of military, special and dual purpose; revenues from maintenance and use of highway property and other proceeds from the use of property in federal ownership); also from the allowed activities of organizations to be accounted in the federal budget; proceeds from sales of government reserves of previous metals and stones.

[9] – revenues from renting of property in operating management of federal government authorities and institutions established by these authorities and in FGUPs' management: transferred to operating management to the following institutions with a government status: (i) research institutions, (ii) organizations of scientific services for Academy of Sciences and sector Academies of Sciences, (iii) educational institutions, (iiii) health institutions, (iiiii) federal postal offices of the Federal Communications Agency, (iiiiii) government institutions of culture and arts, (iiiiiii) state archives (iiiiiiii) other revenues from renting of property in operating management of federal government authorities and institutions established by these authorities and in FGUPs' management[1] (for2006–2009 without revenues from the allowed types of activity and federal property use located outside the Russian Federation gained abroad which had not been separated in previous years [2]).
Source: Laws on the execution of the federal budget for 2000 – 2008; Report on the execution of the federal budget as of January 1, 2010, www.roskazna.ru; estimates made by the authors.

As for the analysis of preliminary results of the budget effect of the government property policy in 2009 regarding renewable sources, first of all a considerable drop of revenues should be noted that is a direct consequence of the economic performance results (dividends and remittance of a part of profits of unitary enterprises).

The dividends on federal stock fell sharply, by 5.3 times vs 2008 being compared to the 2002 level (slightly more than RUR10 bln) [3], not mentioning the benchmarks outlined in 2008[4].

In this connection the Federal Property Management Agency was active in recovering debts from joint-stock companies which shares are owned by the Russian Federation and the companies that evaded from their obligations to transfer dividends to the federal budget or failed to transfer dividends in full volume for 2006 – 2008[5].

As of summer 2009, the Agency issued 20 claims against major debtors which total debt to the government was about RUR60 mln. Some of the debtors wishing to avoid court proceedings that would enforce them to pay outstanding dividends and interest on those dividends repaid their debts at once or expressed their intent in doing so. As for other debtors, the Agency lawyers prepared statements of claim for court prosecution. The aggregate debt amount (several hundreds million of rubles) does mot make us believe that the general situation with dividends payment to the federal budget can change for the better even if such debts are retired quickly and in full amount.

Certain parts of FGUPs profits demonstrated lower sensitivity to the crisis. They reduced roughly by 30%, and their absolute value (RUR1.75 bln) exceeded the 2002 indicator by almost two times though was lower than the transfers to the budget in all subsequent years.

[1] In 2008-2009 FGUPs as a source of revenues from renting of property in economic control were not mentioned while renting of property in operating management of federal authorities and institutions established by these authorities excludes the property of federal autonomous institutions..
[2] According to the RF Ministry of State Property, the revenues from the use of federal property being abroad (in addition to revenues due to the interest of the Russian participant of JV Vietsovpetro) amounted to RUR315 mln in 1999 and RUR440 mln in 2000. Further on FGUP "Predpriyatie po upravleniyu sobstvennostiyu za rubezhom (Company for managing property abroad) came to play a major role in the organization of commercial use of the federal property abroad.
[3] It should be noticed that in 2002 in addition to dividends on the shares of Russian joint-stock companies inside Russia the federal budget received about RUR13.4 bln as revenues on the stake of the Russian participant in JV Vietsovpetro. However, after completion of the actions for development of JSC Zarubezhneft which charter capital in 2007 in addition to stock of two joint-stock companies (research institutes) received a share (50%) of the Russian participant of JV Vietsovpetro., the federal budget ceased to receive revenues from this source which was not mentioned in the revenue structure from the renewable sources in 2008-2009.
[4] See Russian economy in 2009. Trends and prospects. (Ed. 31) M. IEPP.
[5] www.rosim.ru, 24.08.2009.

Against this background the situation with rent revenues looked quite favorable where the government received rent (for the use of real estate and land plots) not being involved in the organization of business processes of renting companies and building the relations with then on the contract basis concluded, as a rule, for a specific period of time at the earlier agreed rates. Rentals from the federal property (RUR13.5 bln) reduced slightly, by 7.4%, being pushed back to the level of 2003-2004. At the same time land rent proceeds did not shrink but rather increased by 7% in 2009 reaching their absolute maximum value since 2000'es.

Thus a certain reconfiguration of the federal budget revenue structure from the renewable sources occurred. The revenues from leasing of federal property became the most significant item (42.4% vs 19.1% in 2008). Dividends regardless of their sharp decline preserved their important place (31.8%) though in 2007 – 2008 they made half of all the revenues from the reviewed sources. Specific weight of revenues from land rent grew considerably (20.3% against 5–8% of all revenues from the renewable sources in 2006 – 2008) while the profit input transferred by FGUPs (5.5%) reached its highest value in 2003 (5.8%) for the period starting 2000.

In analyzing the revenues of the federal budget from privatization and sales of state property (*Table 8*) it should be noticed that from 1999 proceeds from sales of the major part of such assets (shares, and in 2003 – 2007 - land plots[1]) have been looked at as sources of funding of the budget deficit.

Table 8

Federal budget revenues from privatization and sales of property (non-renewable sources) in 2000 – 2009, in mln rubles

Year	Total	Sale of stock in federal ownership (2000–2009) And other forms of equity participation (2005–2009)#	Sale of land plots	Sale of various property
2000	27167.8	26983.5	–	184.3[1]
2001	10307.9	9583.9	119.6[2]	217.5+ 386.5+0.4 (intangibles)[3]
2002	10448.9	8255.9[4]	1967.0[5]	226.0[6]
2003	94077.6	89758.6	3992.3[7]	316.2+10.5[8]
2004	70548.1	65726.9	3259.3[9]	197.3+1364.6+0.04 (intangibles)[10]
2005	41254.2	34987.6	5285.7[11]	980.9[12]
2006	24726.4	17567.9	5874.2[11]	1284.3[13]
2007	25429.4	19274.3	959.6[14]	5195.5[15]
2008	12395.0	6665.2+29.6	1202.0[16]	4498.2+0.025 (intangibles)[17]
2009	4544.1	1952.9	1152.5[16]	1438.7[17]

–refers to internal financing sources to cover deficit of the federal budget, the amount of RUR29.6 mln for 2008 (Report on the execution of the federal budget as of January 1, 2009) refers to the federal budget revenues, but it is missing in the Law on the execution of the federal budget for 2008;

[1] – revenues from privatization of state-owned organizations included in the sources of internal financing of the federal budget deficit;

[2] – revenues from sales of lands and rent rights to lands in federal ownership (the land sites under privatized enterprises are shown separately) included in the federal budget revenues;

[3] – aggregate revenues from (1) sales of property in federal ownership included in the sources of internal financing of the federal budget deficit; (2) revenues from (i) apartment sales, (ii) sales of state production and non-production funds, transportation vehicles, other equipment and material values, also (3) revenues from sales of intangibles included in the federal budget revenues; ;

[4] – with RUR6 mln generated from sales of stock owned by the RF subjects;

[1] In 2003-2004 with account of sales of rent rights.

[5] – proceeds from sales of land and intangible assets which have not been shown separately; included in the federal budget revenues;
[6] – proceeds from state-owned property sales (including RUR1.5 mln from sales of property owned by the RF subjects) included in the sources of internal financing of the federal budget deficit;
[7] – includes proceeds from: (1) sales of land plots under real estate facilities that have been in federal ownership before their disposal; to be credited to the federal budget; (2) sales of other land plots and sale of rights to conclude rent contracts thereto; (3) sales of land plots after the land property rights have been delineated; also sale of rights to conclude rent contracts thereto; to be credited to the federal budget and treated as sources of internal financing of the federal budget deficit;
[8] – sum of (1) proceeds from federally owned property sales that are referred to the sources of internal financing of the federal budget deficit, and (2) proceeds from sales of intangible assets referred to federal budget revenues;
[9] – includes proceeds from: (1) sales of land plots under real estate facilities that have been in federal ownership before their disposal; to be credited to the federal budget, (2) sales of other land plots and sale of rights to conclude rent contracts thereto; (3) sales of land plots after the land property rights have been delineated; also sale of rights to conclude rent contracts thereto; to be credited to the federal budget and treated as sources of internal financing of the federal budget deficit;
[10] – sum of (1) proceeds from federally owned property sales that are referred to the sources of internal financing of the federal budget deficit, (2) revenues from (i) apartment sales, (ii) sales of equipment, transportation vehicles and other tangible property to be credited to the federal budget; (iii) sales of ships utilization products; (iiii) sales of GUPs' property, property of institutions and military property; (iiiii) sales of products of utilization of weapons, military equipment and ammunition; (3) proceeds from sales of intangibles to be included in the federal budget revenues;
[11] – includes proceeds from: (1) sales of land plots under real estate facilities that have been in federal ownership before their disposal; to be credited to the federal budget (2) sales of land plots after the land property rights have been delineated to be credited to the federal budget, (3) sales of other land plots owned by the government before the federal ownership on land have been delineated and not designated for housing construction (the last statement refers to 2006 only), the proceeds are included in the sources of financing of the federal budget deficit;
[12] – proceeds from sales of tangibles and intangibles (less federal budget funds from disposal of confiscated and other property converted to the state income) include proceeds (i) from apartment sales, (ii) sales of FGUPS' property, (iii) sales of property in operational management of federal agencies; (iiii) sales of military property, (iiiii) sales of utilization products of weapons, military equipment and ammunition; (iiiiii) sales of other property in federal ownership; (iiiiiii) sales of intangibles, referred to federal budget revenues;
[13] – proceeds from sales of tangible and intangible assets (less revenues in the form of profitable products of the state under PSA) and federal budget funds from disposal and sale of confiscated, heirless and other property converted to the state income, include revenues from (i) apartment sales, (ii) FGUPs' property sales; (iii) sales of property in operational management of federal institutions; (iiii) sales of military property, (iiiii) sales of utilization products of weapons, military equipment and ammunition; (iiiiii) sales of other federally owned property, included in the federal budget revenues;
[14] – proceeds from sales of land plots in federal ownership after the land property rights have been delineated , included in the sources of financing of the federal budget deficit;
[15] – proceeds from sales of tangible and intangible assets (less revenues in the form of profitable products of the state under PSA) and federal budget funds from disposal and sale of confiscated, heirless and other property converted to the state income, proceeds from sales of sequestrated lumber include revenues from (i) apartment sales (ii) FGUPs' property sales; (iii) sales of property in operational management of federal institutions; (iiii) sales of released movable and immovable military and other property of the federal executive authorities with the military service and the service equated thereto; (iiiii) sales of products of military designation available at the federal executive authorities within the framework of military and technical cooperation; (iiiiii) proceeds from sales of other federally owned property, included in the federal budget revenues;
[16] – proceeds from sales of lands in federal ownership (except lands of federal autonomous institutions) to be included in the federal budget revenues;

[17] – proceeds from sales of tangible and intangible assets (less revenues in the form of profitable products of the state under PSA) and federal budget funds from disposal and sale of confiscated, heirless and other property converted to the state income, proceeds from sales of sequestrated lumber. Proceeds from sales of special feed-stock and fissionable materials include proceeds from: (i) apartment sales, (ii) sales of property in operational management of federal institutions (except autonomous)[1], (iii) sales of released movable and immovable military and other property of the federal executive authorities with the military service and the service equated thereto, (iiii) sales of utilization products of weapons, military equipment and ammunition; (iiiii) sales of products of military designation available at the federal executive authorities within the framework of military and technical cooperation (2008 only), (iiiiii) sales of utilization products of weapons and military equipment under the federal target program "Industrial utilization of weapons and military equipment (2005-2010);», (iiiiiii) proceeds from sales of other federally owned property and proceeds from sales of intangible assets included in the federal budget revenues;
Source: Laws on the execution of the federal budget for 2000 – 2008; Report on the execution of the federal budget as of January 1, 2010; www.roskazna.ru; estimates of the authors.

In 2009 the federal budget revenues of property nature generated from non-renewable sources continued falling down sharply following the trend of the previous year.

Proceeds from stock sales fell almost by 3.5 times, from sales of various types of property – by more than 3 times. While the proceeds from the latter source appeared to be comparable in absolute values (over RUR1.4 bln) with those in 2004 and 2006 and exceeded the 2005 level by 1.5 times, the proceeds from stock sales (leas RUR2 bln) reached its absolute minimal value for the entire period of 2000'es. Unlike 2008, when the proceeds from land sales grew by almost 1/4, in 2009 they dropped though insignificantly (by 4%) reaching RUR1.15 bln. However this source (land sale proceeds) remained less valuable (in terms of weight) (about ¼ of all revenues from non-renewable sources, approximately at the level of 2006) vs the proceeds from stock sale (43%) and sale of various types of property (31.7%). The proceeds from stock sales made less than a half of all such revenues for the first time in the period of 2000'es; the unit weight of the proceeds from sales of other property also shrank vs 2008.

The year of 2009 demonstrated a more than double fall of the overall volume of federal budget revenues from privatization (sales) and use of the state-owned property (*Table 9*). Their absolute values (RUR 36.4 bln) vs 2008 reduced by more than 2 times and proved to be minimal for the entire period of 2000'es. Still we can state that this value has exceeded the target figure voiced out at the working meeting of the RF Government Chairman with Yu. A. Petrov, Head of Federal Property Management Agency held in the mid of July 2009 where the latter expressed his assurance in that the Agency would remit to the budget about RUR20 bln in 2009 [2].

[1] Also less proceeds from sales of FGUPs' property .

[2] www.rosim.ru, 16.07.2009. It should be noted, however, that the Federal Property Management Agency administers not all the revenues connected with the use of the state-owned property and its privatization.

Table 9

Structure of the federal budget revenues of property nature generated from various sources in 2000–2009

Year	Aggregate revenue from privatization (sales) and use of state-owned property		Revenue from privatization (non-renewable sources)		Revenue from the use of state-owned property (renewable sources)	
	RUR, mln.	% to total	RUR, mln.	% to total	RUR, mln.	% to total
2000	5041.3	100.0	27167.8	53.9	23244.5	46.1
2001	39549.8	100.0	10307.9	26.1	29241.9	73.9
2002	46811.3	100.0	10448.9	22.3	36362.4	77.7
2003	135338.7	100.00	94077.6	69.5	41261.1	30.5
2004	120798.0	100.0	70548.1	58.4	50249.9	41.6
2005	97357.4	100.0	41254.2	42.4	56103.2	57.6
2006	93899.8	100.0	24726.4	26.3	69173.4	73.7
2007	105761.25	100.0	25429.4	24.0	80331.85	76.0
2008	88661.7	100.0	12395.0	14.0	76266.7	86.0
2009	36393.4	100.0	4544.1	12.5	31849.3	87.5

Source: Laws on the execution of the federal budget for 2000 – 2008; Report on the execution of the federal budget as of January 1, 2010; www.roskazna.ru; estimates of the authors.

In 2009 the trend of increasing weight of the renewable sources in the structure of aggregate revenues from privatization (sales) and use of the state-owned property had further developed. The share of revenues from the use of the state-owned property was 87.5%, being the highest in the 2000'es. The share of revenues from privatization and sales of property was minimal – 12.5%.

If in 2008 the revenues from the use of the state-owned property played a buffer role, not going lower than the 2006 level, in 2009 they exceeded the similar figues for 2000-2001 only when the actions were performed under the Concept of Management of State-Owned Property and Privatization in the Russian Federation in 1999, while the revenues from privatization and sales of various types of property proved to be minimal for the entire period of the 2000'es.

5.1.5. Changes in the legislative and normative framework regulating the public sector

The year of 2009 was marked by introduction of a number of important innovations in the legislative and normative framework regulating activities of the unitary enterprises and economic entities where the government has its stake (participates). Indeed, these innovations are going to influence seriously the property policy of the federal government in the near future.

Of priority is Regulation of the RF Government of December 31, 2009 No 1188.

This Regulation demands from the executive federal authorities except President's Administrative Department, to present, within three months and according to the established procedure, draft acts for specifying the lists of federal government unitary enterprises (FGUPs) in their jurisdiction.

The Federal Property Management Agency is instructed, by July 1, 2010, to carry out actions in reference to FGUPs not included in the mentioned lists for their restructuring, liquidation or inclusion into a forecast plan (program) of privatization and to exercise ownership rights in relation thereto until such actions are completed.

The said Regulation made a number of amendments in and additions to the legislative and normative acts regulating functions of the unitary enterprises in federal ownership, the most significant changes being as follows:

Amendments in Regulation of the RF Government of December 3, 2004 No 739 "On the authorities of the federal executive authorities in exercising the ownership rights to the federal government unitary enterprise" expanded the range of authorities of the federal executive authorities in relation to enterprises in their jurisdiction that are included in the Forecast plan (program) of privatization of the federal property.

Earlier these authorities were exercised only in relation to enterprises to be converted into joint-stock companies with the contribution of shares into the charter capital of other joint-stock companies or keeping them in federal ownership.

Besides, the range of authorities now includes rendering support in preparation of documents by the enterprises required for taking decisions about the terms of privatization and the submission of these documents to the Federal Property Management Agency that has been granted the right to:

- request documents from the enterprises which the enterprises are obliged to keep according to the 2002 Law on Unitary Enterprises; while in relation to enterprises included in the Forecast plan (program) of privatization of federal property – request also documents required for taking decisions on the privatization terms and also to set the dates for their submission;
- launch claims to courts on invalidation of transactions performed by enterprises in violation of the established procedure;
- audit, within the framework of their authorities, the use of federal property being in economic management of the enterprises, decide on and carry out documentary due diligence and other audits, including inspections, and make decisions on auditing enterprises including those in the Forecast plan (program) of privatization of federal property to see whether federal property is used efficiently and kept safe.

The list of grounds to terminate an employment contract with a Leader of a federal unitary enterprise under the RF Government Resolution No 234 of March 16, 2000, was supplemented with such grounds as a failure to present or a failure to present on time, a failure to present valid (correct) and/or complete data (information) as necessary to the Federal Property Management Agency and/or a respective executive federal authority under which jurisdiction the given enterprise falls.

The Federal Property Management Agency was also granted the right to include their representatives with the decisive votes in the commissions in organizing a competition to fill the vacancy of the enterprise director and in certifying director's competences.

The Regulation on the management of federally owned shares of open joint-stock companies and the use of a special right of the Russian Federation ("golden share") to participate in the management of open joint-stock companies approved by the RF Government Resolution of December 3, 2008 No 738 was changed as follows:

Earlier the Federal Property Management Agency exercised the right of the federal government as a shareholder in different ways based on the classification of joint-stock companies with the federal government interest in their capital (three categories):

- joint-stock companies included in a specialized list[1] as agreed with the federal ministry or federal authorities of executive power vested with the authorities of management of

[1] A group of companies of importance in relation to which the position of the federal government as a shareholder on a number of significant issues is defined by resolution of the federal government, Russian Government Chairman or his/her Deputy upon the Chairman's assignment. Initially this List was approved by the RF Government in 2003, however it has been changed since then many times.

state property under the guidance of the President of Russia or the Government of the Russian Federation;

– joint-stock companies included in the list of strategic companies approved by the President of Russia (hereinafter the Strategic List)[1], except joint-stock companies that are included in a specialized list – based on proposals of a federal agency in the jurisdiction of the federal ministry concerned or the respective federal body;
– other joint-stock companies - independently, while where a federal agency or a federal body as a shareholder presents proposals according to the established procedure – with account of those proposals.

RF Government Resolution of December 1, 2009 No 978, cancelled the category of strategic joint-stock companies keeping only the category of joint-stock companies in the specialized list; it was stated that in other joint-stock companies the Federal Property Management Agency exercises the shareholder's rights based on the proposals of the federal agency in jurisdiction of the federal ministry or the relevant federal body.

It was stated additionally that if a joint-stock company not included in the specialized list does not submit any proposals (also on candidates proposed for inclusion in the list of candidates for electing board of directors), the Federal Property Management Agency shall develop independently proposals on the federal government position as a shareholder.

The general change of the legislative and normative framework regulating activities of the unitary enterprises and economic entities where the federal government is involved, may be described as having a growing number of exclusions.

Thus certain government acts established that the above mentioned Regulation on the management of federally owned shares of open joint-stock companies and the use of a special right of the Russian Federation ("golden share") to participate in the management of open joint-stock companies shall not apply to management of federally owned shares of OJSC State Transportation Leasing Company, shares of joint-stock companies to be transferred to GK Rostechnologies as an asset contribution of the Russian Federal Government before such shares are transferred. A number of authorities of the Federal Property Management Agency have been passed over to Administrative Board of the President of the Russian Federation and the Federal Agency of Marine and River Transport in relation to unitary enterprises in their jurisdiction, while late 2008 these authorities were transferred to the RF Ministry of Defense.

5.1.6. Possible impact of the financial crisis on the property relations and prospects of their development

The anti-crisis actions of the RF Federal Government with a domineering trend of limiting direct involvement of the government in capital in principle set the context for this or other privatization scenario.

The development of a future privatization agenda and its possible format, however, meets with certain difficulties.

Firstly, the bulk of the state-owned property was represented by either low-liquidity assets (that required sizable investments or were insufficient in terms of giving control as in case of

As for joint-stock companies included in this specialized list, if a federal ministry has federal agencies under its control, proposals submitted to the Federal Property Management Agency must reflect consolidated positions of the federal ministry and its federal agencies on each issue.

[1]Decree of President of Russia of August 4, 2004 No 1009.

minority shares) or very attractive assets (e.g. control or blocking stakes in national monopolies) which sale was quite possible but at the adequate market price if certain conditions allowed for this. It is quite probable that the list of problematic assets owned by the state will be expanded as the crisis continues.

Secondly, the financial crisis that brought about the collapse of the stock market, devaluation of assets and withdrawal from the market of many potential investors who experienced serious problems in their native countries still acts as a natural limiting factor of privatization.

In such situation prospects of significant growth of budget receipts from privatization are quite low moreover with account of lacking assets in the fuel and power complex. We may hope receiving large amounts of revenues only when the Russian economy begins showing signs of going out of the crisis while in the countries with more developed economies the crisis will be close to its end, and as a result of this a flow of capital and investments would be observed to the emerging markets including Russia.

Therefore no inclusion of major assets such as Sberbank, VTB, RZhD, Airoflot, Sheremetievo airport in the privatization program is planned for the near future. As for VTB, it is enough saying that in the mid-term there is a probability of selling its minority block of shares while presently the government interest in the VTB capital reaches 85.5%.

Thirdly, the orientation on the budget revenues as the only criterion of conducting the privatization policy, specifically in the context of crisis, contradicts the tasks of the so-called structural privatization primarily in attracting investments for production upgrade.

The Ministry for Economic Development jointly with the Federal Property Management Agency is drafting amendments for the Law on privatization that would allow conducting auctions with investment terms. In a number of cases, e.g. where state-owned stakes in infrastructure facilities are sold the auction terms may include the requirement to preserve the business profile[1].

In this connection it would be worth reminding the low efficiency of the investment bids in the 90"es. The volume of investments received from the sales at the investment auctions (with account of delivery of obligations of the previous years) in 1997 made 1.3% only of the total investments in the capital assets (in 1994–1996 less than 1%). Alongside with this quite a large number of investors participating in the investment bids demonstrated obvious examples of unfair behavior disrupting their commitments. As a result, the investment bids were cancelled (Second Law on privatization of 1997) and replaced for commercial bids with investment and/or social terms[2] where the property rights were granted to the auction winner only after certain commitments had been delivered. The current 2001 Law on privatization provides for bids as an independent method of privatization, however the exhaustive list of its possible terms[3] does not contain the terms of attracting investments for restructuring of a company. De-facto an auction with social terms may be deemed.

[1] Interview with the Head of the Federal Property Management Agency E. L. Adashkin, RIA Novosti, www.rosim.ru, 25.11.2009.

[2] The commercial bid as an independent method of privatization was actively applied in 1992-1997 mainly for privatization of small businesses when the buyer of an enterprise undertook certain obligations, preserving the business profile, among them. After Law on privatization was enforced in 1997, the investment and the commercial bids merged actually into one method.

[3] The bid terms may be like follows: (1) keeping a certain number of jobs (2) retraining and raising qualification of the employees; (3) restriction on changes of the business profile of the unitary enterprise or designation of

Speaking about possible return to privatization practices with investment obligations and their future, we can assume that this aspect is similar to the issue of reasonable fine tuning of the tax system towards encouragement of certain types of activity (e.g. innovations). In other words, whether the government administration is sufficiently able to control the use of certain legal norms/provisions for compliance with their target purpose.

Fourthly, the critical condition of many private companies that rushed to get support from the government threw light on the fact that had not been obvious until recently that the private business is not always a synonym of an efficient and responsible owner of the assets. Comparison of efficiency of state-owned and private companies in terms of their resistance to crisis and needs in the government support requires additional examination in the context of present-day realities.

Fifthly, a partial shift of the "gravity center" from the government authorities to various integrated entities with government involvement in making decisions on privatization (one of such examples is Rosneftegaz that secures its indirect control over Rosneft and Gazpromneft) when these entities become owners of a large number of assets due to various reasons (assets are received from the government in the process of establishment and M&A) makes the position of the management of such entities very weighty.

Where such entities initiate sales of their assets, the state is obliged to receive certain reimbursement at least for the assets that had been contributed to those entities earlier for free. It refers primarily to state corporations established in 2007 – 2008 that proved to be outside the scope of true corporatization, and to the recipients of state support programs during the crisis. In some cases the government may put up with ignoring budget-related problems in the course of "big privatization" by integrated entities; but then the obligatory set of behavioral requirements to such business entities must include the absence of outstanding debts, refusal from participation in mergers and acquisitions for the definite period of time, active investments with account of priorities of the federal government anti-crisis program.

Otherwise there may be a return to the earlier privatization stages in Russia with fast and uncontrolled enrichment of the management in cases where a "shell" of a holding head company became a subject of corporate governance or privatization deprived of its valuable subsidiaries with their expensive production or financial assets.

In the sixth place, one should understand that stimulation of the privatization process as such is not a sufficient condition for changing the corporate control market situation. Much depends on the regulation of participation of companies with the government stake in mergers and acquisitions. The focus here should be placed on restricting the acquisition of non-core assets, better selection of decisions that require the agreement of the state both as the owner and the market regulator.

Thus the degree of real submission to the state control of the management of those companies in which the state participates, the degree of manageability, loyalty and the vision of the place and roles of particular assets through the lenses of long-term development of various integrated entities including state corporations moves to the forefront. This makes the task of improving corporate and strategic governance in the companies with the government involvement more urgent and up-to-date.

facilities for cultural, utilities or transportation services, or termination of their use; (4) f rehabilitation, repair and other works on the facilities of cultural heritage and of social, cultural and utilities designation.

In this context rolling out the practice of attracting professional directors[1] to the management bodies of such companies could play a certain role.

The Federal Property Management Agency jointly with the RF Ministry for Economic Development began doing some work in execution of the assignments of the President of Russia set as a follow-up of his meeting with representatives of the Russian Union of Industrialists and Entrepreneurs held in April 2008.

For this purpose general provisions and normative acts regulating both the process of attraction of independent managers to the board of directors of joint-stock companies with the stake of the Russian Federation in their charter capitals and the issues of their activities[2] were developed; changes were made in the RF Government Regulation of December 3, 2004 No 738 "On the management of federally owned shares of open joint-stock companies and the use of a special right of the Russian Federation ("golden share") to participate in the management of open joint-stock companies" regarding election of independent directors to the management bodies of those joint-stock companies which shares are owned by the Russian Federation. Early 2009, the Federal Property Management Agency by its order established a Commission for selection of independent directors, representatives of the interests of the Russian Federation and the auditors for electing them to the management bodies of joint-stock companies and approved the respective Regulation[3].

The RF Government performed certain actions to secure the conclusion of contracts with the members of the board of directors who are professional directors; also joint-stock companies with the state involvement and professional directors on their boards of directors have been monitored with the subsequent evaluation of the implementation efficiency of this institution.

At the first stage of work in this direction, professional directors were selected in nine joint-stock companies that are in the specialized list approved by the RF Government Resolution of January 23, 2003 No 91-r, which 100 % shares belong to the Russian Federation

[1] Following the established tradition of corporate governance of joint-stock companies with the state participation, board of directors members elected by votes according to shares owned by the federal government as a shareholder can be grouped as follows: (1) government officials who represent the interests of the federal government are obliged to vote according to the owner's instructions; (2) representatives of the government interests who are proxies are obliged to vote according to the owner's instructions on the limited range of 5 issues while on other issues – at their own discretion (this mechanism of securing the government interests emerged in 1996 but has not been widely applied since then); (3) independent directors who vote being guided by their personal professional experience and opinion and meet the established selection criteria. According to the Federal Property Management Agency, the persons in the second and third groups may be called professional directors.

[2] Among others, were defined:
- criteria of professionalism and independence of BoD members applied to individuals proposed by the federal government for their selection and further engagement as independent directors in joint0stock companies;
- the list of joint-stock companies which BoDs should have professional directors;
- the number of independent directors and professional proxies determined in relation to the size of the RF government stake;
- the selection procedure of professional directors and the principle of creating a list of candidates for election into open JSC management bodies as independent directors and professional directors-proxies;
- criteria of referring a board director to independent directors and the development of the respective requirements to the candidates.

[3] Does not apply to JSC that are included in the specialized list in relation to which the position of the state as a shareholder on a number of important issues is defined by the decision of the RF Government, the RF Government Chairman or the RF Government Chairman Deputy in the name of the Chairman. Initially approved by the RF Government.

(OJSC Agency for Mortgage and Housing Crediting, OSC Joint-Stock Company for Oil Transportation Transneft, OJSC Zarubezhneft, OJSC Corporation Roskhimzaschita, OJSC International Airport Sheremetievo, OJSC Russian Railways, OJSC Rosselkhozbank, OJSC SG-Trans and OJSC Modern Commercial Fleet).

At the second stage of the implementation of the objective to increase the number of professional directors on the boards (Supervisory councils) of the joint-stock companies which shares are owned by the Russian Federation, extraordinary general meetings of shareholders were held, and new management bodies were elected with participation of professional directors in another seven companies: OJSC Airoflot – Russian Airlines, OJSC Russian Fuel Company Rostoprom, OJSC FSK Unified Energy Network, OJSC Rosagroleasing, OJSC RusHYDRO, OJSC Holding MRSK and OJSC RAO Energy Networks of the East[1].

According to the Federal Property Management Agency, by autumn 2009 the BoDs (Supervisory councils) of 253 joint-stock companies had 563 professional directors while at the end of 2008 their number was about 50)[2]. Thus we can state that early 2009 this institution was implemented in 7.6% of the companies with the federal government stake of their total number. This institution has been most widely applied in the electric energy and communications sectors.

Besides, the Federal Property Management Agency also applied the practice of engaging managing companies that acted as sole executive bodies of the joint-stock companies, but this practice has been even less popular than the institution of professional directors (as of the end of 2009 only six managing companies had been involved in management of the joint-stock companies with the government stake).

A most important area of activities of professional directors to improve performance and efficiency of the joint-stock companies with the government interest should be their work on three specialized Committees at the management bodies of these companies (Strategic Planning Committee, Audit Committee and HR and Remuneration Committee); it is proposed to elect as Chairmen of these Committees those board members who are not government officials (but independent directors or professional proxies).

5.2. Government Support of strategic companies: key instruments, specifics and practical implementation challenges

5.2.1. Specific measures and approaches to the support of backbone enterprises in crisis situation

To correctly evaluate government support of strategic companies it is important to understand specific economic conditions in which government anti-recession instruments and measures were developed and the approaches underlying government support to strategic companies were defined[3].

[1] Federal Agency for Federal Property Management. Progress report for 2008, M., 2009.
[2] T. Zykova.To replace civil servants// Russian Gazette, September 16, 2009. Federal Agency for Federal Property Management. Progress report for 2008, M., 2009.
[3] This section is based on part of the deliverables of the project implemented by the Academy of National Economy under the RF Government focused on evaluation of various instruments of government support to strategic companies. The project was implemented by a group of experts in the end of 2009 in the interests of the Expert Council with the Government Commission for improving sustainable development of Russian economy.

Russian banking system was the first to be hit by global economic crisis. In September 2008 certain efforts on behalf of the monetary authorities were already in demand to support the liquidity of the banking system. In October such support was already provided on a bigger scale allowing for avoiding the financial system collapse, but not capable of improving the credit terms for the real economy entities. By October 2008 the crisis has already affected the manufacturing industry as well, though recession examples at that time were mainly of local character: significant drop of production was evident in metallurgy (milled products reduced by 21% versus October 2007, steel casting – by 19%), in mineral fertilizers production (14% reduction), cement production (20% reduction), in certain mechanic engineering subsectors (materials handling, construction and road engineering, commercial vehicles).

However by mid-end November it became clear 2008 that the crisis might affect a broader range of sectors. Several factors were pointing at that. First of all, drastic decay of external environment: FTSE/S&P indices slump, fall in oil prices, growing challenges for global financial system. Secondly, despite the efforts of the Bank of Russia and of monetary authorities to support the banking system, the credit terms for Russian companies continued to deteriorate –with regards of both loans accessibility, and borrowing prices. Thirdly, a steady trend for unemployment rate growth became obvious: the number of registered unemployed increased by 4% in the end of November 2008 (vs. October). In the fourth place, negative monetary trends accelerated: сокращение forex/gold holding decrease, ruble devaluation.

It is worth noting that recession, unemployment and other indicators were critical per se, but the main problem was in highly uncertain development outlook, in significant concerns of all market players including the government with regards of possible scale and length of crisis.

It was no longer possible to view the crisis as just financial one associated with insufficient liquidity. Moreover, it was not possible to view it as the crisis affecting mostly major financial and industrial groups with high external debt. It became clear: global energy markets fall and decrease of export is going to affect a significant number of major Russian exporters; inevitable disinvestment and lending reduction jeopardizing all sectors of the economy will have a chain effect leading to material deterioration of market situation and of financial positions of companies across all industries and sectors of Russian economy. Collapse and bankruptcies of major companies in any sector were quite possible; and in the environment when the business community was close to panic, any announcement about suspension of production or about insolvency of just one company could have caused significant growth of mutual distrust among market players and provoked knock-off effect along the cross-sector links.

In the situation of vague economic outlook due to the specifics of Russian banking system the possibilities for effective support of real sector businesses solely through monetary policy instruments turned out to be quite limited: support of bank liquidity was not backed by maintaining the credit terms for real economy. In particular, during late 2008 – early 2009 when ruble was devaluated, it much more profitable and less risky to invest into buying currency rather than to issue loans to enterprises. In other words, high uncertainty generated total collapse of confidence between banks, banks and borrowers, suppliers and consumers. Those were credibility gap and high risks that impeded restoring normal credit terms for enterprises.

Concerns about rapid growth of unemployment in case companies start mass layouts were also justified, and that could lead to extremely negative social consequences, especially in mono cities and in certain regions highly dependent on a limited number of major city-forming enterprises.

It became obvious that anti-crisis measures cannot be completed with just support to major banks. Prevention of bankruptcies or shutdowns of major enterprises due to inaccessibility of funding requires other "pinpointed" instruments of government policy focused on resolving the problems of selected, the most valuable businesses. It is worth noting that most of serious concerns had not come true, but they looked quite realistic by the end of 2008.

However, at that point of time the Government did not have any better fine-tuned "pinpointed" support instruments, or more or less adequate action list.

This, Strategic Actions and Strategic Companies List[1], first of all, is focused on other objectives, mainly – on special procedure for privatization and/or incorporation; secondly, it includes only government owned enterprises and joint-stock companies with government holding blocking or controlling interest. Other officially approved lists (e.g., the Register of Business Entities with market share of 35%+) turned out to be not instrumental for defining the priorities for support, – the latter, in particular, contains several thousand organizations, not all of them being real majors.

It is necessary to acknowledge: the *List of systemic companies of strategic importance* (hereinafter – the List) was formed as an "all-hands-job" simultaneously with defining its goals and objectives and with discussing the possible government's measures. This, of course, marked an imprint on the composition of the List. On top of that, the benefits for the future members of the List were still unclear, so different groups of stakeholders were lobbying the process of the List development. It appears that if only the business community had known the scope and format of future government support in advance, the number of willing participants could have turned out not as big.

Government support to strategic companies was stated to have the following objectives:

– First and foremost – assure social stability, prevent massive layouts at major enterprises;
– Second – assure sustainability of critical cooperation value chains by way of supporting their elements;
– Third – assure stable operations of the key infrastructure elements.

Today we have to recognize: forming the List and administering it (which meant, first of all, monitoring its members and providing government support to them) have become the critical element of the anti-crisis policy. With that, support to strategic companies had its own specifics in different sectors – from the standpoint of both the applied mechanisms and the scope of measures.

We have identified the following topics allowing for detailed review of the government anti-crisis policy:

(1) the List of strategic companies – its objectives and formation principles, sector breakdown;

(2) the key areas and mechanisms of government support to strategic companies – specifics and practical implementation challenges;

(3) high-level definition of sector-based specifics within the government support to strategic companies – benchmarking the scale of support and instruments used in priority industries.

[1] Decree of the RF President of August 24, 2004, No. 1009 "On Approving the List of Strategic Enterprises and Strategic Joint-Stock Companies"

The following material limitations applied to the performed analysis need to be highlighted:

Support rendered to defense industries was quite special, so we are going to refrain from its review (except for some very limited examples);

The scope of our analysis covers only the instruments and measures which the RF Government was really using during the crisis period.

5.2.2. List of systemic organizations of strategic importance: formation principles and composition

Objectives, principles and criteria for forming the list of strategic companies

As per public information, the first approaches to forming the List of strategic companies were discussed at the government level as early as early December 2008. At that time the inclination was to select about 150–200 companies with the biggest contribution to Russian GDP. Various government agencies were simultaneously developing their proposals on including companies into the list and on criteria for qualifying the companies as strategic ones. They were mostly focused on such attributes for as size and social value of a company.

However, already at the first stage at least part of the stakeholders was viewing this List formation not only from the standpoint of preventing bankruptcy of major enterprises, but also from the point of view of creating the capability for future development. Thus, according to the representative of the RF Ministry of Commerce, List preparation was approached from the standpoint of "demand configuration, so that in several years when the crisis is over the companies could enter the market being fully competitive"[1]. Respectively, the following criteria were offered: unique technological capabilities, availability of export contracts for 2009, on-going major capital projects, and key positions within the inter-sector business network.

In December 2008 the List of strategic companies was finalized[2], 295 organizations were included. Initially it was declared open for including other companies; however, no significant changes were made even though there were a number of attempts to increase the list.

As per available data, over 300 proposals to increase the List of strategic companies were received during the first year. However, the List was only insignificantly increased[4] *by way of adding several agricultural enterprises, one agricultural engineering enterprise, two jewelry industry plants and Goznak (money-printing enterprise).*

In our opinion, based both on the finalized List as a whole and on comments provided by various government officials, the formation of the List of strategic companies was associated, on one hand, with significant lobbying by certain agencies to include the maximum possible range of their subordinate organizations into this List; and on the other hand – with the tendency for minimizing the List to the extent possible demonstrated by a number of other agencies. The last tendency, in our view, was based not only on the fact of Government resources to support businesses being limited, but also by a *limited "throughput capacity" of the respective decision-making system.* The number of reviewed issues was limited by multistage endorsement practice within the complicated system of sector-based, inter-sector and gov-

[1] Cited as per Article "Putin's List", *Vedomosty*, December 9, 2009

[2] List of systemic organizations of strategic value was approved by the RF Government Commission for improving sustainable development of Russian economy on December 23, 2008

ernment commissions. Besides, those commissions did not have enough resources and staff for developing the solutions – they were relying on the available personnel of the respective government agencies.

For example, the Cross-Sector Work Group for monitoring economic and financial positions of organizations included in the List of strategic companies held 6 meetings between January 17 and 30, 2009. 15 strategic companies were reviewed at those meetings[1]*. And still, with the List comprising more than 300 companies at that point of time, even such facilitated review would not allow for immediate monitoring of all the strategic companies totality.*

In addition to lack of clear understanding of the List objectives and criteria, the situation was complicated because *the package of potential "rights and responsibilities" of strategic companies was not defined at that point of time.* In particular, the format of potential government support to the List members was not clear, which stimulated the companies for lobbying their inclusion into the List. In our opinion, some pretty tough statements by officials declaring that becoming members of the List would mean thorough control on behalf of the government and would not guarantee financial support[2] could be explained by their desire to somehow limit such lobbying activity.

A very meaningful, though ambiguous from the methodology standpoint decision was made to include multidiscipline holdings and business groups into the List. On one hand, they undoubtedly belong to the backbone of Russian economy and provide for its sustainability to a great extent. On the other hand, major groups comprise of multiple enterprises, businesses and organizations, and most of them do not fall under the criteria for "strategic" companies. The transparency of intra-group connections and relations is extremely poor, so selecting such groups for monitoring and support significantly limits both pin-point selective support capabilities and efficiency of situational monitoring by different sectors and activities.

Thus, due to the above listed contradictions the List of strategic companies viewed as a government policy instrument lacked clear overall objective, but was a sort of a compromise between various specific objectives. And given numerous commentaries to the List including those by government officials, none of the available official documents contain a definition of its main objective. All we can do is just to "recover" some of them by analyzing the method of forming the List and its composition. We need to emphasize that it would be an "ideal" set of objectives and that not each and every of them has eventually been achieved.

The List was aimed to:

- provide for *on-line monitoring of key companies* which are indicative for the economic situation and responsible for socially valuable sectors of economy; also for – presumably – preventing opportunistic actions by the companies' owners and management – actions potentially leading to serious negative social consequences and/or damaging economic security of the country (e.g., due to infrastructure deterioration);
- assure immediate review of government support to major companies *to prevent catastrophic scenarios* in unfavorable circumstances;
- *monitor the efficiency of government support rendered to specific companies.*

[1] Press-Release by the RF Ministry of Finance of February 4, 2009.

[2] See, for example, the RF Government Press Service commentary to publishing the List of strategic companies (http://premier.gov.ru/events/messages/2883/).

All those objectives to a certain extent were reflected in the criteria for selecting the future members of the List. The size of the company actually became the dominating criterion, which is quite disputable from the standpoint of reflecting the true role of the company for the national economy, as well as distorting the sector structure by way *shifting the focus to the sectors with high concentration of industries and domination of business super-giants.*

Initially it was planned to perform screening of the companies with revenues no less than Rb 15 mln and headcount no less than 5,000 pers.[1] These numbers were not underpinned by any meaningful analysis of Russian economy profile, and soon it became clear that many de-facto strategic companies turn out to be beyond the set limits. Eventually the quantitative criteria became softer, but they still were not differentiated by sectors (except for special requirements set for agriculture). The finalized criteria were set in the Methodology Guidelines by the RF Ministry of Economic Development[2] as follows:

Qualitative criteria (a company should comply with at least one of them):

- technology capabilities (availability of hi-po / unique technology included into the List of technologies of social and economic importance or valuable from the national security/defense standpoint (critical technology)[3];
- impact on social stability (jobs maintenance and prevention of massive one-time unemployment единовременной безработицы);
- meaningful for maintaining infrastructure and production chains;
- participation in hi-po investment projects;
- participation in international agreements / commitments.

Quantitative criteria (all of them are mandatory):

- annual revenue for 2007 – no less than Rb 10 bn (for agriculture – no less than Rb 4 bn);
- fiscal charges into different level budgets for the last 3 years – no less than Rb 5 bn (for agriculture – no less than Rb 2 bn);
- headcount – no less than 4,000 pers. (for agriculture – no less than 1,500 pers.).

As it is easy to see, the qualitative criteria were rather high-level and could be interpreted were broadly and in a biased manner, because they were based on non-regulated concepts, such as "hi-po investment projects", "production chains", "mass one-time unemployment", etc. We can take the risk and assume that a very big portion of major and mid-sized businesses in Russia could be recognized as compliant with at least one of those qualitative criteria. No wonder, *the qualitative criteria became the ones that really worked.*

Composition of the List of Strategic Companies

Let us see if the List of Strategic Companies was adequately representing Russian economy[4], was in line with the challenges and priorities of both the crisis stage and of the mid-term perspective.

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[1] Lower thresholds were set for agricultural businesses.

[2] Methodology Guidelines for including businesses into the List of Strategic Companies, April 16, 2009 (http://www.economy.gov.ru/minec/activity/sections/macro/politic/doc1239893148108)

[3] Approved by the RF Government Resolution No.1243-p of August 25, 2008

[4] It is worth noting that it is very difficult to fully evaluate the List from the standpoint of sectors and regions representations – due to a number of reasons. Reason number one: the List comprised not just companies per se – stand-alone productive assets with the status of legal entities – but multidiscipline diversified corporations with dozens and even hundreds of subsidiaries. In addition, the List comprised holdings at the level of their headquarters – and it is difficult to define their sectors and even the level of their control over their own enter-

The results of data search for separate enterprises included into the list allow for the following conclusion: the publication of this document was not backed by public information about the key characteristics of the entities of this List. The main sources of data for analytical purposes were SPARK, Expert-400 rating, official corporate sites, media publications.

List of Strategic Companies versus the list of major Russian companies

As it has been noted above, the main numeric criterion for including a company into the List was its size. In this context it is interesting to benchmark the List against the list of 400 Russian majors composed by "Expert" journal. Let us remember that Expert-400 comprises all major companies irrespective of the business area or sector the operate in, while as mainly "real sector" (productive) companies and trading companies were included into the List of Strategic Companies. To assure like-for-like comparison we excluded financial sector players (banks and insurance firms) from Expert-400 list, as well as a number of servicing companies (entertainment, IT).

The finalized "cleared" list of major companies has got 344 instead of 400 (compare with 304 in the List of Strategic Companies). Let us note that the "passing score" – the size of the annual revenue – was Rb 11.3 bn for Expert-400, which is pretty close to Rb 10 bn threshold approved for the List.

However, comparing the two lists proves that only about 50% of major "real sector" and trade companies were included into the List of Strategic Companies. *40% of the List are companies which cannot be called majors of Russian economy.*

prises (the shares of which are owned by the respective holding). However, the biggest challenge is to analyze a number of managing companies included into the List. The best data available about such companies is list of assets they manage, but it is impossible to assess any consolidated reporting. "Solnechniye Produkty" Managing Company may be one example – it controls several major fat-and-oil producers, cereal-handling elevators, etc., but has no consolidated reporting. This company having got material market share in the respective business areas (mayonnaise, vegetable oil, etc.) is not part, for example, of major enterprises rating Expert-400.

Data about major state-owned corporations are not always available for analysis. This mainly pertains to Rosatom Corporation, the business of which may be evaluated only through some of its subsidiaries (such as OJSC "Atomenergoprom"). But neither for Rosatom, nor for Rostekhnologiyi (formed in 2008 and still being in the process of set-up at the point of time the List was created) consolidated performance reports are available. At the same time, it is impossible to evaluate all separate enterprises – members of Rostekhnologiyi, as there are several hundreds of them.

A significant number of state unitary enterprises included into the List are yet another challenge. They do not disclose their production output and financial performance data.

And finally, there is the "double count" issue due to the fact that the List comprised both the corporations' headquarters and separate subsidiaries/affiliations.

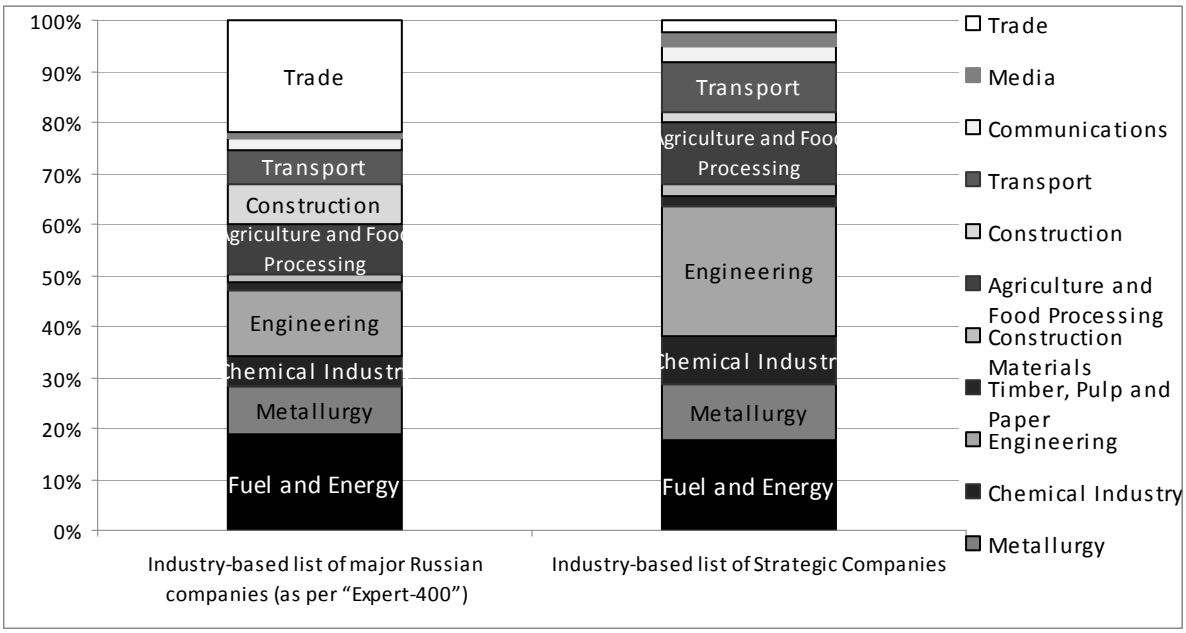

Fig. 1. Sector Profile of Russian Majors According to Expert-400 and the List of Strategic Companies

The biggest discrepancies were noticed in three sectors: engineering, construction and trade. A ten-fold gap in trade share between the two lists proves that *trade companies were included into the List as exceptional cases* and this business area was not recognized as a priority one for identifying the "strategic" component of the economy. If we exclude trade from both lists, then the majority of deviations will be found mainly in two sectors: *construction is strongly underestimated in the List of Strategic Companies*, *and machine engineering companies are, on the contrary, occupy a much bigger place than they are given in the major companies Expert-400 list.*

It is necessary to say that the fact of insufficient presentation of construction companies is caused by the fact that the List comprised only major companies engaged in residential development, while as Expert-400 list comprised mainly companies engaged in industrial (non-residential) construction (like Transstroy, Mosremstroy, Stroytransgas, etc.).

But even coincidence of sector shares in both lists does not always mean that the companies are the same. Thus, in energy (and fuel) sector the lists are 80 similar, while as in agriculture and food processing – only 40% similar.

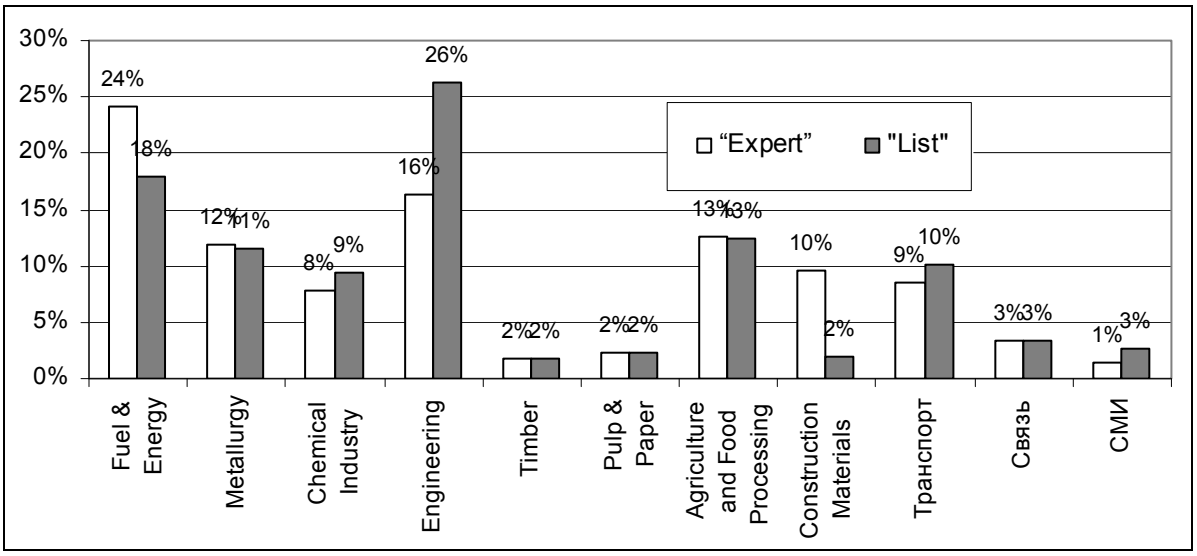

Fig. 2. Sector-based Differences Between Expert-400 and the List of Strategic Companies

If we analyze the lists by sectors in greater detail, it is obvious that *the most critical deviation factor for both lists is the ownership,* though this particular criterion was not specified as important one in the Methodology Guidelines. We need to emphasize that some companies were *discriminated with regards to qualifying them as strategic ones* based not only on the fact of government's interest, but mostly – on *the fact of foreign capital participation.*

Such discretion in including companies with foreign capital into the List may be illustrated by an example in automotive industry: such foreign companies operating in Russia as Ford-Motors, Volks Wagen, GM-Auto and others (all of them – members of Expert-400 list).

The same approach is quite visible in other sectors. Thus, in food processing not only foreign brewing companies were not included into the List, but such major food producers as Nestle-Russia, Krafts-Food and others.

Discrimination based on the fact of foreign capital participation is absolutely obvious, while as preference in favor of companies with government participation versus private capital is not that transparent.

Specific weight of unitary enterprises and government corporations included into the List is ca. 12%, which exceeds significantly their share in the economy (as per Russian Statistics Service, the share of government and combined ownership is less than 8% of the total number of organizations) or their share in the major companies list. This may be explained, first of all, by the fact that many infrastructure companies were included into the List, and most of them are "federal state unitary enterprises (FGUPs)". Also 20 design bureaus and research institutes in the area of shipbuilding, aviation, rocket and missile engineering and in energy sphere were included into the List.

Another 18% of the List covers joint-stock companies with dominating or blocking government stake. Thus, by number of assets the share of the "public sector" in the List is a bit less than 1/3. As for the annual revenue, the share of state-owned companies or companies with material government stake is significantly higher (ca. 50%), but this is explained by the

fact that the List comprises such giants as Gazprom, Rosneft and OJSC RZhD holding the first, the third and the fourth positions in the list of major Russian companies.

Representation of particular sectors was evidently not a criterion for including companies into the List. In other case individual thresholds would need to be established for different sectors – and this was done only for agriculture and food processing. That is why the extent of coverage of different sectors differs materially depending on the sector profile: if majors and super-majors are characteristic of a sector, this sector is broadly represented in the List; for sectors where majors are not typical (e.g., light industry) – the coverage is much smaller. It is difficult to evaluate the "coverage" just by the list of productive sites, because significant number of companies, as we have emphasized earlier, have got those in various areas of business, while as data on revenues distribution between different positions within the All-Russian Classifier of Types of Economic Activity are rarely available.

We can use expert method to evaluate the share of production in individual aggregated areas of business – in terms of its distribution between companies included into the List. Thus, in power generation, there is maximum coverage, up to 90%. For oil and gas industry the coverage is also pretty significant – 80%. Some of relatively "small" industries are also strongly represented in the List, such as pharmaceutical industry (10 producers and 1 distribution chain were included, while as only one producer and three distribution chains from pharmaceuticals were part of Expert-400). Other well-covered sectors are shipbuilding industry, aviation, missile and rocket engineering, defense industry. Chemical industry and metallurgy have over 50% coverage.

Least coverage is found in construction materials (only a few major cement producers were included), construction, food processing and light industry.

Thus, the List of Strategic Companies is not a comprehensive totality of major companies (even though the correlation is pretty close). Neither is it the reflection of the sector-based profile of Russian economy. Nevertheless, it would be wrong to say that the List has no scientific basis at all and is a result of mere lobbying by companies and organizations.

The analysis of this document allows for clear definition of the priorities, which were not explicitly worded, but still underpinned the approach for selecting companies to be included into the List. In our opinion, *such priorities were infrastructure (mainly, energy and transport), export, national security with regards to hi-tech defense enterprises, and agriculture.* In total, two thirds of the List is dedicated to such companies[1].

Such focus on infrastructure companies is to a certain extent justified, because termination or abrupt reduction of their operations at key infrastructure sites could indeed have a very strong negative impact on citizens, on national security and on businesses in other sectors of the economy. Special attention to major exporters may also be explained in the situation when drastic external demand decline and world markets prices slide with regards to Russian exported products became one of the major implications of the global crisis.

[1] Multidiscipline companies were qualified as parts of such priority sectors based on the expert opinion taking into account their core business

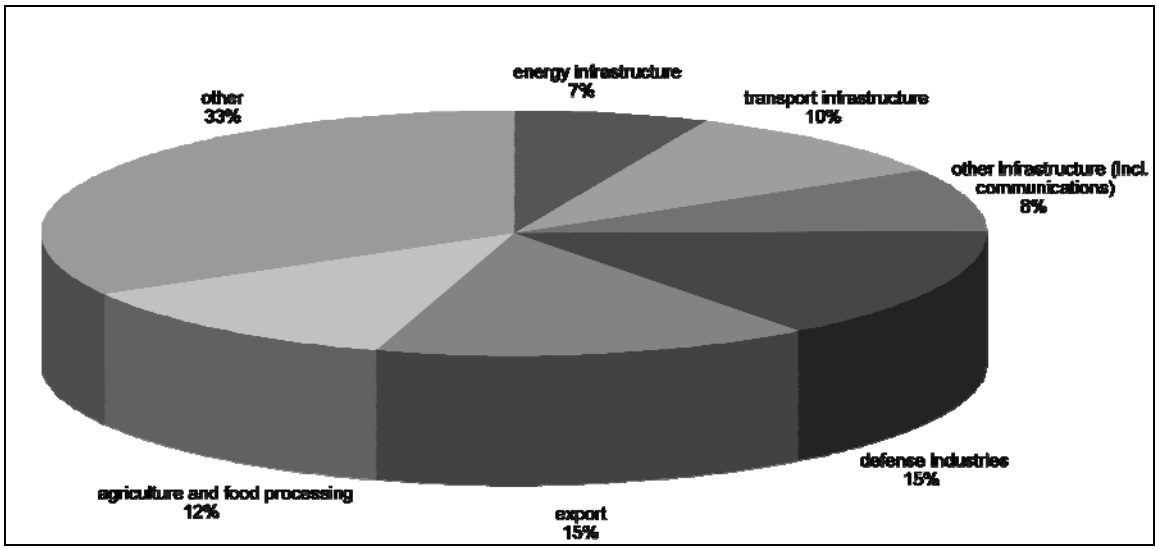

Fig. 3. Distribution of the List of Entities by Priority Business Areas

The following general observations may be made on the structure and purposes of the List of Strategic Companies:

1. In general the List is more than 50% consistent with the Expert-400 major companies list. This is especially true for such sectors, as fuel and energy, metallurgy and chemical industry.

The exceptions are mainly associated with "discriminating" certain companies with foreign capital participation, as well as with underestimating certain sectors of the economy: service sector, trade and construction. The so-called "additions" to the List (meaning companies which are not in the Expert-400 major companies list, but were included into the List of Strategic Companies) pertain mostly to engineering (because many manufacturing and R&D centers of defense industry were included), pharmaceuticals and transport (by way of including major airports and sea ports).

Despite the discrepancies between the List of Strategic Companies and Expert-400 list of major companies, the cumulative dynamics and key financial indicators of the List reflect the totality of major Russian companies.

2. The List of Strategic Companies is mostly focused on infrastructure (primarily energy and transport), export and defense. Due to these industries being more or less "autonomous" (in the sense of their challenges and threats being very different and relating to different spheres) the List appears to be pretty eclectic.

3. If we were to evaluate the instrumentality of the List from the point of view of the objectives declared at the stage of its formation, our opinion would be: it did not provide for fully achieving any of them. In particular, the List has substantial deficiencies from the point of view of "on-line monitoring of key economic entities": first of all, it does not include major manufacturers in quite some sectors and industries; secondly, in many cases it includes both holding companies headquarters and companies being parts of such holdings. At the same time, the List comprises many companies which can be qualified as "strategically important", but have no impact on the overall economic situation (and even on the situation in a particular sector).

The List also raises certain doubts with regards of preventing opportunistic behavior by businesses owners and management and implementation of decisions with seriously negative social implications and/or damage to national economic security, because – on one hand – the List is too extensive to provide for on-line monitoring of management decisions for all the selected companies, and on the other hand – it includes significant number of unitary enterprises and corporations fully owned by the state, in which the owner should control such decision-making within their standard internal governance procedures.

The List is not very instrumental for "reviewing the issues of government support to major companies with the purpose of preventing catastrophic scenarios in unfavorable circumstances", because it does not include quite a few major companies. Besides, it is unclear, what scenarios should be regarded as "catastrophic". The decision-making practices during the time of the crisis build-up, social catastrophes may occur not only at major companies, but at medium-sized ones, if they are city backbones.

4. The key problem with forming the List of Strategic Companies, in our opinion, was not only the "diluted" criteria for selecting companies, but even more – lack of clear understanding of why this List was needed. It is evidently redundant to be viewed as the list of candidates for receiving government support because it comprises too many entities, most of which have such complicated structure that detailed review of the issues associated with one of such entities (e.g., Gazprom or Rostekhnologiyi) is too difficult for Work Groups and industry commissions.

Publication of the List reflected, most likely, the political declaration of the government at the critical stage of the crisis and in the environment of extremely vague outlook for 2009 development, stating that the government would not allow for bankruptcy of the key "strategic" companies. This declaration was aimed at reassurance of creditors and suppliers to avoid panic in case of the risk of major business entities insolvency. This objective was achieved – to a certain extent.

It may be assumed that the very fact of a company being included into the List irrespective of receiving real financial aid provided for decreasing the risk ratings for this particular entity - on behalf of both banks and suppliers. Besides, inclusion into the List could force regional governments to be more attentive to the situations at particular enterprises providing for immediate organization support and other types of assistance.

5.2.3. Key areas and instruments of government support to strategic companies: specifics, challenges and practical implementation progress

A number of official documents[1] declared the following instruments to be used for government support of strategic companies:

– debt financing;
– government guarantees;
– subsidies from the budget;
– additional capitalization;
– tax arrears restructuring;

[1] Ref. RF Government Anti-Crisis Program for 2009 (approved by the RF Government on June 19, 2009), presentation by E. Nabiullina, RF Minister for Economic Development at the ministerial board meeting "2008 Performance of the RF Ministry for Economic Development and Key Objectives for 2009" on March 24, 2009 (http://www.economy.gov.ru/minec/press/news/doc1237883863610), Press Release by the RF Government about publication of the List of Strategic Companies (http://premier.gov.ru/events/messages/2883/)

– government procurement;
– change of import and export duties.

In this sub-section we will review *the instruments actually applied to strategic companies (and having impacted their situations),* their coverage and industry focus. Three comments need to be made for this purpose.

The first one: many measures listed as possible government support instruments were not really focused predominantly on strategic companies (e.g., partial interest rate subsidies).

The second one: one of the key measures to support strategic companies was refinancing of the external debt of major companies by Vnesheconombank, even though this particular mechanism had been in use before the List of Strategic Companies was in place.

And the third one: a significant portion of anti-crisis measures were not de-targeted at strategic companies and was not listed among government support instruments; rather, it was focused on a number of particular industries and sectors (automotive, oil-and-gas); however, due to high plant concentration in such sectors these measures had a focused impact mainly on respective strategic companies. In particular, such measures included partial interest rate subsidies to citizens for purchasing new cars, raising the non-taxable limit for MET assessment.

Direct and indirect anti-crisis measures to support strategic companies may be grouped by key areas of support:

(1) assuring financing resources accessibility:

– loans by Vnesheconombank to major companies to settle their external debt,
– government guarantees for loans,
– partial interest rate subsidies,
– expanding the Lombard List of the Central Bank,
– budget subsidies to prevent bankruptcy (recipients – strategic companies of defense industry), compensation of shortfalls in income (OJSC Russian Railways),
– increase of share capital, additional capitalization;

(2) incentives for domestic demand:

– additional government procurement programs (cars for federal executive authorities, public vehicles fleet renewal at regional and municipal levels),
– partial interest rate subsidies to citizens for purchasing new cars;
– additional capitalization of OJSC RosAgroLeasing to increase procurement of agricultural vehicles, equipment, etc.;
– increasing import customs duties (for used and new cars, buses, grain harvesters, pipes, rolled metal, etc.), decreasing import quotas (poultry)[1];

(3) decreasing burdens for businesses:

– reducing oil-and-gas sector tax burden (raising the non-taxable limit for MET assessment, changing the procedure for accruing the expenses for acquisition subsoil use licenses, introducing tax holidays for developing some of the fields);
– mandatory payments arrears restructuring for some of automotive companies;
– changing the calculation methodology and decreasing export duties (price monitoring period decreased, respectively – period for fixing crude and products export duties de-

[1] Big number of government measures in this sphere does not allow for detailed review within this Section. We can only note that most of them were focused on supporting automotive industry, agricultural engineering, metallurgy and agriculture/food processing.

creased, export duties cancelled for unalloyed nickel and copper cathodes, nitrogen and mixed fertilizers, etc.)[1].

We believe it is necessary to focus on a detailed review of the following three mechanisms and the ways they were implemented:

– loans to companies to refinance their external debt;
– government guarantees to borrowing companies;
– providing budget subsidies to partially compensate interest rates.

The reasons we are especially focused on these three mechanisms are, firstly, their scale (at least, the planned scale), and secondly – the fact of them not being limited to one or two priority sectors.

Assuring financial resources accessibility for strategic companies

Loans by Vnesheconombank to major companies to settle their external debt

The legal framework for this mechanism of Vnesheconombank refinancing the external obligations of the real sector companies was defined in mid-October 2009[2] – approximately two months prior to approving the List of Strategic Companies. The bank was granted the right to issue foreign currency loans to Russian companies for the purposes of redemption and servicing of previously received loans from foreign credit institutions, as well as to purchase receivables from foreign creditors. The minimal interest rate for loans issued was set at the level of 5 points LIBOR spread (in USD for 1 year). The ceiling was set for overall amount of loans issued by Vnesheconombank and of the acquired receivables at the level of not higher than $50 bn.

At the same day Vnesheconombank Supervisory Board approved the Procedure for refinancing the external debt of Russian companies[3], setting the following key criteria for application of this mechanism:

- economic security of the Russian Federation is jeopardized, significant assets of the borrower may be lost leading to its business reduction or bankruptcy;
- refinanced obligations were formed as a result of raising funds for major investment projects or for purchasing assets to significantly expand the borrower's operations in the territory of the Russian Federation.

The refinanced obligations should be no less than $100 mln. The maximum loan to a single company (or to interrelated companies) was also capped – $2.5 bn. Besides, co-financing on behalf of the borrower was stipulated – at the level of at least 25% of the overall refinanced obligations amount (unless otherwise prescribed by Vnesheconombank Supervisory Board). The borrower was also to provide the loan security to Vnesheconombank equal to security provided to foreign creditors (and in case it was insufficient – additional security).

[1] Just like in the case of changing import duties we will refrain from detailed review of such measures, and limit ourselves with the most meaningful ones (in our opinion, those are measures targeted at exporters in oil-and-gas sector, non-ferrous metals, chemical and petrochem industries.

[2] Federal Law No.173-FZ of October 13, 2007 "On Additional Measures to Support the Finance System of the Russian Federation".

[3] The procedure for the State Corporation "Development and Foreign Economic Activity Bank (Vnesheconombank)" to implement measures stipulated by Articles 1 and 2 of the Federal Law No.173-FZ of October 13, 2008, "On Additional Measures to Support the Finance System of the Russian Federation" (approved by Vnesheconombank Supervisory Board on October 13, 2008, Minutes No. 11).

To receive such loan a real sector company had to provide a package of several dozens documents to Vnesheconombank (as a rule, it comprised at least 40). The requests had to be reviewed in sequence by Investment Operations Development Committee, Credit Committee, Management Board, Special Committee for Review of Requests and finally – by Vnesheconombank Supervisory Board. Requests having successfully passed the Investment Operations Development Committee review had to undergo comprehensive expert review.

Just one week after defining the legal framework for external debt refinancing Vnesheconombank Supervisory Board approved the internal regulatory framework for practical implementation of this measure[1]. Prior to the end of October the Supervisory Board made its first decisions about external debt refinancing. y early December Vnesheconombank received requests for external debt refinancing for the total amount of $78 bn, including requests from real sector companies for about $50 bn[2]. At the same time, it is worth noting, that only 32 requests for the total amount of $27.1 bn were able to successfully pass through all the stages and reviews and reach the final one – review by the Supervisory Board. Out of them – only 15 requests from 12 organizations were approved for the total amount of $14.3 bn (without co-financing)[3] comprising less than 30% $50 bn allocated by central Bank for these purposes.

Out of 11 real sector companies[4], the requests of which were approved by Vnesheconombank Supervisory Board, 7 were included into the List of Strategic Companies in December (Rosneft, Rusal, Russian railways, PIK Group, Sitronix, Gazprom, Mechel), and the remaining 4 had direct links to the companies from the List (Evraz Group S.A., Gazpromneft, En+ Group Limited, ECO Telecom Ltd.).

Evraz Group S.A. is the holder of assets operated in Russia by Evraz Holding LLC included into the List of Strategic Companies.

Gazpromneft is a subsidiary of Gazprom (which was included into the List).

En+ Group Limited is the holder of controlling interest of Rusal (in the List) and of the parent company of EvroSibEnergo (in the List).

ECO Telecom Ltd. is part of telecommunications block of Alpha Group headed by Altimo, which owns 44% of OJSC Vympelkom shares and 25.1% of OJSC Megaphone (both in the List)[5].

Two companies, the requests of which were approved by Vnesheconombank Supervisory Board (Mechel and En+ Group Limited) further refused from the loans by Vnesheconombank. According to media publications, the first one did not like the security coverage requested by Vnesheconombank, and the second one was not able to provide a full set of docu-

[1] Vnesheconombank 2008 Performance Report (http://www.veb.ru/common/img/uploaded/files_list/VEB_Annual_2008_rus.pdf)

[2] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on December 1, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=3&id32=5446)

[3] From here downwards, unless otherwise specified, ref. data from the RF Government Reports about implementing measures to support capital market, banking system, labor market, Russian economy sectors and social net of citizens, and other social policy measures.

[4] One of the companies that received refinancing represented the finance sector - OJSC VTB Bank.

[5] It is also worth noting that ECO Telecom Ltd. raised 2 bond loans from Deutsche Bank AG in 2007 using 44% of OJSC Vympelkom shares as security. Vnesheconombank issued its loan to refinance this debt.

ments required for closing the loan deal[1]. Other companies received the loans from Vnesheconombank with the total amount of $11.28 bn (less than ¼ of the initially allocated $50 bn). The loans term did not exceed 1 year, the interest rate was 7–10%.

In early February 2009 it was declared that Vnesheconombank suspended accepting the requests for external debt refinancing due to the following reasons:

- Russian commercial banks having got excessive foreign currency liquidity will "help the borrowers to settle with their foreign creditors";
- Companies are finding ways to settle their external debt without loans by Vnesheconombank.

At the same time Vnesheconombank management was not excluding the possibility of resuming this activity in future[2].

In early June Vnesheconombank management declared the possibility of extending the 1-year loans "subject to implicit discharge of the borrowers' obligations under initial loan agreements and under original format for redemption and servicing of the debt"[3].

By mid-October 2009 the borrowers redeemed part of their debt to Vnesheconombank for the total amount of $2.43 bn (the principal). 3 borrowers – Rosneft, Russian railways and VTB Bank – provided for pre-scheduled full redemption. Vnesheconombank Supervisory Board approved extension of the loan period for one year for 6 companies – Rusal, PIK Group, Sitronix, Evraz Group S.A., Gazpromneft and ECO Telecom Ltd. – with the total amount of $8.34 bn.

Finally, in December 2009 the right of Vnesheconombank to extend the loan period was de-jure confirmed[4].

Overall. The following conclusions can be made with regards to specifics of practical implementation of major companies' external debts refinancing mechanism:

- Despite the fact that external corporate debt refinancing was not de-jure an instrument for supporting strategic companies (at least because the List of such companied was finalized 6 weeks after the first requests for such refinancing had been approved), all the companies having received loans from Vnesheconombank were either de-facto included into the List of Strategic Companies, or were directly linked with some companies from the List;
- Different from many other anti-crisis measures, the external debt refinancing mechanism was promptly developed and "launched": the first requests for Vnesheconombank loans were approved two weeks after creating the appropriate legal and regulatory framework (remember that the requests had to be backed by several dozens of documents, and the Procedure of their review comprised 7 stages), and the first loans with the total amount of over $10 bn were issued as early as before the end of 2009;
- Request for external debt refinancing from the companies were subject to pretty strict screening: it is sufficient to say that the amount of loans issued by Vnesheconombank was several times lower the requested amount;

[1] Ref: T.Komarova, V. Kovalenko. Trojan Tranche – Corporate Secret, May 4, 2009; D. Shabashov, E. Godlevskaya. Deripaska qualified as non-payer. – RBC Daily, November 12, 2009.

[2] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on February 5, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=2&id32=5449).

[3] Briefing by V. Dmitriev, Vnesheconombank President, on the outcomes of the Supervisory Board meeting on June 1, 2009, (http://www.veb.ru/ru/about/press/ns/index.php?from32=2&id32=5450)

[4] Federal Law No.361-FZ of December 27, 2009 "On Amendments to the Federal Law "On Additional Measures to Support the Finance System of the Russian Federation"".

- After pretty strict initial screening of obligations qualified for refinancing, Vnesheconombank demonstrated a rather "liberal" attitude to the debtors further down the way: it extended the loan period practically for each company undergoing difficulties with redemption of obligations (and those were more than 50%).

Government loan guarantees to strategic companies[1]

The legal grounds for providing government loan guarantees to strategic companies were defined as early as in 2008 – the respective amendments were made into the Federal Law on 2009 Budget[2] one week after the List of Strategic Companies had been approved. It was anticipated that the coverage for this area of government support would make RB 200 bn in 2009. In mid-February the RF Government approved the Rules for Granting Government Guarantees[3].

Let us note here that 6-week delay with enacting the delegated legislation (probably, caused by lengthy inert-departmental coordination) was criticized by the RF President[4]. Further on top Russian leaders repeatedly turned to the topic of government guarantees, which may be viewed as an evidence of high political value of this particular instrument.

Initially the following basic conditions for government guarantees were defined:

(1) Guaranteed loan terms:

- loan shall be used for funding the core business operations of the company and of the related capital projects;
- loan shall be received from Russian banks (including the revolving credit facilities);
- loan period shall be between six months and five years;

(2) Guarantees parameters requirements and limitations:

- guarantee shall be provided to a company to secure its loan pay-back obligations *in the amount up to 50%* of the received loan (the principal);

[1] It is necessary to state that along with the reviewed mechanism of providing guarantees to strategic companies, another similar mechanism was formed in late 2008 – early 2009. It stipulated government guarantees to strategic companies within the defense industry: the above mentioned Federal Law No.324-FZ of December 30, 2008, stipulated government guarantees to such companies for the total amount of RB 100 bn (further on it was decreased down to RB 75 bn). The respective Rules were approved by the RF Government Resolution No.104 of February 14, 2009. At the same time a number of companies included into the List of Strategic Companies complied with the criteria set for strategic defense companies, due to which some of them received government guarantees in 2009 under the second mechanism. However, due to significant specifics of this area of government guarantee support, relatively modest coverage and insufficient data about it in public sources we will refrain from reviewing it here.

[2] Federal Law No.324-FZ of December 30, 2008, "On Amendments to the Federal Law "On 2009 Federal Budget and 2010 - 2011 Plan"".

[3] RF Government Resolution No.103 of February 14, 2009, "On Provision of Government Loan Guarantees for 2009 to Companies Selected as per the Procedure Set by the RF Government Borrowing for Supporting Core Business Operations and capital Projects".
Strictly speaking, neither this document, nor the previously enacted law explicitly stated that the recipients of such guarantees should be qualified as strategic companies – they refer to "companies selected as per the procedure set by the RF Government". However, government officials repeatedly emphasized in their various comments and presentations, that this mechanism was focused on strategic companies – ref., "V. Putin: RB 326.3 bn provisioned for support to the RF economy", Prime-TASS, December 30, 2008.

[4] Ref. Abstracts from the veRbatim records of the extended Presidium session of the Government Council for Improving the Efficiency of Government Support to Real Sector held on February 20, 2009, in Irkutsk (http://www.kremlin.ru/transcripts/3258).

- *guarantee period shall be defined based on the obligation discharge deadline set by t he Loan Agreement extended by 1 year,* and in case the company's obligations are also secured by *real property collateral – by 2 years;*
- guarantee shall be provided for the amount *of no less than RB 150 mln;* the total amount of guarantees provided to one company *shall not exceed RB 10 bn;*

(3) Terms and limitations for providing guarantees:

- guarantee *shall not be used to secure obligations to payout interest on the loan,* other interest, commission, forfeit (fines and penalties), as well as responsibility of a company for failure to fulfill or for unduly fulfillment of its obligations under the Loan Agreement and for infliction of loss;
- guarantee *shall not be provided to a company with outstanding (unsettled) debt* to the Russian Federation (mandatory payments), nor to a company subject to *insolvency law suit and/or bankruptcy procedure;*
- *availability of counter-security for the company's obligations* under Loan Agreement shall be *the mandatory condition for receiving government guarantees*. With that *the total amount of the security for the company's obligations, guarantee inclusive, shall comprise no less than 100% of the loan amount* (the principal);

(4) Conditions for exercising guarantee:

- guarantee shall be exercised in the amount not to exceed 90% of the amount of non-fulfilled company obligations for payback of the principal;
- the Russian Federation shall bear subsidiary liability for the guarantees; guarantee shall be subject for exercise after other security for the company obligations under Loan Agreement is fully exercised;
- Creditor's receivables under Loan Agreement in part equal to the guarantee amount shall be subject to cession in favor of the Russian Federation represented by the RF Ministry of Finance before the guarantee is exercised.

It was also established that the Joint Inter-Departmental Committee set up by the RF Ministry for Economic Development shall select the companies for providing guarantees in the amount not to exceed Rb 5 bn, and that companies for providing guarantees in the amount above Rb 5 bn shall be selected by the RF Government Commission on improving Russian economy sustainability. Provided the decision of the respective Commission is positive, the company shall submit a package of documents to the RF Ministry of Finance no later than December 1, 2009. This package needed to include, among others, the original copy of the Loan Agreement with the bank. The RF Ministry of Finance together with Vnesheconombank shall perform the compliance check of the presented documents against the established requirements and shall within 10 days make a decision about providing or not providing government guarantees.

Simultaneously with developing the legal framework for government guarantees mechanism the required organizational infrastructure was formed in late 2008 – early 2009. The already mentioned RF Government Commission on improving Russian economy sustainability[1] and the Inter-Departmental Work Group for monitoring financial and economic status of

[1] The Commission was established by the RF Government Resolution No.957 of December 15, 2008. The scope of the Commission was not at all limited to reviewing the issues and making decisions on support to strategic companies. By now this Commission has been liquidated due to establishing the Government Commission for Economic Development and Integration (RF Government Resolution No.1166 of December 30, 2009).

organizations included into the List of Strategic Companies[1] (starting from March 2009 it was transformed into a Commission with the same name[2]) became the key elements of such infrastructure.

The first requests for government guarantees from strategic companies had been preliminary approved before the RF Government adopted the above described Rules.

Thus, according to mass media, on February 4, 2009, the Inter-Departmental Work Group approved provision of government guarantees to OJSC KAMAZ in the amount of Rb 4.6 bn[3].

However, after that *during about half a year* the requests for guarantees were reviewed and approved in an extremely slow manner, and government guarantees were not provided to strategic companies at all. The key reason pertained not to bureaucratic delays, but rather to the difficulties of executing Loan Agreements with banks. Banks' disagreement with one of the key conditions for providing guarantees became the main stumbling stone in negotiations. This was the condition according to which *the government was obliged to exercise the guarantee only after all other security for the loan had been exercised in full*. On top of that, the banks were very much dissatisfied with the norm providing for the government guarantee to cover no more than 90% of the outstanding company obligations[4].

By March-April of 2009 lack of any visible progress in provision of government guarantees raised certain concerns in the top echelons of power[5] resulting in declarations of possible modifications to this mechanism in the interests of the banks: it was planned to establish the norm that the banks shall receive money against government guarantees immediately upon guarantee event occurrence – prior to exercising other security[6].

The first amendments were introduced into the legal framework for the mechanism of government guarantees to strategic companies in late April. They, however, did not change the procedure for granting and exercising the government guarantees, but just *expanded the list of possible grounds for provision of guarantees:* in addition to funding the core operations and capital projects it was allowed to use loans issued against government guarantees for *redemption of loans and bonded loans* previously raised by the companies for supporting their core operations and capital projects [7].

In May 2009 the topic of government guarantees for credit facilities to strategic companies again was put into the focus of the top government officials[8]. Soon the RF Ministry of Fi-

[1] Order No. 7 by the RF Ministry for Economic Development of January 17, 2009
[2] Order No. 83 by the RF Ministry for Economic Development of March 16, 2009
[3] G. Stolyarov. Guarantee for KAMAZ – Vedomosti, February 5, 2009
[4] Ref.: Yu. Chaykina, T. Alyoshkina. Guarantees are not profitable for SbeRbank – Kommersant of March 30. 2009
[5] Ref. Materials for the working meeting of the RF President D. Medvedev with the First Vice-Premier I. Shuvalov on March 16, 2009 (http://www.kremlin.ru/transcripts/3454).
[6] Opening remarks by Prime Minister Putin at the economic conference on April 22, 2009 (http://premier.gov.ru/events/news/3936/).
[7] Federal Law No.76-FZ of April 28, 2009, "On Amendments to the Federal Law "On 2009 Federal Budget and 2010-2011 Plan"
[8] Thus, in his Opening Remarks at the conference on banking system development on May 13, 2009, President D. Medvedev acknowledged that the idea of providing government guarantees had failed in its initial format. He proposed to make the government jointly and severally responsible for its guarantees (http://www.kremlin.ru/transcripts/4048).

nance submitted draft amendments to the legal framework for granting government guarantees, and they were adopted at the end of June[1].

The key changes to the norms regulating government guarantees provision were as follows:

- redemption of loans and bonded loans previously raised by the companies for supporting their core operations and capital projects was included into the list of possible borrowing objectives along with funding core business operations and associated capital projects (as has been stated above, the respective changes were prior to that introduced into the Budget Law);
- *additional requirements were set for the companies* seeking government guarantees, including the following:
  - top management bonuses cancellation;
  - transparency of financial and business operations;
  - discharge of employer's obligations during layouts, maintaining jobs for the disabled and other socially disadvantaged categories of employees;
- elimination of the norm about government guarantees covering not more than 90% of the company's outstanding obligations to the bank;
- elimination of the norm about exercising government guarantees only upon other company's securitization is fully exercised. Instead it was set that the bank in case the borrower does not perform against its loan payback obligations issue the respective claim to this company, and in case the latter is not fully settled within 30 days – the bank is qualified for claiming the respective guarantee to be exercised by the Ministry of Finance.

We need to state here that the main objective of modifying government guarantees mechanism was to provide additional incentives to the banks for issuing loans secured by government guarantees. Commenting this measure Prime-Minister V. Putin called for banks leadership to make a counter-move by increasing the issue of loans to priority businesses and to reduce borrowing costs[2].

In August 2009 the process of issuing loans to strategic companies against government guarantees finally got on rolling.

In the end of August 2009 VTB announced issuing the first tranches to OJSC KAMAZ (total loan amount – Rb 2.9 bn, government guarantee amount – Rb 1.45 bn), OJSC Sollers (Rb 1 bn and Rb 500 mln respectively) and OJSC Sollers – Naberezhnye Chelny (Rb 700 mln and Rb 350 mln).

Approximately at the same time the number of approved requests for guarantees started growing fast. However, we believe that amendments to the regulations were not the only fac-

[1] RF Government Resolution No.542 of June 30, 2009. Remarkably, the respective amendments into the Federal Law "On 2009 Federal Budget and 2010-2011 Plan" (except for the norm expanding the list of possible purposes of using the borrowed funds) were introduced later still – in early October (Federal Law No.230-FZ of October 3, 2009).

[2] Opening remarks by Prime-Minister V. Putin at the conference on preliminary key parameters of federal 2009 budget and 2011-2012 plan and on the principles of budget expenditure formation on June 29, 2009 (http://premier.gov.ru/events/news/4529/)

tor underpinning such growth. *The political message to major banks with government stake* on behalf of the Prime-Minister about the need to increase issue of loans was extremely important, as well as *relative economic recovery* (significant retardation of the decline and reduction of uncertainty level).

According to some official statements, by the end of October 2009 requests from strategic companies for government guarantees for the total amount of RB 189 bn were approved making approximately 95% of the amount allocated within 2009 federal budget. The practice of granting government guarantees was also improved: in early October the total amount of government guarantees granted to strategic companies was RB 8.2 bn, and by the end of this month this amount was already RB 41.8 bn[1] – a bit more than 20% of the amount allocated in 2009 budget.

By early December 2009 the overall amount of the approved requests was making Rb 199.4 bn almost achieving the limit set by the federal budget (RB 200 bn). Most likely due to this fact this limit was *increased by Rb 25 bn*[2]. Before the end of the year all the allocated funds were disbursed. The key government guarantees recipients were companies from metallurgy sector, agriculture and food processing, automotive industry, and construction.

At the same time, the process of granting government guarantees was still lagging behind: thus, by mid-December the amount of guarantees effectively provided to strategic companies was only about Rb 70 bn[3]. All the paper work and issuance of the guarantees approved in 2009 was to be continued in the next coming year.

We need to pay attention to certain specifics of the structure of government guarantees mechanism and of its applications:

- guarantees were provided to the companies with significant backlog: first loans against government guarantees were issued only in August 2009 – 6 months after the legal framework and organizational of the planned amount was actually provided. Thus, this mechanism *did not result in the required economic effect with regards to provision of long-term financing to the companies in the most acute phase of the crisis* – early in 2009 (which was especially valuable in the context of delaying other government support measures such as government procurement, budget subsidies, etc). At the same time, the intensive process of coordinating the interests of various stakeholders, settlement of claims and agreeing on the obligations for future borrowing against government guarantees became an important stabilizing factor for the economy suffering from the crisis;
- the key reason for the delay in issuing loans secured by government guarantees was the banks' disagreement with the established procedure for exercising guarantees by the government. Modification of this mechanism in mid-2009 was undertaken mostly in the interests of the banks;

[1] Ref.: E. Pismennaya. Guarantees for modernization. – Vedomosti, October 30, 2009, and also materials for parliamentary hearings of the Council of Federation Commission for interaction with the RF Accounting Chamber on the topic: "Modernization of the Economy as Major Anti-Crisis Measure", December 17, 2009.

[2] Federal Law No.309-FZ of December 2, 2009 "On Amending Federal Law "On Federal 2009 Budget and 2010-2011 Plan"". At the same time the amount of government guarantees to strategic companies of defense industry was decreased by Rb 25 bn

[3] A.Gudkov, O. Sapozhkov. Government Guarantees Are Growing. – Kommersant, December 18, 2009
It is necessary to say that by the end of 2009 the aggregate amount of government guarantees provided to both strategic companies and defense sector companies made Rb 145.9 bn. M.Tovkaylo, V. Kholmogorova. Coming Late report. – Vedomosti, February 4, 2010.

- initially the government guarantees mechanism was focused on loans for funding the core business operations and investment activity of companies. Including restructuring of previous debt into the list of possible borrowing purposes, on one hand, was in line with the companies' needs, but on the other had it converted government guarantees from the mechanism for business development into the method of delaying urgent problem solving;
- the complexity and the duration of procedures to prepare the request and get it approved, in particular – the difficulties of executing Loan Agreements with the banks resulted in the fact that some companies initially looking for government guarantees further rejected the idea after several attempts to get everything right;
- the important feature of the mechanism was approving the requests stipulating for provision of government guarantees to several principal companies simultaneously. One of the reasons for that was the officially established ceiling for government guarantee to an individual company – Rb 10 bn. Distributing the requested amount of government guarantee between several affiliated companies allowed business groups for receiving government support in much bigger amounts than Rb 10 bn.

The new law on the federal budget[1]*, just like the previous one, stipulated provision of government guarantees in 2010* to companies selected in accordance with the procedure established by the RF Government to assure their borrowing for the purposes of *maintaining their core business operations and capital projects, as well as for redemption of previous loans and bonded loans.* In 2010 the total amount of government guarantees is planned to be RB 200 bn, while as this specific type of government support is not planned at all for 2011 and 2012. The legal framework remained the same except for one additional requirement setting that guarantees shall be provided to organizations selected in 2009 in case such guarantees were not actually issued in 2009. It is also worth noting that the rules for providing government guarantees applied in 2009 were extended onto 2010, but solely with regards to the companies, whose requests had been already approved in 2009[2].

In addition to "traditional mechanism of providing government guarantees to strategic companies" the new law of the federal budget stipulated for *another version of providing government guarantees* to the companies selected in accordance with the procedure set by the RF Government – *for loans issued to fund investment projects.* In 2010 the amount of such guarantees is to make Rb 100 bn ($3.3 bn), and they are not planned for 2011 and 2012. With that the legal norms established with regards to this new mechanism of providing government guarantees are visible different from those regulating the "traditional" mechanism described above.

The key specifics of guarantees-based support to the investment projects are the following:

- Guarantees shall cover 100% of the principal of the loan borrowed by strategic company to fund an investment project. At the same time, the amount of guarantee shall not exceed 50% of the investment project budget;
- The minimal amount of government guarantee shall be Rb 1 bn or $30 mln;
- The loan period covered by the guarantee shall be from 4 to 20 years, with that exercise of the guarantee shall not be possible before 2014;

[1] Federal Law No.308-FZ of December 2, 2009, "On Federal 2010 Budget and 2011-2012 Plan"
[2] RF Government Resolution No.1181 of December 31, 2009

- Securing of the government obligations shall not be required with regards to recourse issued to the company is case of exercising the government guarantee.

We need to emphasize that in case the new mechanism for providing government guarantees is also applied mostly to strategic companies, the aggregate amount of guarantee-based support in 2010 may reach Rb 400 bn – more than 50% of the government guarantees stipulated within the law on the federal budget for the current year.

The following comments should be made with regards to the new mechanism for providing government guarantees:

- The "investment focus" and long-term nature of this mechanism are, most likely, defined (at least partially) by the fact that the "traditional" mechanism was excessively focused on solving the current financial challenges of strategic companies;
- The fact that at least 50% of government guarantees for the investment-targeted loans shall be provided in US dollars allows for assuming that implementation of such projects will be to a great extent linked to importing equipment and technology;
- The fact that government guarantees are to cover 100% of the principal is a sign of the government planning within the framework of this mechanism to accept practically all the risks of banks financing such investment projects (and thus assure incentives for them to participate in such projects), however, this may result in less attentive review of investment projects on behalf of banks;
- Limiting the total amount of guarantee to 50% of the overall investment project budget in general allows for counting on the respective risks being shared by the government and the business, however, it may turn out very difficult to access the real contribution of business;
- Lack of the established ceiling for provided government guarantees contributes to significant increase of the interest on behalf of different stakeholders to lobbying very big, lengthy – and respectively very risky investment projects, which requires material improvement of project evaluation infrastructure.

Subsidizing part of interest rates paid by strategic companies on their loans

Eventually the RF Government Anti-Crisis Program for 2009 stipulated the following areas of subsidizing the interest rates of real sector companies' loans (under which strategic companies could be the recipients of borrowed funds)[1]:

- Subsidizing interest rates for the loans issued to manufactured goods exporters (RB 6 bn allocated for such purposes within the budget);
- Subsidizing interest rates for the loans issued to meat-and-dairy companies (Rb 7 bn);
- Subsidizing interest rates for the loans issued to Subsidizing interest rates for the loans issued to other agricultural companies (Rb 10 bn);
- Subsidizing interest rates for the loans issued to forestry enterprises to set-up shoulder-season stock of timber, feedstock and fuel (Rb 0.325 bn);

[1] In addition to the listed areas the RF Government Anti-Crisis Program also stipulated subsidies of interest rates on the loans received by fisheries in the amount of Rb 1.07 bn, however, such companies are not represented in the List of Strategic Companies. On top of that, 3 measures were stipulating subsidizing of the shortfall in revenues associated with carrying out government assignments, and 1 measure – providing subsidies to strategic defense companies to prevent their bankruptcy

- Subsidizing interest rates for the loans issued to automotive and transport engineering companies for their technical refurbishment (Rb 2.5 bn);
- Subsidizing interest rates for the loans issued to defense industry companies being the prime contractors (contractors) for the government defense procurement (Rb 15 bn);
- Subsidizing interest rates for the loans issued to defense industry companies for implementing innovations and investment projects targeted at hi-tech products (Rb 1 bn).

We will briefly review here those of the above listed measures that were practically implemented in 2009.

Subsidizing manufactured goods exporters

The mechanism for partial reimbursement out of the Federal Budget of the interest rates on the loans received by Russian exporters of manufactured goods was formed back in 2005[1] and has remained practically unchanged. The norms set the following key conditions for receiving such budget subsidies:

– A company should be exporting manufactured goods for at least 3 years;
– The loans received by a company should be used for exporting goods with high degree of processing[2].

Two thirds of the interest rate of such loans is subject to reimbursement- not to exceed two thirds of the Central Bank refinancing rate.

Early in 2009 the RF Government[3] allocated Rb 6 bn to subsidize interest rates on the loans issued to Russian exporters[4]. This amount was used during the first 9 months of the year. Moreover, the exporters eventually received a slightly bigger amount of Rb 6.135 bn, and 90% of it (Rb 5.709 bn) was distributed among them during H1 2009[5].

In December 2009 the amount of budget allocations for implementing this measure of government support was increased up to Rb 9 bn[6].

Over 100 Russian exporters received interest rate subsidies during 2009 for the overall amount of RB 9.135 bn. It is worth noting that only 1/3 of them belonged to the List of Strategic Companies or were subsidiaries of strategic companies, however, in terms of the amount of budget subsidies they received about ¾ of it. With that the major bulk of the subsidies were granted to various strategic companies from the defense sector (primarily to space rocket engineering and aviation), as well as nuclear sector and automotive industry.

The key areas of the RF Government anti-crisis measures for 2010[1] stipulate budget subsidizing of exporters to reimburse part of their interest rate on the loans they received from Russian credit institution in 2005–2012 in the amount of Rb 7 bn.

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[1] Rules for providing budget subsidies to Russian exporters of manufactured goods to partially reimburse their interest rates on the loans received from Russian credit institutions, as approved by the RF Government Resolution No.357 of June 6, 2005

[2] The procedure for qualifying the goods as those with high degree of processing is currently defined by Order No.31 of the RF Ministry of Industries and Trade issued on February 2, 2009

[3] Federal Law No.204-FZ of November 24, 2008, "On Federal 2009 Budget and 2010-2011 Plan" granted the RF Government the right to allocate up to Rb 175 bn (as effectively amended – up to Rb 450 bn) within the Federal Budget to support capital market (as effectively amended – to support capital and labor markets, and sectors of Russian economy, social net for Russian citizens and other social policy measures)

[4] RF Government Resolution No.24 of January 14, 2009 (Rb 3 bn were allocated for the same purpose in 2008)

[5] Order No.144 of the RF Ministry of Industries and Trade, Order No.144 of the RF Ministry of Finance issued on March 27 2009; Order No.250 of the RF Ministry of Industries and Trade, Order No.175 of the RF Ministry of Finance issued on April 20, 2009.

[6] RF Government Resolution No.996 of December 2009

Subsidizing the RF constituent entities (regional governments) to reimburse interest rates on the loans received by agricultural and food processing companies

This measure practically combines 2 areas stipulated by the RF Government Anti-Crisis Program: subsidizing interest rates on the loans issued to meat and dairy products manufacturers (Rb 7 bn) and other sub-sectors of agriculture and food processing (Rb 10 bn). The legal framework of this particular measure[2] is different from the others and sets a two-stage procedure for allocating such subsidies: first the funds are allocated within the Federal Budget to regional government, and only then they are distributed between agriculture and food processing companies. Payments of interest on short-term loans (up to 1 year) used to procure Russian-make agricultural feedstock and for some other needs, as well as payments of capital loans used to procure certain types of equipment, transport vehicles and machinery (the list defined by the RF Ministry of Agriculture), as well to fund upgrading of farms, storage facilities, greenhouses, etc. may be subject to reimbursement. For certain types of loans issued to meat and dairy companies the amount of subsidies was set at 100% of the refinancing rate, while as in other cases it makes 80%[3].

In February 2009 the RF Government allocated Rb 17 bn to implement this measure, out of which Rb 12.1 bn were meant to reimburse the interest on capital loans, and Rb 4.9 bn – interest on short-term loans[4]. During the first 3 quarters of 2009 Rb 16.9 bn were remitted to the RF regions: Rb 12.1 bn – to reimburse the interest on capital loans, and Rb 4.8 bn – interest on short-term loans. Let us note that over 90% of the funds were disbursed in H1 2009. Most likely, members of the List of Strategic Companies were among the end beneficiaries of funds; however, we do not have reliable data on the amount of subsidies granted to those particular entities under this measure.

Subsidizing companies of the forestry sector

The legal framework for this particular mechanism was the last one to be developed – in late June of 2009[5]. In particular, it stipulated the following:

- Loans subject to partial interest rate subsidies should be received from Russian credit institutions in 2008–2009 and used for setting up the shoulder-season stock of timber, feedstock and fuel;
- Subsidies should cover 2/3 of the interest rate not to exceed 2/3 of the Central Bank refinancing rate.

In September 2009 the RF Ministry of Industries and Trade decided to subsidize 11 companies from the forestry sector for the total amount of Rb 59 mln[6]. In early October these funds were effectively disbursed to the recipients. The names of such recipients were not officially published, however, as per mass media, at least one of them belonged to the List of Strategic Companies – OJSC Arkhangelsk pulp-and-paper plant (received Rb 15 mln).

Subsidizing defense industry companies engaged in government procurement

[1] As approved at the RF Government session on December 30, 2009
[2] Federal Law No.318-FZ of December 30, 2008, "On Amendments to Articles 11 and 18 of the Federal Law "On Development of Agriculture""; RF Government Resolution No.90 of February 4, 2009
[3] In addition, regional budgets are used for additional reimbursement in the amount exceeding the Central Bank refinancing rate by 3% – for meat and dairy manufacturers, and in the amount of 20% of the refinancing rate – for other companies.
[4] RF Government Resolution No.140 of February 24, 2009
[5] RF Government Resolution No.528 of June 25, 2009
[6] Order No. 866 by the RF Ministry of Industries and Trade issued on September 28, 2009

This mechanism stipulates subsidies to defense industry companies performing as contractors (including – as prime contractors) of the government procurement to cover a part of their interest rate payments on the loans received from Russian credit institutions to sustain their core business operations. The respective legal framework was developed in late March 2009[1], but the actual disbursement of funds started only in H2 2009. According to the RF Government Anti-Crisis Program, the aggregate amount of this type of subsidies for 2009 should be making Rb 15 bn; however, according to the available data, the companies effectively received only about Rb 5.5 bn. Over 50 companies became the recipients for these funds, and 2/3 of them either belonged to the List of Strategic companies themselves, or comprised subsidiaries of strategic companies. About ¾ of the effectively disbursed subsidies (Rb 4 bn) covered this 2/3 of the companies.

Subsidizing automotive and transport engineering companies

In January 2009 the RF Government allocated Rb 2.5 bn as subsidies to Russian automotive and transport engineering companies to reimburse part of their interest rate payments on the loans used for technical upgrade and refurbishment[2]. However, the legal framework for this mechanism was developed only by the end of March[3], while as the criteria for selecting the refurbishment projects – only by the end of May 2009[4]. It was defined that 2/3 of the interest rate is subject for subsidizing, not to exceed 2/3 of the Central Bank refinancing rate.

In August 2009 additional opportunity aroused for receiving subsidies for partial reimbursement of funds paid by Russian automotive manufacturers as coupon yields on the bonds issued in 2009 to finance their own or subsidiaries' refurbishment projects[5]. Subsidies were to cover 2/3 of coupon yields payments, not to exceed 2/3 of the Central Bank refinancing rate.

In December 2009 the RF Government reduced budget allocations for such subsidies from Rb 2.5 bn down to 1.5 bn[6]. By this time the RF Ministry of Industries and Trade had reviewed 15 requests for subsidies (9 of them submitted by automotive businesses and 6 – by transport engineering companies). In October 2009 the RF Ministry of Industries and Trade drafted the first Resolution on granting the subsidies for the total amount of RB 59 mln[7]. Nevertheless, no effective disbursement of funds had been initiated by mid-December.

The key areas of the RF Government anti-crisis measures for 2010 stipulate subsidies to automotive and transport engineering companies to reimburse part of their interest rate payments on the loans received in 2008-2009 and used for technical upgrade and refurbishment for the total amount of Rb 2.5 bn.

The following overall conclusion may be made with regards of planned and actually effected interest rates subsidizing:

– The total budget allocations covering 7 areas of subsidizing in accordance with the RF Government Anti-Crisis Program were to make Rb 42 bn. Defense industries together

[1] RF Government Resolution No.255 of March 26, 2009
[2] RF Government Resolution No.24 of January 14, 2009
[3] RF Government Resolution No.262 of March 30, 2009
[4] Order No.453 of the RF Ministry of Industries and Trade issued on May 28, 2009
[5] RF Government Resolution No.675 of August 19, 2009
[6] RF Government Resolution No.996 of December 10, 2009
[7] Materials for parliamentary hearings of the RF Council of Federations Commission for Interaction with he Accounting Chamber of the Russian Federation on the topic: "Modernization of economy as the Main Anti-Crisis Measure", December 17, 2009

with agricultural and food processing companies were to become the main recipients of these funds;

- In the majority of cases interest rate subsidies were to cover no more than 2/3 of the refinancing rate, while as for meat and dairy products manufacturers the subsidies were set at 100% of the Central Bank discount rate;
- These measures covered loans issued not only in 2009, but in earlier periods as well (in 2008, and in some cases – in preceding years). Thus, subsidies were targeted (at least partially) at servicing the debt accumulated by the respective companies and improving financial stability of these companies;
- The measures implemented rather quickly – subsidies to exporters of manufactured goods and to agricultural and food processing companies – represented continuation of programs implemented over the preceding years, while as in other cases actual disbursement of funds either was initiated after a significant delay, or was not effected at all;
- During 10 months of 2009, according to the available data, the funds were disbursed only within 5 measures (*Table 1*). The actual federal budget spent in these areas amounted to circa Rb 32 bn, 80% of which were received by defense industries together with agricultural and food processing companies;
- The overall amount of interest rate subsidies to strategic companies and their subsidiaries (without accounting for the funds provided to agricultural and food processing companies out of the regional budgets) made about Rb 7 bn. The defense industries were the dominating recipients of these funds. Among civil industries the most meaningful amounts of subsidies were granted to strategic companies in nuclear and automotive industries.

Table 1

Interest Rate Subsidizing Mechanisms

	Allocations, Rb bn[1]	**Disbursed funds, Rb bn[2]**	**Execution, %**	**Funds disbursed to strategic companies[3] Rb bn[2]**	**Purposes of borrowing**	**Time of borrowing**
Interest rate subsidies to exporters	6 / 9[4]	9.1	102	6.7	Export of goods with high degree of processing	2005–2010
Interest rate subsidies to agricultural manufacturers and food processing companies	17	16.9[5]	99	NA		
-for capital loans	12.1	12.1[5]	100	NA	Procurement of equipment, specialized vehicles and machinery, pedigree stock (materials; establishment of perennial plantings and vineyards; construction and upgrading of grafting facilities for perennial plants, of livestock units (farms), breeding and forage production facilities, storage facilities for potatoes, vegetables and fruit, greenhouses, etc.	Beginning of 2008
-for short-term loans	4.9	4.8[5]	99	NA	Procurement of lubricants, spare parts and materials for repairing agricultural machinery, mineral fertilizers, crop-protective agents, forage, veterinary preparations and other material resources for seasonal operations; procurement of young stock, of Russian-make agricultural feedstock for primary processing and industrial food processing, etc.	Beginning of 2004, 2005, 2007, 2008 or 2009 – depending on the recipient and pur-

	Allocations, Rb bn[1]	Disbursed funds, Rb bn[2]	Execution, %	Funds disbursed to strategic companies[3] Rb bn[2]	Purposes of borrowing	Time of borrowing
						poses of borrowing
Interest rate subsidies to forestry companies	0.325	0.06	18	No less than 0.015	Set-up of shoulder-season timber, feedstock and fuel stock	2008–2009
Interest rate subsidies and bond loans interest payments reimbursement to automotive and transport engineering companies	2.5 / 1.5[3]	0	0	0	Implementation of technical refurbishment projects	2008–2009
Interest rate subsidies to defense industry companies performing in the capacity of prime contractors (contractors) for government military procurement	15 / 5,3	5,5	104	4	Core business operations	2008–2009
Interest rate subsidies to defense industry companies to implement innovations and investment projects	1	0	0	0	Implementation of innovations and investment projects to assure hi-tech production	

[1] in accordance with the RF Government Anti-Crisis Program for 2009
[2] during 10 months of 2009
[3] accounting for the subsidiaries
[4] after adjustments
[5] during 9 months of 2009

Additional capitalization for strategic companies

The following measures were implemented within this area of support:

(1) using budget monies to fund issue of new private companies shares (to increase of collective capital funds of unitary enterprises);

(2) additional asset contributions to state-owned corporation "Rostekhnologiyi"

Increasing charter capitals of private companies

In the end of 2008 and throughout 2009 the RF Government adopted several resolutions about additional capitalization of 13 organizations – either members of the List of Strategic Companies, or directly linked to companies from the List. Rb 118 bn were allocated within the Federal Budget for this purpose. 10 organizations represented the defense industry, however (Rb 57 bn). As a rule, additional capitalization for such companies was aimed at stabilizing their financial positions, redemption of debt and working capital replenishment.

The major bulk of the allocations were granted to OJSC Russian railways. With that, the RF Government issued to separate resolutions about increase of the company's charter capital: the first one in December 2008[1] – by Rb 41.5 bn, and the second one – in July 2009[2] – by

[1] RF Government Directive No.1877-p of December 16, 2008
[2] RF Government Directive No.918-p of July 7, 2009

Rb 11.3 bn, 3 bn out of which were to be spent on purchasing products from Tverskoy coach-building works, and 8.3 bn – on construction of track between Yayva and Solikamsk.

In addition, in 2009 the RF Government adopted resolutions on additional capitalization of 2 other strategic companies: Research and Production Center "Urals wagon Works" – by Rb 4.4 bn to redeem the debt[1], and OJSC Rus Hydro – by Rb 4.3 bn to fund the construction of discharge sluice at Sayano-Shushenskaya hydroelectric plant[2].

The Law on the Federal 2010 Budget allocated funds for additional capitalization of several dozens of companies, some of which are part of the List of Strategic Companies.

Asset contributions to state-owned corporation "Rostekhnologiyi"

During 2009 the RF Government adopted 3 resolutions about disbursement of the federal budget funds to state-owned corporation "Rostekhnologiyi" for their further disbursement to OJSC AVTOVAZ as interest-free loans:

- in early June the respective asset contribution made Rb 25 bn[3];
- in mid-December it made Rb 12 bn. The following limitations were set: the funds should be used only to assure discharge of AVTOVAZ obligations to suppliers, intermediaries, credit institutions and other counterparties with further increase of Rostekhnologiyi share in the charter capital of the company[4];
- in late December – RB 28 bn allocated for discharge of AVTOVAZ obligations to credit institutions with further increase of Rostekhnologiyi share in the charter capital of the company[5].

It should be noted that in the last case 2 pre-conditions were set for the automotive manufacturer to qualify for receiving the funds:

- prepare and agree with the RF Ministries of Industries and Trade, of Economic Development and of Finance the mid-term Program of ABTOVAZ development including high potential investment projects;
- sign MOU between Rostekhnologiyi, OJSC AVTOVAZ and group of banks including Sberbank and VTB about restructuring the company's debt and banks' commitment to issue loans to fund its core business operations under mutually accepted terms.

In addition, late in 2008 and early in 2009 5 more decisions were made to disburse budget funds to Rostekhnologiyi as asset contributions:

- 2008: Rb 1.5 bn without indicating specific objectives[6];
- 2009:
  - Rb 7.48 bn to finish the construction and commissioning of federal hi-tech medical centers[7];
  - Rb 2.97 bn to settle debt servicing obligations on loans used for consolidation of VSMPO-AVISMA Corporation[8];

[1] RF Government Directive No.346-p of September 15, 2009
[2] RF Government Directive No.1604-p of November 2, 2009
[3] RF Government Directive No.745-p of June 1, 2009
[4] RF Government Directive No.1895-p of December 10, 2009
[5] RF Government Directive No.2080-p of December 25, 2009
[6] RF Government Directive No.1847-p of December 8, 2008 – respective amendments were introduced into 2009 budget by Federal Law No.837-FZ of November 8, 2008
[7] RF Government Directive No.837-p of June 2,2 2009
[8] RF Government Directive No.1466-p of October 8, 2009 – respective amendments were introduced into 2009 budget by Federal Law No.76-FZ of April 28, 2009

- Rb 1.44 bn to fund especially important and special flights of aircrafts[1];
- Rb 900 mln without indicating specific objectives [2].

Providing incentives to increase domestic demand for strategic companies products

Additional government procurement

The RF Government Anti-Crisis Program identified two large-scale measures stipulating government and municipal procurement of products manufactured by the companies included into the List of Strategic Companies:

(1) automotive vehicles for federal executive agencies, their territorial branches and subordinate institutions (Rb 12.5 bn from the Federal Budget);

(2) renewal of the automotive vehicles fleet used by regional and municipal authorities for passenger transfer, medical purposes, of specialized vehicles used by militia, by utility companies and for road construction purposes (Rb 20 bn from the Federal Budget, Rb 10 bn as co-financing from regional budgets).

Procuring automotive vehicles for federal executive agencies

Funds to procure automotive vehicles for federal executive agencies in the amount of Rb 12.5 bn were allocated by the RF Government in February были 2009[3]. In the same month the RF Ministry of Industries and Trade approved the list of automotive vehicles for such procurement[4], comprising over 1 thousand of various types and names (cars and trucks, buses, tow cars), with practically all of them (99.9%) being manufactured by plants either included into the List of Strategic Companies, or by their subsidiaries.

By early October 2009 automotive vehicles were procured for the amount of Rb 11.8 bn (94% of allocated funds), including Rb 2.2 bn spent on purchasing VAZ cars ("Ladas"), Rb 2.1 bn – on KAMAZ trucks (in the amount of 2.1 thousand trucks), Rb 2.0 bn – on UAZ (2 thousand cars), Rb 1.6 bn – on GAZ (1.7 thousand cars), Rb 1.4 bn – on FIAT (1.4 thousand cars)[5].

In early November budget allocations were this purpose were increased up to Rb 15.5 bn.

Renewal of the automotive and specialized vehicles fleet used by regional and municipal authorities

In late March of 2009 the RF Government allocated total amount of Rb 20 bn to purchase automotive and specialized vehicles; at the same time the main rules for disbursement of such funds were approved[6]. In mid-April the RF Ministry of Industries and Trade approved the list of Russian manufacturers of the respective vehicles comprising all automotive manufacturers from the List of Strategic Companies, as well as number of their subsidiaries.

By early October the RF Government allocated the total subsidies of Rb 12.6 bn, and then a month later they amounted to Rb 14.4 bn. The procurement of vehicles was significantly lagging behind due to the need to organize tender procedures, review the bids, award and exe-

[1] RF Government Directive No.1717-p of November 13, 2009 – respective amendments were introduced into 2009 budget by Federal Law No.230-FZ of October 3, 2009
[2] RF Government Directive No.2065-p of December 24, 2009
[3] RF Government Directive No.139-p of February 9, 2009
[4] Order No.78 by the RF Ministry of Industries and Trade issued on February 20, 2009
[5] UAZ and Fiat cars are manufactured by subsidiaries of OJSC Sollers
[6] RF Government Resolution No.253 of March 24, 2009

cute contracts, etc. Thus, by October 2009 the total amount of executed contracts was only RB 4.3 bn. The majority of vehicles were procured from GAZ and KAMAZ.

Creating incentives for demand

The RF Government Anti-Crisis Program for 2009 stipulated a series of measures and steps to create incentives for demand for the product manufactured by the plants included into the List of Strategic Companies. We need to focus on two measures, implementation of which allowed for achieving visible results in 2009:

(1) subsidizing 2/3 of the refinancing rate for 3-year consumer loans for purchasing cars manufactured in the territory of Russia (overall amount making Rb 2 bn);

(2) increasing the charter capital of OJSC RosAgroLeasing to procure domestically made agricultural machinery and equipment subject to further leasing (Rb 25 bn).

Partial interest rate subsidies for loans to consumers

The Federal Budget allocations for subsidizing 2/3 of the refinancing rate for 3-year consumer loans for purchasing cars manufactured in the territory of Russia for the total amount of Rb 2 bn were agreed by the RF Government in February 2009[1]. This measure was applied only to cars with the price not to exceed Rb 350 K included into a special list created by the RF Ministry of Industries and Trade. The initial version of this list[2] contained names of 29 car types, 25 of which were manufactured by strategic companies and their affiliates: 23 – by AVTOVAZ; 1 – by its joint venture with General Motors; 1 – by Sollers Group enterprises.

In March 2009 the RF Government adopted the rules for providing subsidies to Russian credit institutions to compensate for the shortfall in income from consumer loans for purchasing cars[3]. However, disbursement of such funds did not start until the end of the first six months.

In July 2009 the coverage of this measure was significantly expanded: now it could be applied not only to passenger cars but to commercial vehicles with mass not to exceed 3.5 tons, and the maximum price of a car/vehicle was increased up to Rb 600 K[4]. The list of cars/vehicles subject to such measure was also significantly expanded – up to 50 names, 37 of which were manufactured by strategic companies and their affiliates[5]. With the representation of VAZ cars (together with VAZ / General Motors JV) was decreased down to 18 names, and Sollers cars representation was increased up to 12; moreover, 7 other cars were added to the list (manufactured by GAZ).

In Q3 2009 the process of disbursing the subsidies started rolling out, however, the scale of this measure was far from the originally expected: by early October about 39 thousand of soft auto loans were issued (32 thousand – for VAZ cars), and the amount of interest rate subsidies was Rb 33 mln; and one month after the number of loans reached 48 thousand, and the amount of subsidies – about Rb 40 mln. In December 2009 the amount of budget allocations for this purpose was decreased more than 2 times – down to Rb 950 mln[6]. However, the actual total amount of granted subsidies during 2009 made less than 20% of the budget limit – Rb 187.7 mln[7].

[1] RF Government Directive No.139-p of February 9, 2009
[2] Order No.77 by the RF Ministry of Industries and Trade issued on February 20, 2009
[3] RF Government Resolution No.244 of March 19, 2009
[4] RF Government Directive No.905-p of July 7, 2009
[5] Order No.650 by the RF Ministry of Industries and Trade issued on July 15, 2009
[6] RF Government Resolution No.996 of December 1o, 2009
[7] M. Tovkaylo, V. Kholmogorova. Coming Late report. – Vedomosti, February 4, 2010.

The key areas for the RF Government anti-crisis activities in 2010 stipulate subsidies to Russian credit institutions to compensate the shortfalls in income on loans issued in 2009–2010 to individuals for purchasing cars – for the total amount of Rb 1 bn.

Increasing OJSC RosAgroLeasing charter capital

RF Government agreed for additional capitalization of OJSC RosAgroLeasing in the overall amount of Rb 25 bn in early February 2009[1]. By early March the respective funds were disbursed to OJSC RosAgroLeasing. By October 2009 the company used these funds to procure products to be leased to agricultural manufacturers for the overall amount of Rb 28.4 bn, including:

- Agricultural machinery – for Rb 22.8 bn;
- Equipment for cattle breeding and agricultural products processing – for Rb 3.6 bn;
- Pedigree livestock – for Rb 2 bn.

During 9 months of 2009 RosAgroLeasing supplied the agricultural manufacturers with 2,882 tractors, 1,600 harvesters, 4,196 automotive vehicles, 1,719 machinery and equipment pieces for setting-up grain processing facilities, and 18.9 thousand of high-yield pedigree cattle stock.

Decreasing the burden on business

Decreasing tax burden in oil-and-gas sector

The majority of tax measures applied from the time the crisis started were of "general systemic" character. We can identify some measures, however, focused at strategic companies, in particular – measures to decrease the tax burden on oil-and-gas sector:

- increasing the tax-exempt minimum from 9 to 15 $/bbl when calculating MET rates;
- improving the procedure for recognizing (deducting) the expenses for subsoil licenses acquisition when calculating the Profit Tax by providing the taxpayers with the possibility to write-off such expenses during the period of 2 years
- introducing tax holidays for developing off-shore fields, fields in Nenetsky Autonomous District, Yamal Peninsula, East Siberia, Azov and Caspian seas[2].

As per the available estimates, the aggregate benefit for oil-and-gas companies amounted to over RB 100 bn.

We also need to emphasize here, that starting from January 1, 2010, a number of changes were introduced to classification of fixed assets included into amortization groups[3]. These changes are about shifting certain types of equipment (primarily those used in exploration and production) into amortization groups with shorter useful life.

Tax arrears restructuring

The RF Government Anti-Crisis Program for 2009 stipulated adjustments to the effective schedules for *redemption of restructured tax arrears of the automotive companies* to the federal budget, as well as to extra-budgetary funds (in terms of insurance payments arrears). In March 2009 the RF Government adopted respective resolutions with regards to OJSC AV-

[1] RF Government Directive No.122-p of February 4, 2009

[2] Federal Law No.158-FZ of July 22, 2008, "On Amendments to Chapters 21, 23, 24, 25 and 26 of Part II of the Tax Code of the Russian Federation and to some other legislation of the Russian Federation pertaining to taxation"

[3] RF Government Resolution No.165 of February 24, 2009

TOVAZ and AMO ZIL[1]. According to the RF Ministry for Industries and Trade, simultaneous restructuring of tax arrears was performed for the amount of Rb 7.24 bn[2].

Let us also note that in December 2009 the RF Government defined the procedure and conditions for *restructuring the arrears for defense industry companies* engaged in government procurement and included into the List of Strategic Companies – this covered all the arrears to the Federal Budget (taxes, fees, accrued penalties and fines)[3].

5.2.4. Overall evaluation of coverage and sector-based specifics of measures supporting strategic companies

The aggregate amount of government support to strategic companies (taking into account the shortfall in budget revenues and potential budget expenditure) starting from October 2008 until the beginning of 2010 made, according to our estimate, about Rb 1.1 trillion[4]. Oil-and-gas sector, metallurgy, automotive and defense industries received the biggest amounts of such support.

In 2008 the amount of government support was only slightly below Rb 500 bn, the major bulk of it falling under 2 measures: external corporate debt refinancing (approximately Rb 270 bn) and amending the procedure for calculating export duties for crude (about Rb 150 bn, as per available estimates).

The amount of anti-crisis support in 2009 is estimated as exceeding Rb 500 bn; the major portion of budget resources was spent on additional capitalization of companies (direct budget expenditure of about Rb 150 bn), provision of government guarantees (amounting to Rb 150 bn), and tax incentives to oil-and-gas sector (the amount of shortfall in budget revenues exceeds Rb 100 bn, as per some estimates).

Overall, as per our estimates, the amount of direct Federal Budget expenditure and shortfall in budget revenues associated with support to strategic companies exceeded in 2009 г. the amount of Rb 300 bn.

As per the timeline of their implementation, the government support measures reviewed in this material may be clearly split into 2 groups:

- *immediate measures* – their practical implementation started in the end of 2008 or in Q1 of 2009 – such as external debt refinancing, additional capitalization, customs tariffs policy, decreasing tax burden on oil-and-gas sector, interest rate subsidies to exporters, subsidies to the RF regions to reimburse the interest rate on loans issued to agricultural and food processing enterprises, and some others;
- *"delayed" measures* – their practical implementation started only in H2 2009 – partial interest rate subsidies to defense industry and forestry industry companies, provision of government guarantees, interest rate subsidies on consumer auto loans.

A number of comments need to be provided in relation with that:

– practically all the measures having turned out as "immediate" did nit require establishment of any new mechanism for their implementation. Only external debt refinancing was

[1] RF Government Resolution No.260 of March 30, 2009

[2] Ref. Report by V. Khristenko, Minister of Industries and Trade at the Government Briefing in the state Duma on October 19, 2009
(http://www.minprom.gov.ru/press/release/showNewsIssue?url=press/release/818)

[3] RF Government Resolution No.995 of December 10, 2009

[4] Here and onwards – without accounting for "general systemic" measures covering a very broad range of business entities (change of Corporate Profit Tax rate, etc.)

exceptional – this instrument was created "from scratch" and applied very quickly (during about one month);

- the measures falling into the "delayed" group are fully financial measures initiated in 2009. The delay in their practical implementation (provision of government guaranties, interest rate subsidies on consumer auto loans) had some pretty straightforward reasons: imbedded shortcomings of the established norms and regulations, and other cases – the multiplicity of anti-crisis measures and their insufficient administration effected by lack of institutional capabilities;
- due to misalignment and mistiming of a number of anti-crisis measures, their potential synergy effect turned out to be limited.

Table 2

Evaluating the timing for launching government support to strategic companies, and the scope of their application (coverage)

Instrument	Start of practical implementation	Number of strategic companies having received support*	Sector coverage**
External corporate debt refinancing	2008	small	medium
Additional capitalization	2008	medium	medium
Amendments to procedure for export customs duties calculation and decrease of export customs duties	2008	big	medium
Increase of import customs duties, reduced quotas	2008	big	medium
Decreasing tax burden on oil-and-gas sector	Q1 2009	medium	narrow
Partial interest rate subsidies to exporters	Q1 2009***	big****	broad
Subsidies to the RF regions to reimburse the interest rate on loans to agricultural and food processing companies	Q1 2009***	NA	narrow
Additional capitalization of OJSC RosAgroLeasing	Q1 2009	small	narrow
Tax arrears restructuring	Q1 2009	small	narrow
Renewal of automotive and specialized vehicles fleet of the RF regions and municipalities	Q2 2009	small	narrow
Procuring automotive vehicles for federal executive authorities	Q3 2009	small	narrow
Partial interest rate subsidies to defense industry companies performing as contractors for government military procurement	Q3 2009	big****	narrow
Provision of government guarantees	Q3 2009	big****	broad
Partial interest rate subsidies on consumer auto loans	Q3 2009	small	narrow
Partial interest rate subsidies to forestry industry enterprises	Q4 2009	small	narrow

* categories: small – <10 companies; medium – 10-30 companies; big – 30+ companies;
** categories: narrow – 1-2 sectors, medium – 3-5 sectors, broad – 5+ sectors;
*** implementation started in 2009 (instrument was used before);
**** taking into account strategic companies subsidiaries

The majority of government support measures and instruments subject to our review here provided for support of a relatively small number of strategic companies (up to 10). *Measures effecting the most strategic companies were such financial measures as partial interest rate subsidies to exporters; partial interest rate subsidies to defense industry companies, as well as provision of government guarantees.* Two of these measures (government guarantees and *interest* rate subsidies to exporters) are also characterized by broad sector coverage, while as the majority of measures of government support to strategic companies covered only 1 or 2 sectors.

Table 3

Evaluation of importance of the key measures of government support to strategic companies by main sectors

	Assuring access to financial resources				Creating incentives for demand			Decreasing burden on business		
	Debt refinancing	Government guarantees on loans	Interest rate subsidies	Additional capitalization	New regional/municipal government procurement programs	Creating incentives for demand	Increasing import customs duties and reducing quotas	Decreasing tax burden on certain sectors	Decreasing export customs duties	Tax arrears restructuring
Oil-and-gas sector	++							+++	+++	
Energy (power generation)				+						
Coal mining										
Metallurgy	+++	++					++		+	
Chemistry and petrochem		+					+		+	
Construction materials manufacturing										
Automotive industry		+		++	++	+	+++			++
Agricultural machine engineering						++	++			
Transport machine engineering				+						
Defense industry		++	+	++						
Electronics, telecom	++									
Agriculture and food processing		+	+				++			
Construction	+	+								
Transport	+			++						

\+ moderately important;
++ important;
+++ very important.

The biggest number of various government support measures was applied to strategic automotive companies, and some instruments were purposefully developed specifically for this sector. Government support to oil-and-gas sector, metallurgy, defense industry, agriculture was also pretty diversified.

In general, *support to strategic companies was primarily focused on assuring access to financial resources.* At the same time, for certain sectors *incentives for creating domestic demand (automotive industry) and decreasing the tax burden (oil-and-gas sector) were especially important.*

* * *

The following conclusions may be made to summarize the analysis of government support:

1. With all its drawbacks and shortcomings, the List of Strategic Companies has performed a pretty important stabilizing function during the most acute phase of the crisis. The very fact of being included into the List irrespective or receiving actual support provided for decreasing the level of risk assessment for the respective company in the view of both banks and suppliers.

2. During the crisis period the RF Government exercised a pretty broad variety of diversified measures targeted at supporting strategic companies in that or another way. At the same time, the only support measures targeted and designed specifically for strategic companies

were provision of government guarantees and expanding the Lombard List of the Central Bank.

In addition, strategic companies were the key recipients of government support in such areas as external debt refinancing by Vnesheconombank, contributing additional assets into charter capital, interest rate subsidies to exporters. However, in such cases just like in many others strategic companies were becoming the recipients of this support "on common terms" (at least, there were no normative regulations on supporting strategic companies only).

3. The government support to strategic companies was mainly focused on assuring their access to financial resources. At the same time, measures targeted at creating incentives to promote domestic demand were especially important for some sectors (automotive), as well as measures targeted at decreasing the tax burden (oil-and-gas).

From the point of view of real funds disbursed among strategic companies, the most valuable measures were refinancing external debt, provision of government guarantees and changing the customs duties and quotas.

4. Practically all measures of government support to strategic companies were targeted (fully or to a great extent) at improving their financial stability and settling their debt problems. The government guarantees instrument was slightly different from all others in this regards, because certain limitations were set for using the borrowed funds only for certain purposes (core business operations or capital projects). However, settling earlier loans was included into the possible areas for using the newly raised money before even starting to grant the first guarantees.

5. Most of the financial support measures were exercised with significant backlog, sometimes – up to 6 months. The mechanisms which were applied almost immediately were the ones created and used before the crisis. Actually, the only new support mechanism which was created and used within the shortest possible time, was the mechanism for refinancing external debt of strategic companies.

6. Taking into account the scope of some anti-crisis measures and their "extension" into 2010, the task of evaluating their efficiency becomes extremely important. It requires setting the philosophy for such evaluation and creating the relevant infrastructure for monitoring and analyzing changes and progress of companies subject to applying support mechanisms, as well as for controlling their performance against obligations of their owners.

The task of defining the "pro-active" monitoring approach also becomes relevant, because it will allow for short-term forecast any serious aggravations of companies' positions and for timely defining the respective preventive measures.

7. In our opinion, the transparency of the whole system for monitoring the strategic companies and the mechanisms for providing support need to be improved drastically. The principles and criteria of feasibility of support need to be clearly set and defined, they would need to be provided to monitoring commissions and work groups established within the ministries.

5.3. Historical and future trends and legal issues related to 2003–2009 bankruptcies

The global economic crisis coupled with significant growth in foreign borrowings by Russian companies in recent years, shrinking market and industrial stagnation in several economic sectors in 2008-2009, as well as an increase in the number of inefficient investment projects and widespread breaches of contractual obligations starting from 2008, together raised the importance of both effective corporate management in general and of monitoring

the financial condition of companies in particular. In equal measure this applies to companies undergoing bankruptcy[1].

According to the Supreme Arbitration Court of Russia, the number of claims related to civil economic disputes filed in the second half of 2008 increased nearly by half compared to the respective number for the first half of the year, while the number of claims related to administrative disputes increased nearly twofold. The total number of civil claims filed with Russian arbitration courts in 2008 stood at 543,000, or 25% more than the respective number for 2007.

The 51% growth in the overall number of claims filed with arbitration courts in the first half of 2009 compared to the same period in the previous year[2], to a point when this number reached nearly 660,000, as well as an increase by nearly 90% of claims related to complete or partial breach of obligations by the contract parties[3], are indicative of the greater incidence of problems related to the breach of contractual obligations linked to payment for goods and services.

Late 2008 – early 2009 saw an increase of civil claim court filings related to creditor claims that, in the instance of executive writs remaining unpaid, are transformed into bankruptcy cases.

5.3.1. Bankruptcy trends under the third Law on Insolvency (2003–2009)

The third Law on Insolvency (Bankruptcy) adopted in October 2002 is best known for considerably curtailing the opportunities for the misuse of insolvency proceedings as a corporate asset takeover tool. In addition to this, the Law granted equal rights to the state and to general creditors, stipulated special bankruptcy procedures for certain debtor classes, and implemented a number of further changes related to insolvency[4].

The legal practice of applying the third Law on Bankruptcy in 2003-2009 has pointed to an excessive focus on certain issues that arose in the preceding period and to the persistence of the principal shortcomings both of the legislative framework that was in effect previously and of its practical application[5].

Generally speaking, recent years have seen significant growth in the scope of application of insolvency procedures: whereas in 2003-2004 the courts received approximately 12,000-13,000 bankruptcy filings for "substantive" debtors[6], similarly to 1998-2000 levels of 11,000-

[1] See also *Bankruptcies in the 2000s: from a raider's tool to a "double standard" policy*, by E.A Apevalova, A.D: Radigin, published by Economic Policy magazine, issue No. 4 for 2009, pages 91-124.

[2] The increase in the overall number of complaints filed with arbitration courts in 2008 amounted to 13% compared to the respective number for 2007. – Speech by A.A: Ivanov, Chairman of the Supreme Arbitration Court of Russia, at the Federation Council on September 21, 2009 - www.arbitr.ru

[3] Meanwhile, the increase in the number of complaints related to breached obligations under certain specific types of contracts is considerably higher, amounting to 300% for insurance contracts, 131% for supply contracts, and 97% for rental/lease contracts. - Speech by A.A: Ivanov, Chairman of the Supreme Arbitration Court of Russia, at the Federation Council on September 21, 2009 - www.arbitr.ru

[4] See also *Bankruptcies in the 2000s: from a raider's tool to a "double standard" policy*, by E.A Apevalova, A.D: Radigin, published by Economic Policy magazine, issue No. 4 for 2009, pages 91-124.

[5] For a detailed analysis of bankruptcy statistics in 1994-2004, see A.D: Radigin. Yu.V. Simachev, R.M. Entov et al., *The institution of bankruptcy: its establishment, shortcomings, and reform priorities*, Moscow, IEPP, 2005.

[6] Substantive debtors are all debtors except absentee ones.

15,500 filings per year, in 2005-2009 this number doubled to reach approximately 23,000-26,000 filings annually[1]. (see Chart 1 for the trends in the number of debtor insolvency (bankruptcy) filings from 1998 to the first half of 2009).

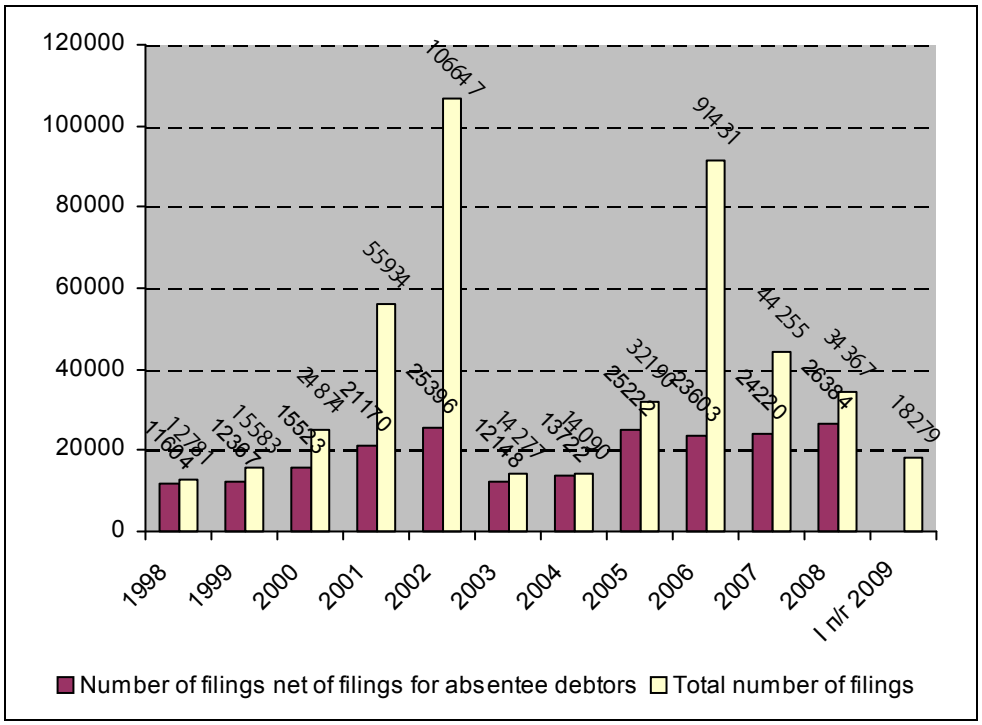

Fig. 1. The number of filings for debtor bankruptcies

As shown in Chart 1, 2002 and 2006 were each characterised by significant growth in the total number of bankruptcy filings, which was caused by an increase in tax authority corporate liquidation operations, including those concerning enterprises that had ceased economic activity (absentee debtors). Thus in 2002-2003, companies that had failed to re-register in accordance with the new Law on Joint Stock Companies were liquidated. By early 2004, the senior experts at the Russian Supreme Arbitration Court estimated the total number of enterprises subject to liquidation due to the cessation of economic activity at approximately 1.5 million. The procedure and terms of financing of bankruptcy procedures for absentee debtors were stipulated in October 2004[2], however, the required financing was only made available by 2006.

Thus in 2006, almost 87% of bankruptcy filings, or approximately 79,500 in absolute numbers, were made by the competent authorities. These included more than 70,000 (76.8%) bankruptcy claims made with respect to absentee debtors or debtors in the process of liquidation. In 2007, the number of bankruptcy filings for absentee debtors decreased 3.5 times compared to the previous year to reach 20,035. The decrease continued in 2008, with the respective number reaching 7,983 filings, or 23.2% of the total number of insolvency claims.

[1] Preliminary estimates show that the bankruptcy filings for "substantive" debtors in 2009 will be no fewer than the respective numbers in 2005-2008.

[2] Russian Government Decree No. 573 dated October 21, 2004, On the Procedure and Terms of Financing of Bankruptcy Procedures for Absentee Debtors

The principal reason for this decreasing trend has been the legislative stipulation in July 2005[1] and the increasing practical application starting from 2007[2] of the liquidation procedure for absentee and/or inactive legal entities by way of their elimination from the register by the tax authorities.

However, even given the tenfold decrease in the number of absentee debtor liquidation filings in 2006-2008, the share of bankruptcy filings made by the competent authorities, predominantly tax authorities, exceeded 67% in 2008. The proportion of debtor-filed claims increased from 13.1% in 2007 to 19.6% in 2008, or from 5,779 filings to 6,734 filings. General creditors filed 4,560 claims, or 13.3% of total claims, in 2008, compared to 4,738 claims, or 10.7% of the total, in 2007. *Thus tax authorities play the leading role in initiating bankruptcy proceedings, including those against "substantive" debtors, while government regulation of the operations of such authorities can have a significant impact both on the scope of application of bankruptcy procedures nationwide and on the general practices of such bankruptcy proceedings.*

As regards bankruptcy claims for specific debtor classes, the following observations must be made:

– Significant growth of individual entrepreneur bankruptcy claims in 2007-2008 (approximately 6.8 times in 2008 relative to 2006). Whereas the number of such claims was in the range of 200-700 in 2004-2006, it reached 2,478 in 2007 and 4,751 in 2008.
– A 2.5-times decrease in the number of agricultural enterprise bankruptcy claims in 2007-2008, from approximately 4,000 in 2006 to 2,465 in 2007 and 1,614 in 2008, and a twofold decrease in the number of bankruptcy claims for farms, from 550 claims in 2006 to 361 claims in 2007 and 273 claims in 2008. This is largely due to government measures aimed at supporting the agricultural sector, such as increased lending, restructuring tax obligations, dating of fuel and lubricant purchases, etc.

The trends in bankruptcy rulings in 1998-2009 were also largely influenced by the activities of government agencies in the area of legal entity liquidation (see Chart 2).

In the first half of 2009, the number of debtor bankruptcy rulings exceeded the respective number for the previous year by more than 16% for the first time since 2006, with approximately 7,500 rulings taken in the first half of 2009 compared to approximately 6,400 rulings in the first half of 2008. Our estimates show this growth continuing in the first half of 2010 unless the state adopts measures aimed at broader use of financial rehabilitation procedures, signing restructuring agreements, etc.

[1] Paragraph 3 of Article 1 of the Federal Law No. 83-ФЗ dated July 2, 2005, On Amendments to the Federal Law on State Registration of Legal Entities and Individual Entrepreneurs and to Article 49 of the Russian Civil Code.

[2] Following the adoption of the Plenary Decree of the Russian Supreme Arbitration Court No. 67, dated December 20, 2006, On the Practical Implementation of Legislative Provisions for the Bankruptcy of Absentee Debtors and the Liquidation of Inactive Legal Entities, that clarified the application procedure in courts of the regulatory provision adopted in July 2005 for the liquidation of inactive legal entities following a resolution by the registration authority.

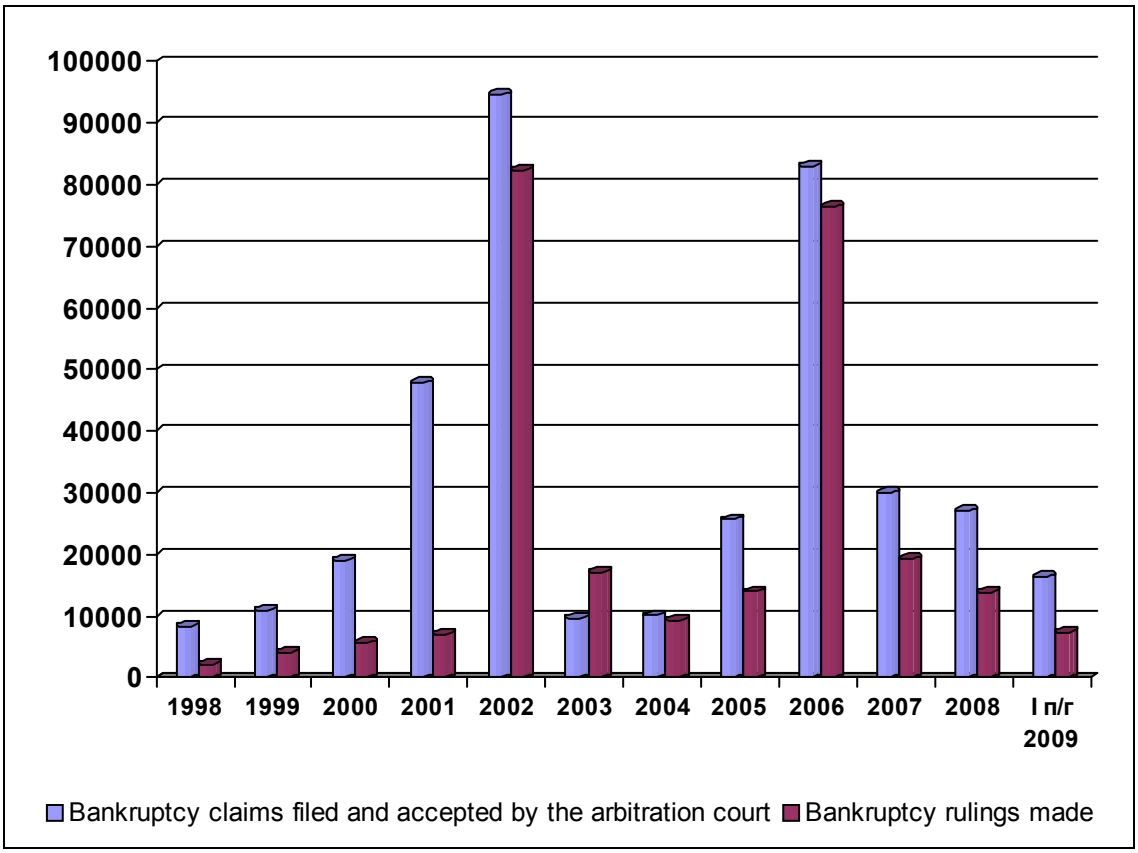

Fig. 2. Bankruptcy claim filing and bankruptcy ruling trends in 1998-2009[1]

The trends vary depending on the specifics of the different bankruptcy procedures envisaged by the Law on Insolvency. Thus the use of observation procedures increased more than twofold, from 4,893 in 1998 to 10,739 in 2002. In 2003-2004 the respective number dropped approximately by half, while in 2006-2008 it came back to 2002 levels, close to the maximum number at more than 10,000.

Throughout the validity period of the third Law on Bankruptcy, *instances of regaining solvency while under external administration* that led to the cessation of bankruptcy proceedings *were isolated*, numbering from 14 to 41 annually. Financial rehabilitation of debtors was likewise seldom used, from 10 to 48 instances annually. Restructuring agreements were signed more frequently, numbering 403 in 2002 and ranging from 84 to 170 in 2003-2008, but their use has amounted to less than 1% of the total number of bankruptcy cases completed annually. The use of external administration by debtors decreased steadily in the 2002-2008 period, dropping more than five times from 2002 to 2008. The trends in the use of external administration, financial rehabilitation, and restructuring agreement procedures in 2002-2008 are shown in *Fig.* 3.

[1] A different reporting system was used for bankruptcy cases in 1998-2001, which may have resulted in data inaccuracies concerning bankruptcy rulings taken in this period.

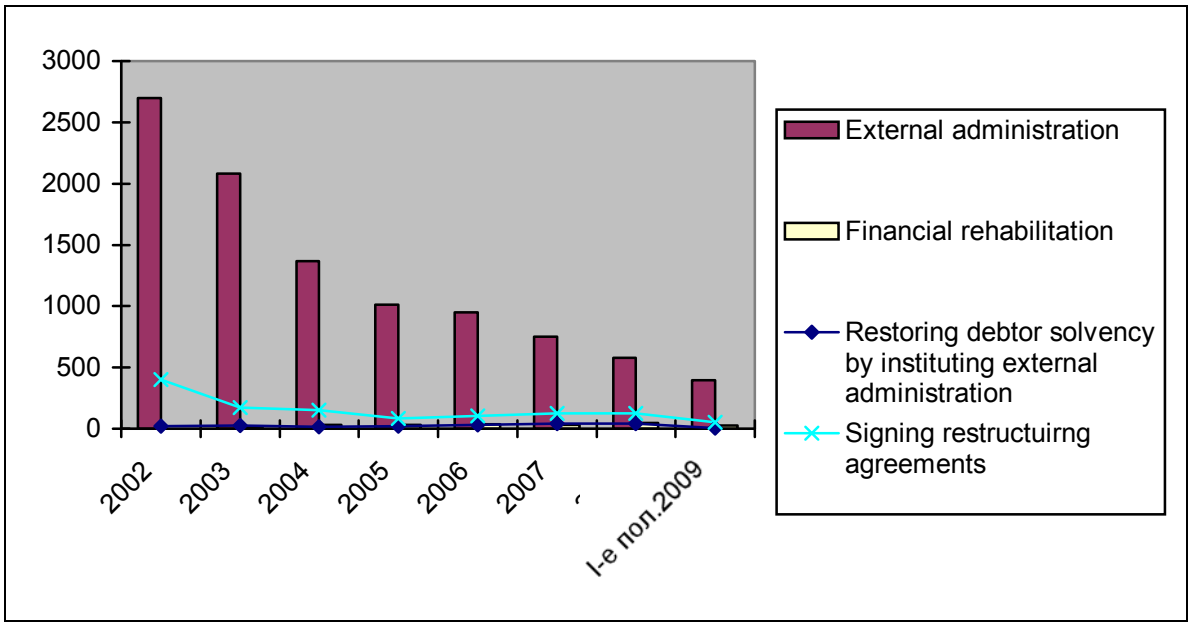

Fig. 3. Trends in the use of external administration, financial rehabilitation, and restructuring agreement procedures from 2002 to the first half of 2009

2008-2009 saw an emerging trend towards an annual decrease in applications for the removal of arbitration managers by approximately a quarter with respect to each preceding year, from 2,491 in 2007 to 1,783 in 2008 to 698 in the first half of 2009 (a 25.3% decrease relative to the respective period in 2008). This trend may be due both to more stringent requirements with regards to the responsibility of arbitration managers and their organizations and to changes in the arbitration manager appointment procedure that at present practically excludes any influence on behalf of the debtor, as well as the greater influence of government representatives and largest creditors upon all stages of the bankruptcy procedure.

The number of bankruptcies among municipal unitary enterprises has significantly decreased from 2007 throughout the first half of 2009, from 1,947 in 2006 to 1,009 in 2007, 676 in 2008 and 273 in the first half of 2009. Conversely, the number of bankruptcies among state unitary enterprises practically doubled in the first half of 2009 compared to the respective period in 2008, growing for the first time since 2007 to reach 163. The trends in bankruptcy rulings regarding state and municipal unitary enterprises are shown in Chart 4.

It should be noted that the 2005-2009 period has been generally characterised by wider application of bankruptcy procedures against "substantive" debtors. However, to a lesser extent the institution of bankruptcy continues to carry out the function of government regulation of the number of inactive legal entities that should be outside its scope. Tax authorities play a leading role in initiating bankruptcy proceedings, including those against "substantive" debtors, while government regulation of their activities can largely determine both the scope of application of bankruptcy procedures nationwide and have a significant impact on the general practices of insolvency proceedings.

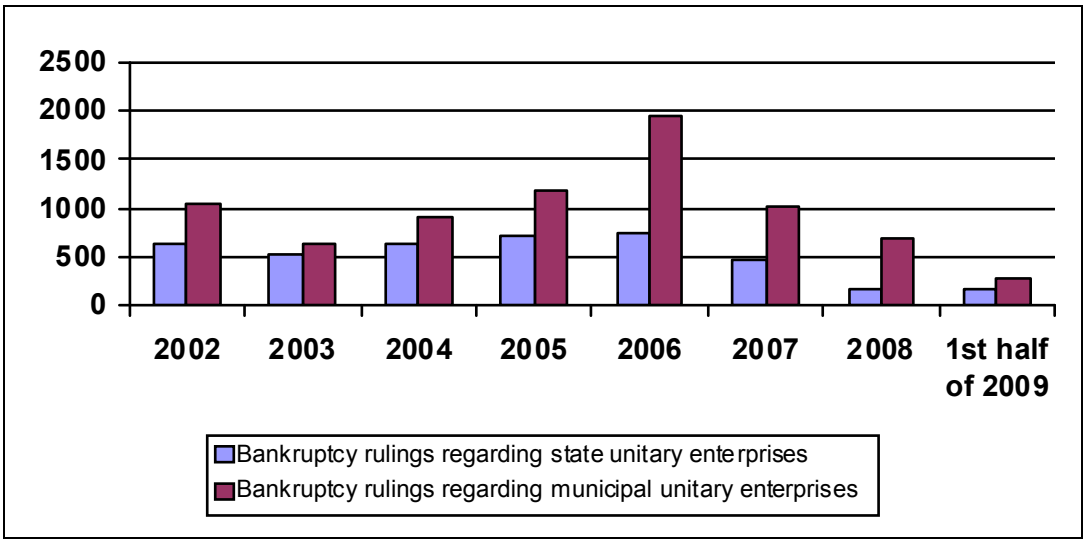

Fig. 4. Trends in state and municipal unitary enterprise bankruptcy rulings

The increase in bankruptcy rulings taken in the first half of 2009 amounted to 16.7% compared to the respective period in the previous year. A 24.1% increase in the number of bankruptcy filings, as well as Supreme Arbitration Court data that show evidence of significant (88%) growth in the number of claims related to breach of obligations, predominantly of contractual obligations, point to the high probability of further growth in the number of bankruptcies in 2010.

Restoring debtor solvency within the framework of bankruptcy procedures and settling creditor claims by signing restructuring agreements, as well as financial rehabilitation, are still confined to isolated instances and leave debtors who have become the subjects of bankruptcy proceedings no practical chances of retaining control over the enterprise. Given the low threshold for an insolvency ruling (RUR 100,000), as well as the large-scale payment defaults, shrinking industrial production volumes, lending volumes, and market demand starting from late 2008, this results in decreasing numbers of economic agents, above all of private entrepreneurs, regardless of their competitive strengths.

5.3.2. 2003-2009 bankruptcy legislation: "identity crisis"

The development of bankruptcy legislation from 2003 through the end of 2008 was largely influenced by the overall policy of direct government expansion in the economy. The creation of seven state corporations and a substantial increase in government-controlled corporate assets led to *the adoption of legislative provisions that lower the risks of loss or decrease of control over assets that are deemed important by the government and by state-controlled companies*.

First, the application of the Bankruptcy Law no longer extends to state corporations (practically all except Rosavtodor that was created later, between May and December of 2007), as well as Vnesheconombank.

The state that actively used the institution of bankruptcy to redistribute the assets of the Yukos oil company has now created preconditions enabling the state corporations, regardless of the economic efficiency of their operations, to unconditionally avoid a similar fate. The narrowed scope of application of the law and the exclusion of specific entities from the appli-

cation of general regulatory provisions is widely used at present to create favourable conditions for such select entities or economic sectors. However, such legal regulation substantially lowers government incentives for the creation of market institutions – in this case bankruptcy – in the interests of all market participants and preserves the persistent lacunae and contradictions in the legislation until such time as they may impact the interests of the key "players".

Second, government control was strengthened with respect to bankruptcy proceedings for enterprises whose activities involved state secrets, together with an increase in the number of companies eligible for a strategic entity designation enabling them to undergo bankruptcy on special terms geared more toward the preservation of the business.

Whereas prior to February 2007 the special provisions regulating the bankruptcy of strategic entities and organisations could only apply to federal state unitary enterprises and joint stock companies that had a government stake and produced goods or rendered services of strategic importance to state defence and security matters, fulfilled government defence contracts, and were involved in a limited number of other activities, at present such provisions apply to an open list of subjects that is being extended with new exceptions concurrent with the adoption of a new federal law.

Entities classified into this category have a higher indebtedness threshold for initiating bankruptcy proceedings (RUR 500,000 versus RUR 100,000 for the rest), higher requirements for arbitration manager qualifications, require mandatory participation by government representatives in the bankruptcy proceedings, and are subject to special treatment with regards to financial rehabilitation procedures, external administration and receivership proceedings.

In essence, the bankruptcy of such entities is subject to more stringent government controls. There can be no doubt that the operations of enterprises that ensure state security and are otherwise strategically important cannot and should not be regulated based solely on market principles. However, the creation of legal preconditions for making an exception for practically any enterprise is unproductive, creating "an illusion of the law for others' sake" and promoting misuse of the law.

Within the overall framework of strengthening government control over bankruptcy proceedings for enterprises whose activities involve state secrets, the requirements for arbitration managers working at such enterprises have been increased, and provisions have been made to allow the participation of regional FSB representatives in bankruptcy proceedings.

A logical extension of the policy of government expansion has been made by the introduction of a *simplified procedure for the reappointment of an arbitration manager that narrows debtor rights*. Effectively, the legislators proposed a mechanism for appointing an administrative (external, receivership) manager bypassing the general procedure for his approval that envisages the debtor's right to veto one of the candidates. The adoption of such norms simplifies the procedure of approving a candidate for arbitration manager in situations when the majority of creditors vote for the same candidate. The adoption of this mechanism in July 2006, its retroactive application and its use in the Yukos bankruptcy proceedings does not appear to be a coincidence[1].

[1] During the court hearing at the Moscow arbitration court regarding the bankruptcy of the Yukos oil company (case № А40-11836/06-88-35«Б» dated August 4, 2006; the Law was adopted on July 18, 2006), a stipulation was made for the approval of a temporary administrator in the capacity of bankruptcy administrator based on the resolution by the creditors' meeting adopted in accordance with Article 45 of the Federal Law on Insolvency (Bankruptcy). By then the indebtedness of Yukos amounting to US$482 million had been assigned by the consortium of foreign banks to the state-controlled Rosneft joint stock company that, jointly with the tax authority

Finally, note should be taken of the prorogation in December 2004of the validity of the Federal Law on the Insolvency (Bankruptcy) of Natural Monopolies dated June 24, 1999, until July 1, 2009, which signified the continued application of a different principle of determining insolvency criteria for natural monopolies in the fuel and energy sector, the so-called payment unfeasibility principle[1]. For such companies, special rules have remained in force for all stages of bankruptcy proceedings that are aimed at ensuring the preservation and integrity of all property of fuel and energy sector natural monopolies and envisage the mandatory participation of fuel and energy sector management agencies in the proceedings (article 7), as well as more stringent requirements for the arbitration manager (article 15).

Other innovations in bankruptcy legislation for the period had more limited reach and were aimed at protecting the interests of specific legal subjects within the bankruptcy process, such as granting preferential treatment to local government agencies facilitating the transfer to such agencies of social sphere assets following bankruptcy and the introduction of legal mechanisms for enhanced protection of the interests of mortgage-backed securities holders.

Thus between 2003 and 2008, legal regulation of bankruptcy evolved to ensure, at the legislative level, the integrity of significant state-controlled assets, while at the same time the development of necessary changes in the interests of other market participants and the development of the institution of bankruptcy as a whole were both stagnating.

The global economic crisis put a stop to government inertia in solving the outstanding issues related to bankruptcy and became an external stimulus for long-overdue changes. The increased legislative activity in this area was particularly spurred by the growth of debt portfolios of the largest Russian banks, as well as by the practice of asset-backed lending to the largest industrial enterprises, many of which experienced a deterioration in their financial condition, and by the expected increase in the number of corporate bankruptcies in 2009-2010.

The government decision to support the banking sector, which is de facto more than 50% state-controlled, and the emphasis on ensuring its stability, including doing so by creating the conditions for ensuring low levels of bad debt in bank loan portfolios, as well as widespread payment defaults on loan agreements have defined the focus going forward of developing bankruptcy legislation that is centered around the notion of *creating real conditions for satisfying creditor interests and increasing the protection of creditor rights*.

The implementation of this concept translated into the following changes instituted by state laws No. 296-ФЗ dated December 30, 2008, On Amendments to the Federal Law on Insolvency (Bankruptcy) and No. 73-ФЗ dated April 28, 2009 On Amendments to certain legislative acts of the Russian Federation:

1. *The exclusive right of the creditor assembly to elect the arbitration manager* has been instituted, along with the previously envisaged possibility of electing a self-governing body of arbitration managers. At the same time, the procedure of appointing the arbitration manager now allows for a single candidate to be proposed by the creditors (three candidates knee were required previously, and earlier still the debtor had the right to veto one of those).

representatives, held the majority vote at the creditors' meeting. The company assets were subsequently sold by the Yukos arbitration manager at an estimated substantial discount to market price, and more than 80% of these assets were transferred under direct or indirect government control.

[1] See V. Vitrianski, Insolvency (bankruptcy) specifics for natural monopolies in the fuel and energy sector (http://www.juristlib.ru/book_1091.html)

2. The liability of the arbitration manager has been increased. Failure to carry out his duties, in full or in part, including the duties envisaged by federal standards, can be the basis for removing the arbitration manager by the arbitration court based on a claim by the bankruptcy case participants. Furthermore, the procedure of disqualifying an arbitration manager has been stipulated in detail.

3. The system of remuneration for the arbitration manager and specialists that he may involve in the bankruptcy proceedings has been changed.

The proposed mechanism of remuneration payments for the arbitration manager is aimed at incentivising the arbitration manager to act in the interests of creditors. It envisages fixed compensation for the arbitration manager of between RUR 15,000 and RUR 45,000 monthly[1] depending on the stage of the bankruptcy process, and the payment of additional remuneration decided by the creditors. Such additional remuneration amounts to:

– Compensation ranging from 4% (for total assets valued at less than RUR 250,000) to RUR 301.500 plus 0.001% of the total value of debtor assets in excess of RUR 1 billion (for total assets valued at more than RUR 1 billion) at the supervision and financial rehabilitation stages;
– 8% of the amounts designated for satisfying the claims or registered creditors in case the bankruptcy proceedings are terminated, or 3% of the increase in value of the debtor's net assets during the external administration period in case the debtor is ruled bankrupt and receivership proceedings are initiated at the external administration stage;
– compensation ranging from 3% to 7% of the total amount of the satisfied claims of registered creditors.

The amount that the bankruptcy administrator can designate as payment for specialist services is also stipulated in detail and, depending on the total book value of debtor assets, can range from 10% for total assets valued below RUR 200,000 to RUR 2,995,000 plus 0.01% of the total value of debtor assets in excess of RUR 1 billion for total assets valued at more than RUR 1 billion. Furthermore, the legally stipulated remuneration for such services, as well as the amounts paid for the services of specialists involved by the arbitration manager can be deemed unjustified based on an appeal by bankruptcy case participants if such services are not linked to the specific object of bankruptcy proceedings or to the responsibilities of such agents, or if the amount of remuneration for such services is "clearly disproportionate relative to the expected results".

4. The responsibilities of arbitration managers with regard to informing the participants of bankruptcy proceedings have been increased: creditors must be informed about transactions and actions that lead or may lead to third party legal liability, as well as about any evidence uncovered of a deliberate or fictitious bankruptcy, while government bodies must be informed about any administrative or criminal breaches identified.

5. The responsibilities and liability of the self-regulating bodies of arbitration managers have been increased.

Thus starting from 2009, self-regulating organisations have been granted accreditation rights with regards to insurance agencies, valuation specialists, professional securities market participants that carry out registration activities, as well as with regards to other entities involved by the arbitration manager when carrying out his duties in the bankruptcy process.

[1] This amount can be increased based on a court decision following an application by the bankruptcy case participants.

Furthermore, such agencies are put in charge of developing standards and regulations governing the professional activities of arbitration managers and monitor compliance with such standards and regulations. These agencies are also entrusted with monitoring the compliance of arbitration managers with the mandatory liability insurance requirements.

Mandatory disclosure by arbitration manager self-regulating bodies has been instituted concerning their activities, including the use of compensation funds; their managing companies; any instances of disciplinary measures applied to arbitration managers (for more details on the issues of arbitration manager self-regulation, see Section 3.2);

6. The Law has stipulated procedures for the use by arbitration manager self-regulating bodies of compensation funds that are utilised to make payments to debtors, including the procedure of making claims for compensation payments, timing deadlines for compensation payments; investment terms for compensation fund assets; responsibilities of the managing company; the transfer of compensation fund moneys to a national association in case of elimination of the self-regulating organization from the register.

7. State control over the activities of arbitration manager self-regulating bodies has been increased.

Control functions that were previously carried out by the Federal State Registration, Land Register, and Cartography Service (formerly called Rosrtegistratsii), were strengthened by granting it additional powers:

– the right to start legal proceedings for administrative breaches against arbitration managers, arbitration manager self-regulating bodies and/or their representatives, and the right to review such cases or remit them for review by arbitration courts;
– the right to include non-commercial organization records into the general state register of arbitration manager self-regulating bodies and the right to keep such a register;
– the right to establish the status of an association of arbitration manager self-regulating bodies as that of a national association, etc.

In case of non-compliance by arbitration manager self-regulating bodies with the directives of monitoring and controlling agencies aimed at correcting deficiencies related to setting standards and developing regulations or related to reviewing complaints about the actions of their members, the representatives of the government agency must file an application at an arbitration court for the elimination of such an organisation from the general state register.

8. Strict requirements have been established with regards to the mandatory liability insurance contracts signed by arbitration managers. The objects of mandatory insurance, insurance events and insurance risks for such contracts have been stipulated along with the insurance payment procedures.

9. Measures have been taken to counteract the transfer of assets.

The focus on maximizing the satisfaction of creditor claims has led to the implementation of mechanisms for contesting transactions aimed at transferring debtor assets, the so-called "suspicious transactions" and "transactions leading to preferential treatment of one of the creditors". *In essence, the state has taken legislative measures to eliminating bankruptcy "grey areas" for the first time in five years*.

10. The concept of liability for debtor owners has been established.

For the first time, in addition to the above entities, subsidiary liability has been established for the real owners, "entities controlling the debtor", understood as persons or entities that have or have had, within the two years prior to the acceptance of a bankruptcy claim by an

arbitration court, the right to issue instructions that are subject to mandatory execution by the debtor or can otherwise determine actions by the debtor[1].

The practical possibility of establishing liability and pursuing legal action against such persons or entities is doubtful due to the impossibility of establishing the real owners and beneficiary owners of many substantial Russian assets even in the context of criminal proceedings.

The duties of the managers and owners of financial institutions in situations approaching bankruptcy have been significantly broadened, and new types of liability have been established including a ten-year prohibition on the purchase of financial institution shares amounting to 5% or more of total stock and a three-year ban on taking top management positions in financial institutions.

11. The possibility of a closed sale of debtor assets has been narrowed. The enterprise sell-off procedure has been given detailed legal treatment, with its rules applying also to the full or partial sale of debtor property (articles 110, 11 and 139 of the Federal Law on Insolvency (Bankruptcy). While the possibility of a closed sale of debtor assets has remained and is now called an "auction featuring closed price offers", numerous necessary technical innovations have been introduced such as the application procedure and application requirements when applying for participation in the auction, as well as requirements concerning the company sale contract, while the information transparency of the sale process has been enhanced. The practice of formally open auctions has been announced; however, the practice of selling assets to "earmarked" buyers will remain (albeit to a limited extent), especially considering the growing influence of the state upon the arbitration manager who acts either as auction organiser or as the person contracting a specialised agency for this purpose.

Furthermore, enterprise sale can now be carried out both by auction and by competitive sale so long as the buyer complies with specific conditions set by a creditor assembly or creditors' committee with respect to the company being sold. The introduction of an electronic format for enterprise sale is a progressive measure, however, its implementation has been postponed indefinitely[2].

Further changes were made to the key provisions of the bankruptcy legislation.

A. Whereas previously the right to make a bankruptcy claim at the arbitration court came into effect 30 days after the date of remittance of the executive order to the court bailiff service, at present such a right comes into effect from the date of the legally binding court decision concerning a monetary claim upon the debtor.

[1] Debtor actions can be determined by a controlling entity, including determination by coercion of the representatives of the debtor manager or of the members of debtor management bodies, or by otherwise exerting influence on the debtor manager or of the members of debtor management bodies (thus, debtor controlling entities can include members of the receivership committee, persons or entities that had the power by way of power of attorney or regulatory act, or by way of special power to enter into transactions on behalf of the debtor, persons or entities that had disposal rights with respect to more than 50% of the voting shares of a joint stock company or more than half of the statutory capital of a limited (subsidiary) liability company). Federal Law No. 73-ФЗ dated APril 28, 2009, On Amendments to certain legislative acts of the Russian Federation.

[2] Electronic auctions for the sale of enterprises shall be held 120 days following the day of approval by the regulatory body of the requirements regarding electronic trading sites, requirements regarding the operators of electronic trading sites when holding open auctions in electronic format, the procedure of verifying compliance of the electronic trading site and its operator with the established requirements, the procedure of holding open auctions and electronic format (Federal Law No. 296-ФЗ dated December 30, 2008, edited July 19, 2009). By November 2009, the relevant provisions have been developed by the Ministry for Economic Development, but they are yet to be adopted.

Thus it becomes possible to start insolvency procedures prior to ascertaining the impossibility of carrying out the court decision and prior to actual insolvency. This allows for the application of bankruptcy procedures to companies that are neither bankrupt nor even in a state approaching bankruptcy.

Such a situation is once again advantageous for creditors who at present compete among themselves. From a legal point of view such stipulation of a creditor's right to file a bankruptcy claim prior to the expiration of the deadline for voluntary execution of a court order by the debtor and prior to the start and end of executive proceedings is illegal as it infringes upon the debtor's rights and the subjects the debtor to bankruptcy proceedings that are the last resort measure of protecting creditor rights, without sufficient legal grounds and unjustifiably bypassing the customary process is of protecting creditor rights. Doubts also arise regarding the stipulation of the right of the competent authorities, primarily tax authorities, to file a bankruptcy claim. The legal grounds for the stipulation of such rights must undergo a fundamental test of substance, and the procedure must be changed if sufficient grounds exist.

B. The list of bankruptcy procedure participants has been expanded with the inclusion of authorised representatives of the Russian Federation and local government bodies. Furthermore, the right to participate in bankruptcy procedures has been granted to the self-regulating body where the arbitration manager is a member, to bankruptcy supervision and monitoring agencies (the Ministry for Economic Development and the Federal State Registration Service), as well as to creditors for current payments.

Overall systemic measures for the development of bankruptcy legislation are accompanied by strengthening direct and indirect government influence upon the execution of bankruptcy proceedings and by the further narrowing of debtor rights that underlines the pro-creditor focus of the insolvency legislation[1]. Apart from direct participation by representatives of the Federal State registration service and other government representatives in bankruptcy procedures, there is growing informal influence of government officials upon arbitration managers (also by way of influencing the self-regulating bodies), and growing influence of the tax authorities by way of arbitration manager selection and establishing his remuneration. The same purpose is served by changing the status of "mandatory payments" that become due after the instigation of the bankruptcy procedure, resulting in ensuring the growing influence of government representatives at the creditors' assembly.

The area of enterprise rehabilitation that is in great need of development has undergone changes linked to its potential application at any stage of bankruptcy proceedings and to stipulating the right of founders (partners) and owners of unitary enterprises and third parties to settle company indebtedness for mandatory payments at any stage of the bankruptcy process. Considering the increasing state control over bankruptcy proceedings and the increase in

[1] The pro-creditor focus of the bankruptcy legislation uses the presumption of the debtor being an ineffective owner. Unlike countries with more advanced economies, Russia has low levels of competition and corporate governance, an underdeveloped financial system, and a high level of criminal involvement in corporate activities. Furthermore, breaches of contract roll obligations, including monetary obligations, were pervasive in Russia even at the time of economic growth due to insufficient asset levels, difficulties in attracting debt financing and in using financial instruments that would ensure the fulfillment of such obligations. On top of that, the methods of financing chosen by the government at the time of crisis have led to the deterioration of the competitive environment. In this situation the practically unchecked right of large creditors with regards to determining debtor activities while depriving the latter of any possibility of preserving their business and restoring company solvency goes against market interests as in such cases efficient owners are likewise in danger of losing their assets.

the methods of directly and indirectly influencing the arbitration manager, this innovation provides a "loophole" for those willing to preserve their business. The measures adopted are insufficient and incapable of radically changing the unsatisfactory situation with regards to preventing bankruptcies.

The increase of bankruptcy participant rights as regards demanding an expertise at any stage of the bankruptcy proceedings to determine instances of deliberate or fictitious bankruptcy is a positive development albeit a clearly belated one.

A number of procedural innovations have also been made:

a) *A general federal register of bankruptcy information* is being created that will contain a broad range of information regarding the procedures used in bankruptcy cases such as asset sale auctions and their results, their removal of arbitration managers, etc.;
b) *Debtor employees have been included among the interested persons who cannot be appointed as temporary, administrative, external, or receivership managers*, while the statute of limitations within which debtor managers, members of its board of directors and executive body, as well as its chief accountant are considered interested persons has been extended from one year to three years;
c) *The arbitration court has been granted the right of independently ordering an expertise* to investigate issues that require specialized knowledge in the preparation of the bankruptcy case.

Important *social innovations* include changing the ranking of payroll indebtedness within the order of creditors for current indebtedness arising after a court bankruptcy ruling. It will now be settled immediately following the payment of legal expenses and remuneration to the arbitration manager and persons contracted by him for the purpose of conducting the bankruptcy proceedings. Previously payroll indebtedness ranked below current utilities and maintenance payments and below creditor claims arising after the bankruptcy filing.

In general, the development of bankruptcy legislation in 2003-2009 can be conditionally divided into two periods. The first was the *pre-crisis* period focusing on the preservation of the overall corporate bankruptcy framework whose functioning had limited impact upon the interests of key players who had significant lobbying potential. The protection of their interests necessitated the strengthening of government control and broadening the scope of application of special bankruptcy procedures for strategic enterprises that were subjectively designated as such, while the most influential economic subjects (Vnesheconombank and government corporations) were exempted from the application of the bankruptcy law.

With the onset of the crisis, the priority changed from ensuring the integrity of state controlled assets to ensuring low levels of bad debts in the loan portfolios of the largest banks, which was meant to contribute to the preservation and support of the banking system. In this situation the banking sector is significantly aided by the state twice, once by way of direct finanscial aid and once again by substantial protection of bank interests in the area of bankruptcy, thus promoting the idea of banks as efficient owners while inefficient owners have been penalised not only by the financial crisis but also by the impossibility of protecting their legal interests given the strengthening pro-creditor focus of the bankruptcy system that practically rules out the preservation of business and at present has little to do with the efficiency for market participants or lack of such.

At the same time, the significant number of expected bankruptcies and the dispersal of state interests in this regard has resulted in *the adoption in December 2008 and later in April*

2009, for the first time since 2004, of general legislative provisions concerned with the interests of all market participants.

A number of proposed measures, such as more detailed stipulation of procedures, more stringent controls over the activities of arbitration managers and their self regulating bodies, stipulation of auction procedures for debtor assets, the introduction of greater information transparency in bankruptcy proceedings are *long overdue and can improve the protection of both creditor and debtor rights*. The efficiency or inefficiency of the new measures will be largely determined by the extent to which the state will continue to use its growing influence to further strengthen its position and protect quasi-government interests in the corporate market by controlling the redistribution of corporate assets, or by whether the economic downturn will cause the state to be guided by the interests of society in general, however contradictory.

The practice of developing both corporate legislation and bankruptcy legislation in the 2000s shows a growing trend toward a merger or government interests with those of the largest state-owned (pro-government) companies and banks, along with amending economic legislation predominantly in the interests of such agents and to the detriment of the interests of society in general. The only exception is provided by the reaction to acute social phenomena.

At present there is no planned systematic development of either corporate law or bankruptcy law in the interests of all market participants. In this respect the pre-crisis and post-crisis developments in bankruptcy law are similar, with legislation serving as *an instrument of upholding the interests of a specific group of subjects that the state identifies itself with at various points in time*. Until such time as this identity crisis is resolved by the state, the development of economic institutions we'll be chaotic and destructive to the development of the economy as a whole.

5.3.3. The judicial system and issues of self-regulation

Judicial system

Arbitration courts play a crucial role in bankruptcy rulings with respect to debtor enterprises and individual entrepreneurs. All the key decisions starting from the acceptance of the bankruptcy filing and up to the ruling on the termination of receivership proceedings that serves as the basis for a liquidation entry with respect to the debtor in the state register of legal entities are taken by the arbitration court that reviews the bankruptcy case. Within the framework of this judicial process, the court takes decisions that have a significant impact on the economic status of the participants of bankruptcy proceedings. In some cases, significant shortcomings and mistakes in the court rulings cannot be rectified. It is therefore of supreme importance that the numerous decisions taken within the bankruptcy process, such as the appointment and removal of arbitration managers, settling disputes among creditors and between creditors, the arbitration manager, and the debtor, including creditor claims in the register, removal of debtor management, the adoption of safeguard measures, the invalidation of debtor transactions and other such decisions should be taken by an independent court, be legally enforceable, be well grounded, and be implemented.

Otherwise the institution of bankruptcy cannot function effectively within the economy. The above applies in equal measure to settling other disputes arising from economic and administrative legal relations where the rulings, in cases of noncompliance with the same, form the basis for initiating bankruptcy cases.

In practice the Russian judicial system, having inherited many of the traditions of the Soviet judicial system, *continues to be significantly influenced by the executive power*. It would be unfair to claim that all or most judges lack independence; however, rulings for legal cases "of special importance" are entrusted to those whose decisions follow the recommendations of the presiding judge who assigns the cases. According to the determination of the president of the Russian constitutional court V.D: Zorkin[1], ensuring the independence of such presiding judges is a key issue.

Recent assessments of the judiciary system range from "a mockery of justice" and "a tool serving the executive branch" [2] to "a comprehensive judiciary system albeit riddled with numerous shortcomings" [3]. These shortcomings arise from inadequacies in the legal mentality, including that of professional practitioners, in professional personnel training, in organizing the functioning of courts, including workload issues, in the selection criteria, selection mechanisms, and appointment mechanisms for judges, in receiving and improving professional qualifications, and in the degree of transparency in the system.

A widely known shortcoming of the Russian judiciary is the *lack of enforcement of Russian court rulings*. Statistically, half of the rulings by both general courts and arbitration courts in Russia are not enforced. [4]. The most urgent issues related to the enforcement of court decisions are to do with the inefficient and illegal sale of arrested assets, as well as with staffing issues. The possibility of selling corporate assets to "designated" buyers at discount prices is a significant component of corporate takeovers. An analysis carried out by the Federal Court Bailiff service has revealed the following shortcomings of the present property sale mechanism[5]:

– lack of access to "closed" debtor property sale auctions
– lack of information on property sales, which information in the majority of cases is published in low circulation periodicals dealing with unrelated subjects
– the auctioning off of property at discounted prices.

Thus corporate takeovers still use the well established old practice involving the sale of arrested and confiscated property.

In order to deal with the above shortcomings, the Federal Court Bailiff service supports the development of the system of selling arrested property based on mixed auctions using global auction practices (Dutch and English auctions).

Such a system must combine various features aimed at attaining the full of sale of arrest and property at a maximum price. This will allow to minimise the issues related to the current system of valuing arrested property.

If the new property sale system is implemented, property valuation by the court bailiff or by a professional assessor will be mostly indicative, as necessary for determining commensu-

[1] Speech by V.D. Zorkin, president of the Russian constitutional court, at the seventh Nationwide Congress of judges.- Russian Judiciary, No. 1 (2009), p.12
[2] A. Pushkarskaia, The Constitutional Court loses its dissenting opinions – Kommersant, No. 225 (December 2, 2009)
[3] Here and further below, Yu. Kolesov, "Valeri Zorkin: each component of the judiciary system has its shortcomings"- Vremia Novostei, No. 105, June 16, 2005
[4] Speech by the President of Russia D.A: Medvedev at the seventh Nationwide Congress of judges.- Russian Judiciary, No. 1 (2009), p.4
[5] Here and further below, "The Federal Court Bailiff service on the liquidation of assets arrested, confiscated, and otherwise converted to state property" - http://www.fssprus.ru, June 28, 2007

rate penalties. Such indicative values for arrested property will serve merely as initial auction prices that can then change during the auction (either grow under the English system or decrease under the Dutch system) to reach an equitable price. Some of the proposed innovations limiting the closed sales of debtor assets have been adopted, however, these have not yet been implemented in practice.

As regards *staffing*, the inefficiency and abuses of power by court bailiffs are widespread and have long been an urgent issue. In 2008, 522 criminal cases were initiated for the 780 crimes committed by officials of the Federal Court Bailiff service. It must be noted, however, that the court bailiff service works diligently to uncover such breaches and crimes committed by its employees. 87.4% of the overall number of criminal cases was initiated based on the information provided by the Federal Court Bailiff service itself[1].

The high level of abuse instances by representatives of the Federal Court Bailiff service is coupled with the very low proportion of court decisions to satisfy claims contesting the action or inaction of and rulings by the officials of the Federal Court Bailiff service, at 0.0063% (6.6%)[2] and with the very low proportion of satisfied claims against the Federal Court Bailiff service itself, at 2.3%[3]. Such indicators, together with the practice of contesting the rulings and actions of Federal Court Bailiff service officials, are evidence that the creditors lack an effective mechanism of influencing the enforcement of court rulings and of receiving adequate compensation for losses incurred due to inefficient functioning of the Federal Court Bailiff service.

One of the contributing factors for the low quality of court case review and the long review duration is the *unprecedentedly high workload of judges*. The relatively reasonable workload per judge at an arbitration court in Russia is an average of 15.6 cases reviewed monthly. Meanwhile, in the first half of 2009, the average workload in the arbitration courts had increased by 22% relative to the respective period of the previous year to reach 45 cases per judge monthly[4].

Due to the above, the *level of public confidence in the judicial system* remains low. The number of complaints by Russian citizens filed with the European Court of Human Rights has been steadily growing: 2002 saw the first two rulings on complaints lodged against Russia, with five rulings in 2003, 15 in 2004, 83 in 2005, 102 in 2006, and 192 in 2007. Russia currently has the highest number of complaints lodged against it and the second highest number after Turkey in terms of court rulings that deem state authorities to be responsible for the infringement of at least one provision of the Human Rights Convention. By the beginning of 2008 there were 20,300 complaints against Russia waiting to be reviewed by the European Court, which amounts to 26% of the total number of such complaints (compared to 15,000 complaints at the beginning of 2007). Half of the total number of complaints to the European Court contested the non-enforcement of judicial decisions[5].

[1] On the results of measures aimed at identifying, stopping, and preventing illegal activities by the employees of the Federal Court Bailiff Service regional agencies in 2008 - www.fssprus.ru

[2] The "Key Indicators of Federal Court Bailiff service activities" contain both of the above percentages- www.fssprus.ru

[3] "Key Indicators of Federal Court Bailiff service activities"- www.fssprus.ru

[4] Speech by A.A: Ivanov, Chairman of the Supreme Arbitration Court of Russia, at the Federation Council on September 21, 2009 - www.arbitr.ru

[5] Speech by V.D. Zorkin, president of the Russian constitutional court, at the seventh Nationwide Congress of judges.- Russian Judiciary, No. 1 (2009), p.12

A number of laws were adopted in December 2008 that were aimed at combating corruption, including corruption among judges[1].

Innovations made to the Law on the Status of Judges envisage a new procedure for submitting information on the income, property and property-related obligations of the candidates for the positions of judges, as well as the spouses and underage children of such candidates. The law changed the appointment procedure and requirements for judges. Obvious shortcomings of the proposed edition include:

– The small number of persons whose property records can be verified in connection with the judge's activities (spouse and children). In such situations, the bulk of abuse instances related to illegal payments (bribes) remains beyond the scope of application of the law.
– the impossibility of establishing legal liability for corruption for the judge so long as the illegal or unjustifiably high income is received by the judge's relatives, spouse, or other related persons.
– the impossibility of establishing legal liability for corruption for the judge so long as the illegal income is received by a legal entity owned by the judge, his/her spouse, relatives, or other related persons.
– The provision for legal liability by judges for the failure to provide income and property information or for the provision of false or incomplete data is made using the wording "legal liability may arise", which in practice leads to the routine practice widespread in Russia of the selective application of liability.

At the same time, the provision for the initial appointment of a federal court judge for a duration of three years was eliminated in July 2009[2], while the judge's overall term of office was amended to be limited only by reaching the "maximum age of holding office", i.e. 70 years. Both amendments are aimed at raising the status of judges and increasing their independence.

The above issues are directly related to the issue of *the judges' accountability and setting the standards for judiciary ethics*. This issue is being discussed throughout Europe as part of seeking to balance the judges' independence and accountability. However, there is still a lack of unified standards for judiciary ethics and judges' behavior. In December 2009, the Judges' Council of Russia was presented with a new draft Code of Judiciary Ethics. The Chairman of the Supreme Arbitration Court A. Ivanov characterised the Code presently in force as a "statement of intent" that is of little help to judges in dealing with ethically complex situations. The new draft Code is considerably more detailed, dealing with the judges' relations with court proceeding participants, court senior officials, administrative employees, family members and relatives, as well as extra-judiciary activities. For the first time in Russia, the Code prohibits court presidents from exerting influence on the adoption of rulings by judges for specific cases.

[1] Federal Law On Amendments to certain legislative acts of the Russian Federation due to the adoption of the Federal Law on Combating Corruption, No 274-ФЗ dated December 19, 2008 and On Amendments to certain legislative acts of the Russian Federation due to the ratification of the UN Convention against corruption dated October 30, 2003, and the Convention on criminal liability for corruption dated January 27, 1999, and the adoption of the Federal Law on Combating Corruption, No. 280-ФЗ dated December 25, 2008.

[2] Federal Law No 157-ФЗ, dated July 17, 2009 On Amendments to Articles 6 and 11 of the Law of the Russian Federation Law on the Status of Judges and to Articles 17 and 19 of the Federal Law on Judiciary Bodies in the Russian Federation

The draft devotes considerable attention to the cases of conflict of interest where the judge is prompted to withdraw his candidacy or to inform the proceeding participants about such conflict of interest and obtain their written consent for the case being reviewed by the judge in question. The judges and their family members are prohibited from using their office for the acquisition of any material benefits. Limitations are also proposed that investment activities by judges, whereby such activities must not give rise to doubts concerning the independence and neutrality of judges. Furthermore, judges are cautioned against maintaining "lasting business relationships" with lawyers and other potential court case participants[1].

The issue of ensuring true independence of judges as the necessary precondition for court rulings based solely on considerations of law and justice continu7es to command urgency.

Among the measures discussed recently and aimed at increasing the independence of courts are the introduction of elected office for court presidents who are currently appointed by the President, the strict legislative stipulation of the amount of financial support for the judiciary system, such as a fixed percentage of the GDP automatically assigned for such purposes within the state budget, and the creation of an autonomous logistical division within the judiciary system. This would absolve the courts of the need to seek help in locating buildings, apartments, etc. from the regional authorities, which gives the regional governors an opportunity to control regional courts.

The focus on increasing the independence of judges represents an attempt to restructure the existing system of relationships in the power triangle between supreme executive power, security services, and courts, by minimizing the informal and extralegal elements in favor of formal and legal ones. It is obvious that these measures will not give us an ideal judiciary system fully immune to any involvement by the executive power. However, they offer the possibility of substantially limiting the nature and scope of such interventions that would be confined to the top tier of the political system[2].

The implementation of such measures is only possible upon condition of changing the existing legal policies in the economy where the interests of specific groups and clans concerning the management and use of major Russian assets are currently seen as socially significant, which in turn results in the adoption of laws conflicting with the goals of national economic development and aimed solely at the preservation and redistribution of assets under immediate state control in favour of entities affiliated with "the powers that be" and of individual businessmen loyal to the authorities.

Issues related to self-regulation of arbitration manager organisations and assessors

Starting from the moment when an arbitration manager is appointed for bankruptcy proceedings, he becomes the crucial touch and as an agent carrying out crisis management within the company that has become the subject of an insolvency claim. The competence, independence, and integrity of this manager largely determine the outcome of bankruptcy proceedings.

The number of arbitration managers decreased more than threefold from 2000 to 2007, from 20,000 to 6000[3]. In 2008 there existed 41 self-regulating bodies of arbitration manag-

[1] O. Pleshanina, A. Zanova. Rules for all judicial occasions. – Kommersant, No. 225, December 2. 2009

[2] See Property, oil, and bread – Expert magazine, No. 20 (609), 19 May 2008 (www.expert.ru/printissues/ expert/2008/20/sobstvennost_neft_i_hleb/)

[3] E. Bychkova, "Alexander Georgievich Komarov: to me, the company is sacred"

ers[1], three of which are large, with more than 200 managers in each. However then need to reduce the number of arbitration managers are still being discussed.

The activities of arbitration managers have undergone other significant changes, related to the introduction at the end of 2002 of the institution of self regulation stipulated by the current (third) Federal Law on Insolvency (Bankruptcy). The law defined the structural concept of the market for arbitration manager services. Based on previously existing arbitration manager associations, more than 30 self-regulating arbitration manager organizations were created in a fairly short time.

The new law completely changed the procedure for appointing arbitration managers in bankruptcy cases. Previously, the arbitration manager obtained registration at an arbitration court, and the court used its judgment to select an arbitration manager in a specific case. The new law on bankruptcy determined that each self-regulating organization should have an arbitration manager selection committee. This committee would select three arbitration managers based on applications received from arbitration managers interested in being appointed for a specific procedure and ranks managers in order of decreasing qualifications, will the court only approves the candidates. If all three arbitration managers meet the requirements of the Bankruptcy Law, the court cannot influence the choice of candidate. By adopting this law, the state effectively precluded arbitration courts from exerting influence on the selection of arbitration managers.

Implementing the idea of transferring the supervision and monitoring of arbitration manager activities from the state to self-regulating organizations that started in 2002 received new impetus in 2008 when these organizations were made responsible for the accreditation of assessors and other specialists involved by the arbitration manager in bankruptcy proceedings and gained the right to participate in bankruptcy proceedings directly.

However, according to the data by the State Registration Committee that has been supervising such organizations since 2005, the transfer of broad powers to these bodies has not yet translated into the effective monitoring by them of the observance by arbitration managers of legal requirements relevant to insolvency. Thus, in 2007 the number of complaints to the state registration committee about the unjustified actions of arbitration managers grew approximately threefold compared to 2005 and reached more than 9200 complaints. The number of court rulings imposing administrative liability on arbitration managers increased accordingly, from a total of 425 sanctions including 378 administrative fines and 47 instances of disqualification in 2005 to a total of 1938 sanctions including 1897 administrative fines and 41 disqualifications in 2007, an increase of more than 4.5 times[2].

The state registration committee believes that the self-regulating bodies of arbitration managers have *failed to establish themselves as efficient professional regulators* of their members' activities.

A number of self-regulating organizations of arbitration managers failed to take timely measures even in cases of breaches of law by their members that were evidenced by courts. A few examples are below.

[1] Speech by S.D: Denisenko, Deputy Director of the Federal registration service, at the Russian State Duma parliament hearings on the legal aspects of the emerging self regulation in various sectors - http://www.rosregistr.ru/to_print.php?id=4854

[2] Speech by S.D: Denisenko, Deputy Director of the Federal registration service, at the Russian State Duma parliament hearings on the legal aspects of the emerging self regulation in various sectors - http://www.rosregistr.ru/to_print.php?id=4854

S. V. Bychkovski was dismissed from the self regulating arbitration manager organization of the Central federal region only following 13 court rulings regarding his administrative liability. M.R. Enukashvili was dismissed from the "Inter-Regional Investment Centre" self regulating arbitration manager organization following 17 court rulings, Sh.A. Fazailov was likewise dismissed from the Inter-Regional Centre of Experts and professional managers following 17 court rulings, while I:R: Mullabaev was dismissed from the "Crisis manager association", a self-regulating inter-regional public organization, following eight court rulings. Furthermore, all the decisions concerning the dismissal of the above arbitration managers from self-regulating organizations were taken only following court rulings regarding their disqualification, and in the cases of Mr. Bychkovski, Mr. Enukashvili, and Mr. Fazailov such decisions were initiated by the Federal registration service. V.D: Nesterov, who incurred administrative liability fines 15 times according to documents held by the Russian Registration Committee as of April 9, 2008, continues his membership in the Siberian Inter-Regional self regulating arbitration manager organization.

According to the Russian Registration Committee, such cases are due to the absence in most self regulating bodies of the systemic approach to monitoring the professional activities of their members that should be based on an analysis of the activities of member arbitration managers and of their efficiency and should investigate the causes of any legal breaches committed[1].

The most typical breaches committed by arbitration managers in their activities include:

- Failure to hold creditor assemblies
- Failure to furnish information to creditors
- Failure to pay payroll arrears[2;]
- Failure to take measures to ensure the integrity of debtor property
- Sale of debtor property without a prior inventory taking and valuation and without seeking the prior consent of the creditor assembly[3].

The greatest current challenges in the activities of arbitration manager self regulating bodies are the following:

- Creating effective member activity monitoring mechanisms and other compliance monitoring mechanisms;
- The lack of effective mechanisms for removing disreputable arbitration managers from the professional community
- Liability insurance for arbitration managers
- Interactions with arbitration management infrastructure (insurance companies, valuation specialists, auditors, auction organizers)
- Selective access granted to arbitration managers in bankruptcy proceedings due to the stance of the tax authorities that "blacklist" arbitration managers and veto their candidacies in arbitration courts using criteria are that are unclear for the professional community[4].

[1] Speech by S.D: Denisenko, Deputy Director of the Federal registration service, at the Russian State Duma parliament hearings on the legal aspects of the emerging self regulation in various sectors - http://www.rosregistr.ru/to_print.php?id=4854

[2] Data by the Federal Registration Service Vologda regional department, www.rosregistr.ru

[3] Data by the Federal Registration Service Ryazan regional department. www.rosregistr.ru.

[4] Summary of the speech by V.A. Varvarin, Director of the corporate relations department of the Russian Industrialist and Entrepreneur Association and Deputy Chairman of the Board of the Russian association of arbitration

The low effectiveness of state control over the activities of arbitration manager self regulating bodies is due to the lack of self regulating traditions in Russia given that it is a recent institution and thus relations in this area are not yet established and the legislative basis for dealing with the issues of state supervision and monitoring is still insufficient.

Necessary prerequisites for developing government monitoring in this area include:

– Establishing an official list of documents and information that government agencies are entitled to receive from self regulating organisations and the self regulating organisations are required to furnish
– Making amendments to the Administrative Code of the Russian Federation with regards to the substance of specific breaches that can result in administrative liability of self regulating organisations and giving government monitoring agency is the right to initiate administrative proceedings for such breaches. [1]

At present they only sanction used in cases of noncompliance by self-regulating with the legal requirements is the elimination from the government register of self-regulating organisations.

Meanwhile, in terms of legal implications, such elimination from the register should be a last resort measure as it prohibits the performance of activities that constitute the purpose of the self-regulating organisation. Based on general penal principles, this measure should only be applied after other government sanctions failed to deliver positive results.

The law envisages no other types of liability, including administrative liability.

At present the only other instrument of influencing self-regulating organisations is a document prescribing the elimination of breaches identified during revisions. This measure has proven to be ineffective in practice. Starting from 2003, 79 revisions of self-regulating arbitration manager organisations were performed, including 60 such revisions performed by the State Registration Committee. The activities of more than 30 self-regulating organizations were subject to revision more than once. These revisions formed the basis of prescriptions for the elimination of breaches identified. Statistics show that following reports to the state monitoring agency about the elimination of breaches identified during the revision, self-regulating organizations have continued to breach the legal requirements, and thus that prescriptions are an inefficient government sanction in response to legal breaches. The above statements regarding the inefficiency of government monitoring of the activities of self-regulating organisations apply in equal measure to the activities of assessors that play a crucial role in the bankruptcy process by virtue of valuing debtor assets. Apart from methodological issues that the process entails, especially given the uncertainties imposed by the crisis, the Russian valuation market continues to be plagued by instances of *issuing unjustified valuation reports and process abuses committed during valuation*. Valuation activities in Russia are likewise self-regulated, however, the self-regulation started somewhat later, in 2006. In August 2007 the Russian Ministry for Economic Development adopted the first three Federal Valuation standards that were developed using international best practices. These standards were implemented starting from January 1, 2008. By then, seven self-regulating organizations of assessors had been registered, whose function, formerly per-

manager self regulating bodies, at the Inter-regional conference on bankruptcy and financial rehabilitation on March 28, 2008 - http://www.rspp.ru/Default.aspx?CatalogId=234&d_no=3347

[1] Speech by S.D: Denisenko, Deputy Director of the Federal registration service, at the Russian State Duma parliament hearings on the legal aspects of the emerging self regulation in various sectors - http://www.rosregistr.ru/to_print.php?id=4854

formed by the state, was to regulate the axis of participants to the valuation market. In 2008 these organizations founded the National Council of valuation practitioners.

At present the role of the state in the area of valuation has considerably narrowed, with the state responsible only for registering entities and setting minimal standards. All other tasks have been taken over by the self regulating organizations of assessors.

The key current challenges in the area of valuation are as follows:

– The lack of necessary standards for valuation activities including the standards for monitoring and supervision functions of the self regulating organisations being developed by the National Council of valuation practitioners;
– The lack of an effective system of ensuring accountability of the self regulating organizations and individual assessors for valuation results;
– The lack of methods for large scale real estate valuation;
– The need to ensure high professional qualifications of valuation practitioners the;
– The lack of an effective mechanism for contesting valuation results, including court claims.

The implementation of measures to address the above should considerably limit the market scope for manipulating the valuation process, which would be the greatest feasible achievement given current conditions.

5.3.4. 2009 draft legislation: the crisis as an impetus for addressing deficiencies

Financial rehabilitation, bankruptcy of related entities, and cross-border bankruptcy

The increase in corporate bankruptcy filings, in corporate and individual indebtedness, coupled with falling incomes, inefficiencies in the institution of bankruptcy given the increased workload, as well as within need to defuse social tension, jointly provided a strong impetus for legislative activity that has taken on a new aspect.

The most significant development has been draft legislation by the Ministry for Economic Development aimed at significantly expanding the scope of application of debtor financial rehabilitation procedures. Its submission for debate in October 2009 was accompanied by a statement by presidential aide A. Dvorkovich that financial rehabilitation of enterprises shall now become a state policy priority[1]. The final edition of the draft law was supposed to be agreed upon and submitted to the State Duma for review before the end of 2009. However, the preliminary schedule of State Duma legislative activities during the 2010 spring session does not envisage the review of this draft law.

This may be due to the fact that the draft law affects the contradictory interests of large banks and companies and thus came under heavy criticism by the Trade And Industry Chamber, bankers, tax authorities, etc. It is obvious that the heaviest criticism levelled against the draft law is based on the premise of undermining the financial condition of the banking system and creditors and is due to its pro-debtor bias.

Regardless of the need to remove the pro-creditor bias in developing bankruptcy legislation, the proposed innovations are seen as excessively radical due to the lack of a mechanism for protecting creditor rights that in turn creates conditions for abuse of rights and for responsibility avoidance by debtors.

[1] Here and further below, E. Kukol, The debtor is sent for treatment – Rossiiskaya Gazeta, No. 5024, October 22, 2009

In essence the draft law removes financial rehabilitation from the bankruptcy framework and envisages:

1. The possibility of the financial rehabilitation procedure being initiated by the debtor bypassing the supervision stage (up to seven months) and lasting up to five years regardless of creditor consent. In this case to arbitration court approves the arbitration manager candidate proposed by the debtor.

Despite the need to remove the pro-creditor bias in developing bankruptcy legislation, the proposed measure is deemed unacceptable due to the absence of a mechanism for protecting creditor rights that leaves ample room for the abuse of rights and for responsibility avoidance by debtors.

It appears that the interests of creditors and debtors can be balanced by (a) instituting a mechanism enabling administrative manager candidacies proposed by creditors, (b) instituting mandatory annual debt repayments throughout the duration of the financial rehabilitation stage, the amount of which repayments shall be stipulated in the financial rehabilitation plan and shall be no less than that stipulated by law.

It is also necessary to legally stipulate the possibility for creditors will to contest asset valuations for debtors who applied for financial rehabilitation, since the inadequacy of property valuation and the ease of manipulating value in the Russian context may result in the creditors later being deprived of the possibility of recovering outstanding debts.

2. The right granted to the debtor to submit to the arbitration court a financial rehabilitation plan agreed upon with the creditors that would envisage the full repayment of all creditor claims, including fines, penalties, and compensation for losses, during the financial rehabilitation stage.
3. The introduction of a special procedure for conducting transactions during the financial rehabilitation stage
4. The introduction of a special bankruptcy procedure for groups of related debtors
5. The introduction of a special procedure for cross border bankruptcies, etc

Besides the traditional majority creditor vote mechanism (with certain qualifications regarding different classes of creditors), the approval process for the debtor financial rehabilitation plan envisages the possibility of its approval upon the debtor's request in cases when fewer than 50% but more than 25% of votes by creditors and competent authorities at the creditors' assembly have been cast in favour of approving the plan.

A necessary precondition for the adoption of such a decision is the opinion issued by the self-regulating organization of arbitration managers where the administrative manager is a member regarding the financial rehabilitation plan being in compliance with the law on insolvency. Such an opinion needs to be based on the analysis of the debtors financial condition, on its financial reporting, on data from the register of creditor claims, and other available information. It should be noted that such broadening of debtor rights, as well as the new mechanism of interacting with the self-regulating organization of arbitration managers, is being proposed for the first time. At the initial stage this may permit abuse of the situation by the latter, however, in the medium term, as the practice of claiming material liability for arbitration managers and their organizations becomes more widespread, this risk should diminish.

Furthermore, a simplified procedure has been envisaged for approving the financial rehabilitation plan in cases when the financial rehabilitation plan proposed by the debtor has been approved by the creditors and competent authorities by the moment of application.

It is also proposed that regulatory provisions be introduced for out-of-court settlement procedures for indebtedness claims if agreed upon between the creditors and debtors. Such settlement agreements may define and regulate the mutual concessions that may help prevent company bankruptcies. Such agreements would also envisage the creditors' rights to grant time to the debtor for solving financial problems, within which time creditors would refrain from filing indebtedness claims, while the debtor would voluntarily furnish information regarding its financial condition and would refrain from attempting asset transfers.

A positive feature of the proposed innovations within the bankruptcy framework is represented by the attempt at greater flexibility in settling debt repayment issues related to mandatory payments as part of the financial rehabilitation process that have long hindered the wider application of the practice of restoring company solvency. However, such mechanisms will only function efficiently following the development and adoption of the relevant regulations by competent government agencies (tax, customs, etc)

The debate on the key provisions of this draft legislation inevitably touches upon the issue of the extent of protecting creditor vs. debtor interests in the bankruptcy process. Global practice shows evidence of both pro-debtor and pro-creditor bias in bankruptcy systems, and a choice of system or its development while taking into account both options is largely a politically motivated one. The degree of appropriateness of such choice in each specific case is evidenced by the extent of effective functioning of the bankruptcy institution in the economy, consisting of the liquidation of inefficient companies and the redistribution of assets in favor of efficient owners as well as the preservation of competitive enterprises.

In Russia, the transition to a market economy failed to bring about the creation of a competitive environment in the bulk of economic sectors. Furthermore, government expansion and the increasing direct participation of the state in the economy in the 2000s were accompanied by measures aimed at ensuring the concentration of large assets under government control that further distorted the legal environment. Such measures were adopted in the areas of bankruptcy law, legislation related to competition, and corporate law[1]. Financial support measures for companies during the crisis were also largely geared towards a limited number of companies with state or quasi-state interests and large state controlled banks.

At the same time, amendments were made to bankruptcy law that were once again meant to protect creditors. As a result, these economic entities received dual production, financial and legal, while debtors that received no financial support have also seen their legal protection diminish. The former are now considered efficient owners regardless of the fact that they received government support, while the latter are considered to be inefficient owners. *In this situation, the relations between economic entities at the moment of bankruptcy are not governed by market principles and are not indicative of the efficiency of corporate management, but merely reflect the extent of access to state funding or other funding sources to cover outstanding indebtedness*.

In this case, measures aimed at protecting debtor rights are the only means of redressing the balance to adjust for the state economic policy bias with regards to creating and sustaining

[1] See also Applied issues of internal corporate governance mechanisms by A. Radigin, R.Entov, E. Apevalova et al., – Moscow, IEPP, 2009.; Bankruptcies in the 2000s: from a raider's tool to a "double standard" policy, by E.A Apevalova, A.D: Radigin, published by Economic Policy magazine, issue No. 4 for 2009, pages 91-124; Modern trends in mergers and acquisitions, by A.D. Radigin, R.M. Entov, E.A. Apevalova et al., – Moscow, 2010.

a competitive environment, instituting a culture of corporate governance, and providing financial support to companies.

As a possible measure, limitations may be imposed in a timely manner upon banks and companies that are the recipients of state financial support with regards to initiating the quick sale of debtor assets in the bankruptcy process so long as the debtor retains the prospect of restoring solvency. It is also possible to impose limitations on the initiation of debtor bankruptcy procedures whereby threshold indebtedness amounts would be linked to the amounts of state financial support received.

The development of criteria for assessing debtor prospects is a complex but necessary task in this context. As regards the Russian bankruptcy model per se, its pro-creditor bias is evidenced less by the focus on accumulating funds for their further redistribution among creditors than by its ensuring significant creditor influence upon the arbitration manager and his decisions. Given the practices of inadequate valuation of debtor assets and the closed sales of such assets, this is the only available means of ensuring some degree of protecting creditor interests.

The draft law under discussion also *proposes changes to the ranking of creditor claims*. It is proposed that the current payments that are made prior to payments to ranking creditors include insurance premiums paid to the Russian Pension Fund, the Russian Social Security fund, and the Federal and regional mandatory medical insurance funds. These claims would rank second following the payment of the legal expenses for bankruptcy proceedings.

A significant innovation is represented by the proposed division of creditors into classes based on either the nature of their claims or on the cause of their claims. The terms of the financial restructuring plan should be equal for all ranking creditors and/or competent authorities whose claims have been grouped together in the same class. This innovation is most advantageous for banks.

The proposed draft law devotes significant attention to bankruptcy procedures for groups of related debtors and to cross-border bankruptcies.

The demand for special bankruptcy procedures for groups of entities and the increase in the number bankruptcy filings submitted by debtors, as well as large-scale payment defaults, point to the need to discuss possible changes to insolvency criteria that would supplement the current criterion of outstanding indebtedness amounting to more than RUR 100,000 for over three months by the criterion of outstanding indebtedness in excess of company assets. This proposed amendment is due to the fact that the liquidity gap arising in the course of day-to-day business operations may not reflect the true financial condition of the business, especially given the diminished access to financing, shrinking production and sales volumes of late. The issue of managing the liquidity gap may be addressed by way of out-of-court debt settlement or financial rehabilitation but does not necessarily constitute insolvency as such. Furthermore, the potential for abuse of bankruptcy procedures by a group of related debtors is sufficiently high to merit special consideration.

It should be noted with respect to the issue of bankruptcies for groups of related debtors that the attempt to give proper treatment to this complicated issue, as well as to the issue of cross border bankruptcies, is noteworthy in itself. However, the task of giving maximum formal treatment to all the relevant terms and procedures is highly complicated, especially considering the Russian legal tradition. Complications arise from the very start of the regulatory process of the legal eligibility ruling with regards to initiating bankruptcy procedures for a debtor group. It is expected up and that the proposed five stage system of determining eligi-

bility is too complicated to use in practice and will give rise to "competing" legal eligibility due, among other factors, to the difficulty of determining the "principal location" of entrepreneurial activity, the "principal location" of group member property, and the "principal location" of the majority of group creditors.

It is expected to rule that bankruptcy filings for groups of related debtors shall be reviewed as one legal case, by the same judge a group of judges. A unified set of supervision, financial rehabilitation, external administration, and receivership procedures shall be implemented with respect to groups of debtors.

The concept of "controlling member of the group of the entities" has been introduced to designate the entity that effectively controls the activities of a debtor within the group[1].

The controlling member of the group of entities may incur civil legal liability with respect to settling creditor claims for current payments.

The lack of information transparency regarding the true owners of many Russian assets poses the question of determining beneficiary ownership within the framework of corporate bankruptcy procedures given that such determination is often impossible even in the context of criminal cases. It is quite probable that the application of this legal provision will be limited to a select number of demonstration cases.

The mechanism for filing a single creditor claim with respect to a group of debtors that has been proposed by the authors of the draft law (as per the proposed new edition of Article 201.3 of the Federal Law on Insolvency (Bankruptcy)) leaves unclear the fate of group companies whose rights and interests may be significantly impacted, for example, by carving out specific assets within the debtor group in cases when all group assets are concentrated in one of several companies.

For the first time, the draft law proposed by the Ministry for Economic Development encompasses treatment of *cross border bankruptcy issues*, i.e. the bankruptcies of Russian and foreign legal entities involving different national domiciles of various parties, including cases when debtor property is located abroad, the creditor is a foreign person or legal entity, or legal proceedings against the debtor have been started in a foreign court.

For the purposes of determining the competence of Russian arbitration courts in the crossbow the bankruptcy procedures and determining the governing law in such cases, the notion of "center of principal debtor interests" is introduced to signify the place of its registration as a legal entity unless otherwise provided by law or determined by the nature of debtor operations or by other considerations. The law provides a non-exhaustive list of such considera-

[1] Effective control is deemed to comprise the following rights:

- The right to directly or indirectly control 50% or more of the voting stock of a joint stock company, or a share greater than half in the statutory capital of a limited (subsidiary) liability company forming part of a group of entities;
- The right to give instructions that are mandatory for execution by the debtor forming part of a group of entities based on contractual agreements or statutory documents and the right to otherwise determine the activities of a debtor forming part of a group of entities;
- The right to determine the decisions and/or actions by a debtor forming part of a group of entities, including the terms on which such debtor entity carries out business activities;
- The right to appoint an executive person and/or more than 50% of the executive body of the debtor forming part of the group of entities and/or the possibility to elect more than 50% were of the board of directors (supervisory council) or other collegiate management body of the debtor forming part of a group of entities;
- The right to act in the capacity of managing company for the debtor forming part of a group of entities.

tions including the location of principal debtor assets, the location of the majority of the creditors, of the debtor's production facilities, of its controlling shareholders (beneficiary owners), as well as the location of its principal business activities, the geographical source of the bulk of its revenues, etc.

It is expected that Russian arbitration courts shall review cross-border bankruptcy cases in situations when Russia is:

– The center of principal debtor interests
– The center of principal interests of an entity (Russian or foreign) controlled by the debtor
– The center of principal interests of an entity controlling the debtor
– A permanent representative office and/or property of the debtor (Russian or foreign) when the center of principal debtor interests is located abroad.

Bankruptcy procedures for debtors whose center of principal interests is located in Russia are within the exclusive competence of Russian arbitration courts. Such court proceedings apply to the entirety of debtor property regardless of the country of its location. The competence of Russian arbitration courts in these cases also extends to reviewing bankruptcy cases with regards to entities controlled by the debtor and controlling the debtor.

In case of bankruptcy proceedings for an enterprise that does not constitute the principal production entity, the competence of Russian courts extends to:

1. Initiating bankruptcy proceedings in cases when the debtor has a permanent representative office in Russia

– In case the bankruptcy filing against the debtor is made by a creditor that is permanently domiciled in Russia
– In case the bankruptcy filing against the debtor is based on a claim that is related to the activities of the permanent representative office.

2. Reviewing bankruptcy cases for cross-border bankruptcies in cases when debtor property is located in Russia if debtor and or creditor rights with regards to bankruptcy cannot be realised otherwise (bankruptcy proceedings cannot be initiated against the debtor in the country representing the centre of its principal interests; the bankruptcy process in a foreign country extends only to debtor property located within its territory, etc)[1].

In cases when bankruptcy proceedings are initiated in Russia, such proceedings, as well as their outcomes (with few exceptions), are governed by Russian law.

The proposed mechanism for the regulation of cross-border bankruptcies raises doubts as to the adequate application in Russia of the provisions for determining the centre of principal debtor interests. Apart from the objective difficulty of estimating the size of debtor assets in different countries, determining the location of the majority of creditors, and weighing other factors, other obstacles exist to the determination of legal eligibility using this method by courts that, in the case of the Russian legal system, frequently use formal criteria. These obstacles include:

1. The high level of dependency of the judiciary system upon executive power governing bodies and the practice of selective application of legal responsibility provisions;
2. The significant extent of manipulation with respect to property valuation, coupled with inefficient mechanisms for contesting valuation results;

[1] See also paragraph 3 of Article 223.5 of the Draft Law On Financial Rehabilitation and Bankruptcy (Insolvency) by the Ministry for Economic Development

3. The high level of formality in making court rulings resulting from established historical practice.

Given the above, the adoption or legal provisions envisaging significant discretion on the part of judges may only become acceptable at a time when the extent of influence of the above factors will be significantly decreased. Until such time, the regulation of such issues shall be more in line with the Russian legal and regulatory traditions, i.e. more formal. The practice of implementing regulatory provisions envisaging significant judiciary discretion should be gradual and should be carefully monitored in order to minimise any negative trends.

Bankruptcies of individuals outside the scope of entrepreneurial activity

In November 2009, a new edition of the law on the bankruptcy of individuals outside the scope of entrepreneurial activities was submitted to the Russian government.

According to the Central Bank of Russia, the volume of past due indebtedness for individual loans amounted to RUR 231 billion, or 6.8% of all loans granted, as of the 1 October 2009. Other estimates place these figures at significantly higher levels due to the fact that the Central Bank includes only the past due portion of loans in its estimate of past due indebtedness without considering the principal loan amounts which total another 12%. Experts estimate that the shortening of repayment terms shall start no sooner than 2011[1].

The draft law on individual bankruptcies that was developed in 2007-2009 and has been submitted to the government by the Russian Ministry for Economic Development will create stimuli for individual debtors and their creditors for using civilized methods of restructuring consumer loans[2]. In particular it envisages the possibilities:

– Of granting the possibility to a debtor in financial difficulty to write off its debts against the assignment of its property and a proportion of its income to creditors (the so called fresh start doctrine)
– Of lowering creditor risks and expenses related to bad debt recovery
– Of lowering the administration costs for individual bankruptcies.

The duties of arbitration manager may be placed upon the debtor itself except for cases where the total amount of claims against the debtor is in excess of RUR 500,000 and except for cases when the creditor enters a plea for the appointment of an arbitration manager.

Under the draft law, failure to repay debt exceeding RUR 50,000 (RUR 100,000 in the first draft) for a period of six months constituents individual bankruptcy. Following an eligibility check upon the bankruptcy claim, the court institutes monitoring of the individual debtor for a period of three months. Within the monitoring period, the debtor has a right to submit a debt restructuring plan to the arbitration court that must be prepared in accordance with the provisions of the draft law and should be agreed with the majority of creditors. The draft law also envisages the possibility of approving a debt restructuring plan without the creditors' consent. If the plan is adhered to, the individual is freed from indebtedness and retains his social standing. Conversely, if the individual fails to repay the creditors within the debt restructuring framework, the arbitration court makes a ruling for the bankruptcy of the individual in question and for the initiation of asset receivership proceedings whereby the assets of the debtor

[1] The past due portion of individual loans has reached unprecedented proportions

[2] Thus, in Europe, bad debt levels for consumer loans of 5-6% are considered critical, while the latest Central Bank data show such levels in Russia exceeding 4%. It therefore appears that the state wishes to create the legal basis for reviewing individual insolvency (bankruptcy) cases. See also *Russians will undergo mandatory bankruptcy* by T. Koshkin (www.utro.ru/articles/2007/02/21/626934.shtml).

that are included in the receivership fund are distributed among creditors in proportion to the amounts of their claims[1].

It is further proposed that the provisions for administrative and criminal liability for performing prohibited actions during bankruptcy and for a deliberate bankruptcy, punishable by fines of up to RUR 5,000 for administrative misdemeanors and by fines of up to RUR 500,000 and/or other punitive measures including incarceration for a term of up to six years for criminal breaches the extended to apply to individuals outside of the scope of entrepreneurial activities.

According to a statement by A. Ivanov, Chairman of the Russian Supreme Arbitration Court, the adoption of this law will result in an increased workload for judges which will in turn raise the issue of creating judiciary representative offices[2] dealing with individual bankruptcy cases[3]. At the same time, according to V. Vitrianski, Deputy Chairman of the Russian Supreme Arbitration Court, there will be no significant increase of debtor bankruptcy filings at arbitration courts[4]. Meanwhile, G. Tosunian, President of the Russian Banking Association, believes that the institution of individual bankruptcies in Russia is at present doomed to fail[5].

Bankruptcies of housing construction companies

In November 2009, a *draft law envisaging special bankruptcy procedures for housing construction companies*[6] ("legal entities carrying obligations to provide housing or subject to monetary claims by mutual construction financing participants") with a view to protecting the financing participants was prepared for a second reading. The defining characteristic of housing construction company bankruptcies is the preferential right of federal subjects to acquire incomplete apartment housing construction projects prior to auction.

Federal subjects are entitled to buy incomplete apartment housing construction projects or land parcels at a fair market price as determined by an independent valuation specialist. A necessary condition of any such sale and purchase agreement is the undertaking to complete construction and to transfer the housing to construction financing participants upon completion. The deadline for completing construction is set at three years following the signing of the purchase and sale agreement[7].

Given that construction companies have recently increasingly disregarded the requirements for signing housing construction investment agreements, the fact that individual citizens who signed agreements with the construction company will nonetheless be entitled to receiving the housing they financed regardless of the compliance of the investment agreement with the provisions of the Law on Housing Investments is a positive development.

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[1] The law on individual bankruptcy was expected to come into effect at the beginning of 2009 (www.prime-tass.ru/news/show.asp?id=779274&ct=news).

[2] The permanent representative office of the arbitration court of appeals and the permanent representative office of the arbitration court of a federal subject are detached administrative units of the respective courts outside of their permanent seat and are vested with the powers of such courts.

[3] Supreme Arbitration Court Chairman: arbitration courts expect an increase in individual bankruptcy filings (http://www.dp.ru/a/2008/04/17/Predsedatel_VAS_arbitra).

[4] *The judicial workload issue has been dealt with*, by V. Vitrianski (www.kp.ru/daily/24091.3/321906)

[5] See also *Russians will undergo mandatory bankruptcy* by T. Koshkin (www.utro.ru/articles/2007/02/21/626934.shtml).

[6] Draft Law On Amendments to specific legal acts of the Russian Federation aimed at the protection of instalment-financed construction participant rights.

[7] Mutual financing by Yu. Vasilieva Russian Business Daily, No. 726, November 3, 2009

In summary, a review of government legislative initiatives in the area of bankruptcy or shows both a desire for significant legal innovations in the area of bankruptcy regulation and the focus of such innovations on social aspects. However, recent years in Russia have traditionally seen legal regulation lagging behind the demands of the economy. Given the recent unfavorable economic conditions, this can become a decisive factor in adversely impacting the effectiveness of the measures proposed.

5.3.5. Concluding remarks

In conclusion, it must be noted that the 2005-2009 period was characterised by broadening the scope of application of bankruptcy procedures to "substantive" debtors. However, the institution of bankruptcy continues to carry out, albeit to a lesser extent, the function of government regulation of the number of inactive legal entities that should be outside its scope. Tax authorities play a leading role in initiating bankruptcy proceedings, including those against "substantive" debtors, while government regulation of their activities can largely determine both the scope of application of bankruptcy procedures nationwide and have a significant impact on the general practices of insolvency proceedings.

The increase in bankruptcy rulings taken in the first half of 2009 amounted to 16.7% compared to the respective period in the previous year. A 24.1% increase in the number of bankruptcy filings, as well as Supreme Arbitration Court data that show evidence of significant (88%) growth in the number of claims related to breach of obligations, predominantly of contractual obligations, point to the high probability of further growth in the number of bankruptcies in 2010.

Restoring debtor solvency within the framework of bankruptcy procedures and settling creditor claims by signing restructuring agreements, as well as financial rehabilitation, are still confined to isolated instances and leave debtors who have become the subjects of bankruptcy proceedings no practical chances of retaining control over the enterprise. Given the low threshold for an insolvency ruling (RUR 100,000), as well as the large-scale payment defaults, shrinking industrial production volumes, lending volumes, and market demand starting from late 2008, this results in decreasing numbers of economic agents, above all of private entrepreneurs, regardless of their competitive strengths.

In general, the development of bankruptcy legislation in 2003-2009 can be conditionally divided into two periods. The first was the *pre-crisis* period focusing on the preservation of the overall corporate bankruptcy framework whose functioning had limited impact upon the interests of key players who had significant lobbying potential. The protection of their interests necessitated the strengthening of government control and broadening the scope of application of special bankruptcy procedures for strategic enterprises that were subjectively designated as such, while the most influential economic subjects (Vnesheconombank and government corporations) were exempted from the application of the bankruptcy law.

During the crisis, the priority changed from ensuring the integrity of state-controlled assets to ensuring low levels of bad debts in the loan portfolios of the largest banks, which was meant to contribute to the preservation and support of the banking system. In this situation the banking sector is significantly aided by the state twice, once by way of direct financial aid and once again by substantial protection of bank interests in the area of bankruptcy, thus promoting the idea of banks as efficient owners while inefficient owners have been penalised not only by the financial crisis but also by the impossibility of protecting their legal interests given the strengthening pro-creditor focus of the bankruptcy system that practically rules out

the preservation of business and at present has little to do with the efficiency for market participants or lack of such.

At the same time, the significant number of expected bankruptcies and the dispersal of state interests in this regard has resulted in *the adoption in December 2008 and later in April 2009, for the first time since 2004, of general legislative provisions concerned with the interests of all market participants*.

A number of proposed measures, such as more detailed stipulation of procedures, more stringent controls over the activities of arbitration managers and their self regulating bodies, stipulation of auction procedures for debtor assets, the introduction of greater information transparency in bankruptcy proceedings are *long overdue and can improve the protection of both creditor and debtor rights*. The efficiency or inefficiency of the new measures will be largely determined by the extent to which the state will continue to use its growing influence to further strengthen its position and protect quasi-government interests in the corporate market by controlling the redistribution of corporate assets, or by whether the economic downturn will cause the state to be guided by the interests of society in general, however contradictory.

The practice of developing both corporate legislation and bankruptcy legislation in the 2000s shows a growing trend toward a merger or government interests with those of the largest state-owned (pro-government) companies and banks, along with amending economic legislation predominantly in the interests of such agents and to the detriment of the interests of society in general. The only exception is provided by the reaction to acute social phenomena.

At present there is no planned systematic development of either corporate law or bankruptcy law in the interests of all market participants. In this respect the pre-crisis and post-crisis developments in bankruptcy law are similar, with legislation serving as *an instrument of upholding the interests of a specific group of subjects that the state identifies itself with at various points in time*. Until such time as this identity crisis is resolved by the state, the development of economic institutions will be chaotic and destructive to the development of the economy as a whole.

In terms of the peculiarities of the institutional environment that impacts bankruptcy proceedings, it must be noted that the Russian judicial system, having inherited many of the traditions of the Soviet judicial system, *continues to be significantly influenced by the executive power*. Ensuring the independence of presiding judges is therefore a key issue.

Recent assessments of the judiciary system range from “a mockery of justice” and “a tool serving the executive branch” to “a comprehensive judiciary system albeit riddled with numerous shortcomings”. These shortcomings arise from inadequacies in the legal mentality, including that of professional practitioners, in professional personnel training, in organizing the functioning of courts, including workload issues, in the selection criteria, selection mechanisms, and appointment mechanisms for judges, in receiving and improving professional qualifications, and in the degree of transparency in the system. One of the factors contributing to the low quality and long duration of case reviews is inadequate staffing that results in *unprecedented high workloads for judges*.

Another widely known shortcoming of the Russian judiciary is the *lack of enforcement of Russian court rulings* that contributes to the increasing number of bankruptcy cases. Statistically, half of the rulings by both general courts and arbitration courts in Russia are not enforced. The most urgent issues related to the enforcement of court decisions are to do with the inefficient and illegal sale of arrested assets, as well as with staffing issues.

The development of a system of selling arrested property based on mixed auctions using global auction practices (Dutch and English auctions) is advisable in order to deal with the above shortcomings. Such a system must combine various features aimed at attaining the full of sale of arrest and property at a maximum price. This will allow to minimize the issues related to the current system of valuing arrested property.

As regards *staffing*, the inefficiency and abuses of power by court bailiffs are widespread and have long been an urgent issue. The high level of abuse instances is coupled with the very low proportion of court decisions to satisfy claims contesting the action or inaction of and rulings by the officials of the Federal Court Bailiff service.

Problems likewise exist with respect to the self-regulating bodies of arbitration managers and valuation practitioners that have so far failed to establish themselves as efficient professional regulators of their members' activities. A number of self-regulating organizations of arbitration managers failed to take timely measures even in cases of breaches of law by their members that were evidenced by courts. Such cases are due to the absence in most self regulating bodies of the systemic approach to monitoring the professional activities of their members that should be based on an analysis of the activities of member arbitration managers and of their efficiency and should investigate the causes of any legal breaches committed

The limited effectiveness of state control over the activities of arbitration manager self-regulating bodies is due to the lack of self-regulating traditions in Russia given that it is a recent institution and thus relations in this area are not yet established and the legislative basis for dealing with the issues of state supervision and monitoring is still insufficient. The Russian market is still plagued by instances of issuing unjustified valuation reports and process abuses committed during valuation.

Promoting the effective functioning of the institution of bankruptcy in the economy necessitates the following measures:

1. Continued implementation of legal reform to ensure the independence of judges, including arbitration court presidents, from the executive power, minimising corruption in the judiciary system, etc., along with decreasing the workload of arbitration court judges in the interests of more thorough review of court cases.

2. Substantial changes to the objectives and scope of activities of the tax authorities with respect to insolvency and elimination of inactive legal entities from the register

a. the existing conflict of interest driven by the need to ensure the fulfillment of targets for remittances to the state budget by the tax authorities and the resulting inflexibility of such authorities in initiating and reviewing bankruptcy cases. Ideally, government interests in such proceedings, including those related to taxation issues, should be represented by different government body (such as the Ministry for Economic Development).
b. Legal measures must be taken to create effective mechanisms for rescheduling and restructuring mandatory payments that are to be used within the framework of insolvency cases and whose lack at present hinders the practical implementation of creditor agreements and financial rehabilitation procedures. Given the average level of satisfying registered creditor claims of 10%, such measures are unlikely to have a significant impact upon tax remittances to the state budget.
c. In the medium term, the issue of setting an adequate corporate tax burden, especially in the first three years of the company's existence, shall continue to be of paramount importance.

d. The activities of tax authorities in the liquidation of inactive legal entities must be adequately financed and must be separated from their role in bankruptcy procedures. Ideally, such functions should also be transferred to a different government body. (It has not been possible to analyse the expediency of entrusting tax authorities with the functions of registering legal entities within the context of this paper)

3. Further improvements must be made to the functioning of the court bailiff service with respect to staffing policies, increasing liability for inaction and illegal or inappropriate action, including the obligation to compensate the plaintiffs whose rights have been infringed upon for related losses. This shall be made possible by the improvement of the mechanisms of contesting the actions and rulings of Federal Court bailiff service officials with a view to creating real and effective as opposed to formal mechanisms of legal protection.

4. A crucial task that will result in greater efficiency of the institution of bankruptcy is the creation of preconditions for further development of self-regulatory organizations of arbitration managers and valuation practitioners.

Necessary prerequisites for developing government monitoring (supervision) in this area include:

– Establishing an official list of documents and information that government agencies are entitled to receive from self regulating organisations and the self regulating organisations are required to furnish
– Making amendments to the Administrative Code of the Russian Federation with regards to the substance of specific breaches that can result in administrative liability of self regulating organisations and giving government monitoring agency is the right to initiate administrative proceedings for such breaches.

It is also necessary to create a framework of measures aimed at incentivising the self regulatory organizations toward improving the professional qualifications of their members both by developing and implementing operating standards and by evaluating their effectiveness, as well as by increasing the accountability of their members and active efforts to remove the causes of legal breaches.

Further development of valuation activities requires:

– The development and implementation of necessary standards for valuation activities including the standards for monitoring and supervision functions of the self regulating organisations developed by the National Council of valuation practitioners
– The development and improvement of the mechanism for discharging the monitoring and supervision functions by self-regulating organizations
– The implementation of an effective system of ensuring accountability of the self regulating organizations and individual assessors for valuation results
– The development of methods for large scale real estate valuation
– Creating the conditions ensuring the high professional qualifications of valuation practitioners
– The implementation of an effective mechanism for contesting valuation results, including court claims

5. Of equal importance to redressing the pro-creditor bias in the development of bankruptcy legislation is the approval, subject to certain criticisms being addressed, of the *draft legislation proposed by the Ministry for Economic Development and aimed at significantly expanding the scope of application of debtor financial rehabilitation procedures* in the Russian market. However, provisions regarding the possibility of the financial rehabilitation pro-

cedure being initiated by the debtor bypassing the supervision stage (up to seven months) and lasting up to five years regardless of creditor consent, as well as the approval by the arbitration court of the debtor-appointed arbitration manager, must be amended.

Despite the need to remove the pro-creditor bias in developing bankruptcy legislation, the proposed measure is deemed unacceptable due to the absence of a mechanism for protecting creditor rights that leaves ample room for the abuse of rights and for responsibility avoidance by debtors.

It appears that the interests of creditors and debtors can be balanced by

(a) instituting a mechanism enabling administrative manager candidacies proposed by creditors,

(b) instituting mandatory annual debt repayments throughout the duration of the financial rehabilitation stage, the amount of which repayments shall be stipulated in the financial rehabilitation plan and shall be no less than that stipulated by law.

It is also necessary to legally stipulate the possibility for creditors will to contest asset valuations for debtors who applied for financial rehabilitation, since the inadequacy of property valuation and the ease of manipulating value in the Russian context may result in the creditors later being deprived of the possibility of recovering outstanding debts.

6. As a possible measure to counterbalance the excessive activity of banks with respect to debtor assets, limitations may be imposed in a timely manner upon banks and companies that are the recipients of state financial support with regards to initiating the quick sale of debtor assets in the bankruptcy process so long as the debtor retains the prospect of restoring solvency. It is also possible to impose limitations on the initiation of debtor bankruptcy procedures whereby threshold indebtedness amounts would be linked to the amounts of state financial support received.

The development of criteria for assessing debtor prospects is a complex but necessary task in this context. As regards the Russian bankruptcy model per se, its pro-creditor bias is evidenced less by the focus on accumulating funds for their further redistribution among creditors than by its ensuring significant creditor influence upon the arbitration manager and his decisions. Given the practices of inadequate valuation of debtor assets and the closed sales of such assets, this is the only available means of ensuring some degree of protecting creditor interests.

7. The demand for special bankruptcy procedures for groups of entities and the increase in the number bankruptcy filings submitted by debtors, as well as large scale payment defaults, point to the need to discuss *possible changes to insolvency criteria* that would supplement the current criterion of outstanding indebtedness amounting to more than RUR 100,000 for over three months by the criterion of outstanding indebtedness in excess of company assets.

Such a proposal is based on the notion that working capital shortages that arise within the day-to-day business operations, especially given the diminished access to financing, shrinking production and sales volumes of late, may not reflect the true financial condition of the business. Furthermore, many industrial assets are significantly undervalued and demand for such assets is relatively low, which is likely to change in the medium term but does not allow for the timely and effective settlement of indebtedness at present. The issue of managing working capital shortages may be addressed by way of out-of-court debt settlement or financial rehabilitation but does not necessarily constitute insolvency as such. Furthermore, the potential for abuse of bankruptcy procedures by a group of related debtors is sufficiently high to merit special consideration.

8. It is also necessary to *change the stipulations regarding the right to file bankruptcy claims at arbitration courts*: whereas previously the right to make a bankruptcy claim at the arbitration court came into effect 30 days after the date of remittance of the executive order to the court bailiff service, at present such a right comes into effect from the date of the legally binding court decision concerning a monetary claim upon the debtor. Thus it becomes possible to start insolvency procedures prior to ascertaining the impossibility of carrying out the court decision and prior to actual insolvency. This allows for the application of bankruptcy procedures to companies that are neither bankrupt nor even in a state approaching bankruptcy. Such a situation is once again advantageous for creditors who at present compete among themselves. From a legal point of view such stipulation of a creditor's right to file a bankruptcy claim prior to the expiration of the deadline for voluntary execution of a court order by the debtor and prior to the start and end of executive proceedings is illegal as it infringes upon the debtor's rights and the subjects the debtor to bankruptcy proceedings that are the last resort measure of protecting creditor rights, without sufficient legal grounds and unjustifiably bypassing the customary process is of protecting creditor rights.

Doubts also arise regarding the stipulation of the right of the competent authorities, primarily a tax authorities, to file a bankruptcy claim. The legal grounds for the stipulation of such rights must undergo a fundamental test of substance, and the procedure must be changed if sufficient grounds exist.

5.4. M&A Market Dynamics (2003–2009)

The period between 2003 and the first half of 2008 saw a considerable and stable increase in activity on the mergers and acquisitions market, with both the number of deals and their amounts growing. The 2008 financial crisis – with its stock market collapse, liquidity squeeze, a drop in industrial production, and a sharp fall in some commodity prices – resulted in a decrease in the volume of transactions on the global M&A market. The first estimates of this market's prospects for 2009-2010 were rather contradictory. Overall, the size of the market was expected to further shrink in 2009 (to 60% of the 2008 level), however forecasts for trends to dominate the market were varied: from a further squeeze of the market due to problems with working capital and access to external funding to a boost in activity starting from mid-2009 through the acquisition of troubled assets and companies.

This section contains an analysis of M&A transactions in Russia between April 2003 and June 2009. Information on the transactions was collected from open sources[1]. Many participants in recorded transactions prefer not to disclose detailed information on the sale or purchase of assets, that is why some of the data used in this analysis derive from analysts' and market players' estimates.

For the purposes of analyzing the available data, a classification of companies' characteristics has been introduced. To systematize company owners involved in the M&A process, a typology has been adopted whereby the owner can be either an insider, an outsider or a government structure. Insiders are owners who work at the company in question. Outsiders are individuals who are not employees of the company. For the purposes of this study, this typology has been slightly expanded for the insider group to further break down into managers, rank-and-file employees and managers and employees together, while the outsider group breaks down into financial, non-financial and financial and non-financial outsiders together.

[1] www.mergers.ru; www.ma-journal.ru; www.finam.ru; lenta.ru and several others.

Instances when the owner is a foreign company or a group of owners from different countries have been grouped into a separate category.

Companies' forms of incorporation were classed according to the relevant Russian legislation. In terms of types of economic activity, companies have been classed according to the Russian Classification of Types of Economic Activity (OKVED)[1].

Between Q2 2003 and Q4 2007 the overall annual volume of transactions, both in terms of their number and value, was steadily on the rise. However, in 2008 there developed a downward trend. In 2004 the number of transactions grew by 32% year on year; in 2005 the figure was 14%; in 2006, 26%; in 2007, 41%, while in 2008, minus 21%. In terms of the amount of transactions, 2004 saw an increase of 18% year on year; 2005, 42%; 2006, 30%. In 2007 there came a sharp rise both in the number of transactions (43%) and in their amount (188% as compared with 2006). Whereas 2008 brought a fall in the number of transactions (21%) and in their overall amount (36%) as compared with the previous year (*Fig. 1*). In Q1 2008 the value of transactions grew by 51% against the same period in 2007. In the second quarter transaction amounts fell by 35% compared with the same period in 2007; in the third quarter, by 75%; and in the fourth quarter, by 90%. *In Q1-Q2 2009, transaction amounts dropped by 66 and 55% respectively, against the same period of 2008.*

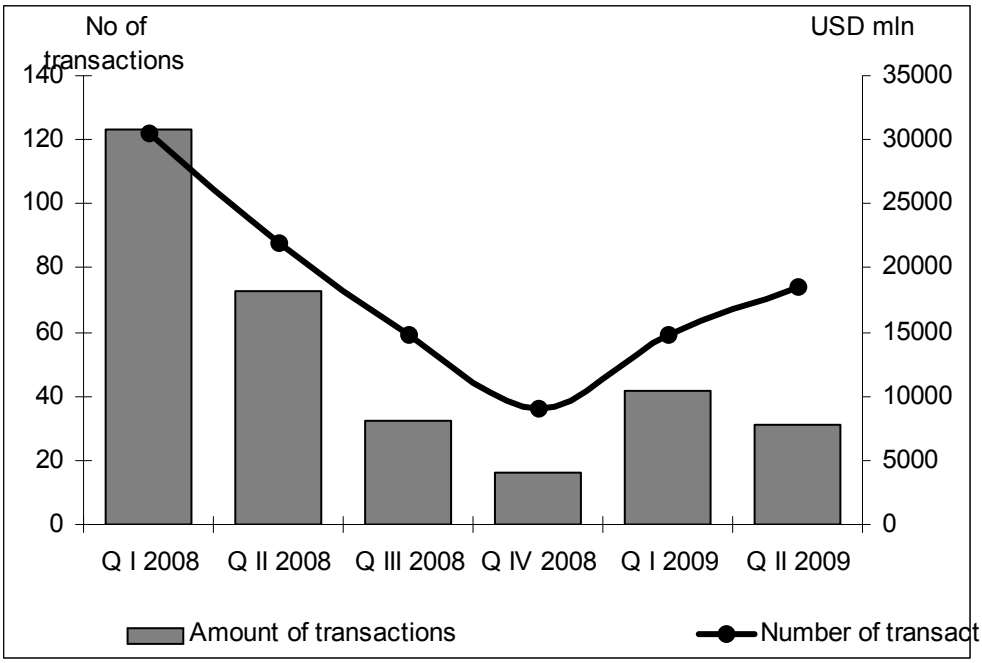

Fig. 1. Number of transactions on the M&A market and their total annual amount between Q1 2008 and Q2 2009.

Despite the fact that the average transaction amount for 2003 was calculated on the basis of data for just April – December, the 2004 figure was 40% higher. In 2005 and 2006 the rate of growth in the average transaction amount somewhat slowed down, to 17% and 4% against the previous year respectively. The growth was the highest in 2007, at 130% compared with

[1] Russian Federal Agency for Technical Regulation and Metrology Resolution No 454-st of 6 November 2001 "On adopting and implementing OKVED".

the previous year. In 2008, despite a drop in the number of transactions, their average amount increased by 30% against the previous year. (*Fig. 2*).

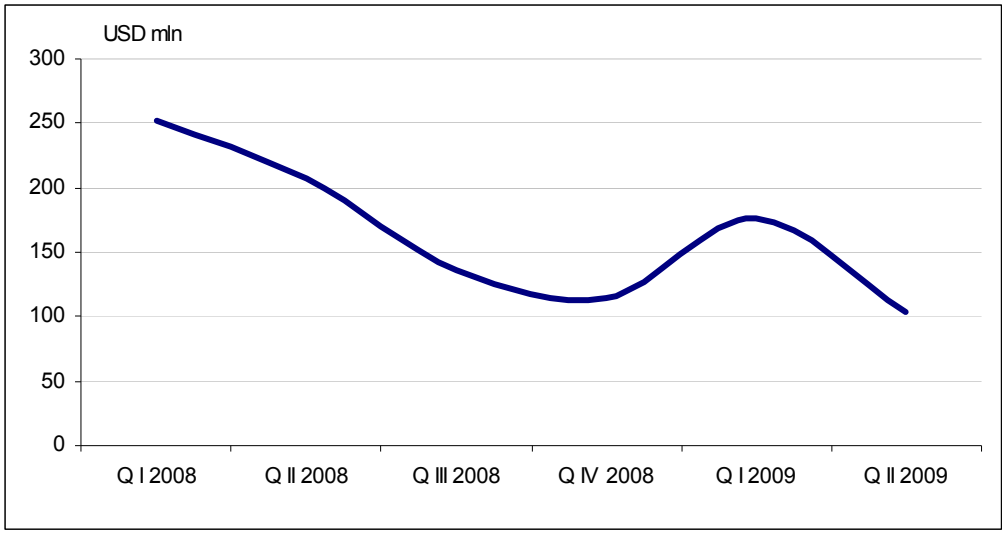

Fig. 2. Average transaction amount per quarter, from Q1 2008 to Q2 2009.

The increase in transaction amounts in 2007 can be attributed both to a growing number of transactions on which amounts were disclosed and to the number of transactions in the oil and gas sector. This situation can also be attributed to objective positive changes at microeconomic level. Spurred by the economic boom in the country, a considerable rise in direct investment year-on-year, corporate management in Russia began to pay more attention to their reputation, made efforts to increase their asset value.

Between Q2 2003 and Q2 2009, some 119 transactions worth over USD 500 mln were conducted, making up about 6.2% of all transactions for the period (*Fig. 3*).

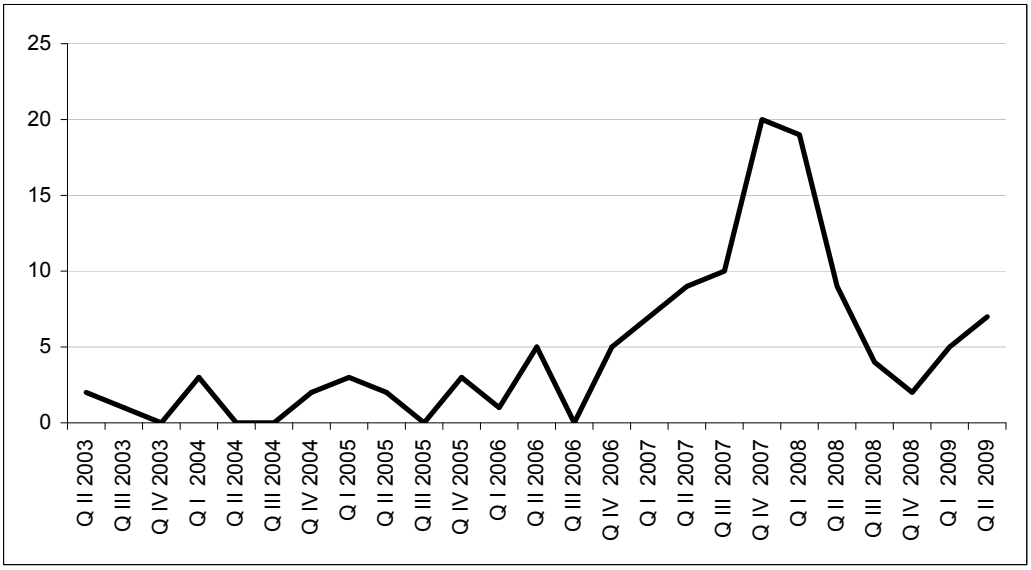

Fig. 3. Number of transactions worth over US$ 500 mln.

In the period between Q2 2003 and Q2 2009, in 81% of transactions on the Russian M&A market the buyers were companies registered in the Russian Federation; in 10% of transactions the buyers were companies registered in the European Union. Companies registered in former Soviet Union republics were buyers in 1% of M&A transactions in the given period, with the rest of transactions effected by buyers from other foreign countries.

The biggest number of M&A transactions were carried out between Russian companies: 69% of the total number of transactions. Russian companies' acquisitions dominate domestic transactions, accounting for 83% of their total number. Russian companies' acquisitions in the former Soviet Union make up 6% of the total number of Russian transactions; in the EU, 5% and in other foreign countries, 6% (*Table 1*, *Fig. 4*).

Table 1

Transactions statistics between Russian and foreign companies between Q2 2003 and Q2 2009*

Statistics of transactions between Russian and foreign companies		M&A target registration				Amount
		Russia	EU	FSU	Other foreign countries	
Buyer's place of registration	Russia	1,292	76	91	66	1,525
	EU countries	164	12	8	13	197
	Former Soviet Union republics	20	0	4	0	24
	Other foreign countries	93	12	4	33	142
Amount		1,569	100	107	112	1,888

*The total number of transactions may differ from the final statistics for the relevant period due to the lack of data on individual companies.

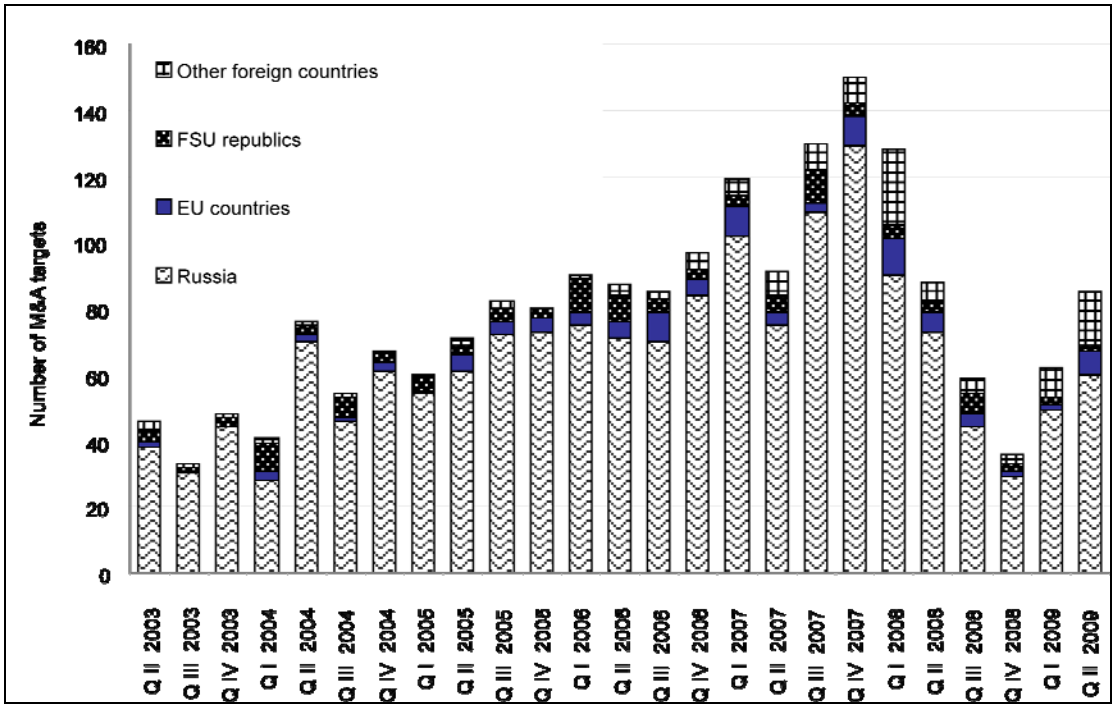

Fig. 4. M&A transaction amounts breakdown between Russia, FSU, EU and other foreign countries

Fig. 4 indicates that the given period was marked by a trend towards a growing number of buyers from EU countries. Restricted access to information on real company owners that operate under other country jurisdictions makes it difficult to say for sure whether they belong to Russian entities.

In the given period, an average of four transactions per quarter involved targets in former Soviet Union countries. Investors are attracted by reasonable real estate prices and the substantial number of yet unoccupied business niches. Entering FSU markets is often easier than those in EU countries.

The Moscow M&A market between Q2 2003 and Q4 2006 saw a rise in the number of M&A targets, with the Q4 2006 figure 227% higher than the Q2 2003 one. However, throughout the year 2007 the number of M&A targets was steadily in decline. Then, in Q1 2008 there came a 40% spike compared with the previous quarter. Between Q2 and Q4 2008 the number of M&A targets was again on the wane. In Q1 2009 the number of acquisitions in Moscow was 29% lower than in Q1 2008, while in Q2 2009 it rose by 50% against Q2 2008. The number of transactions on the St Petersburg market remained stable throughout the given period, not rising above 15 targets a quarter (*Fig. 5*).

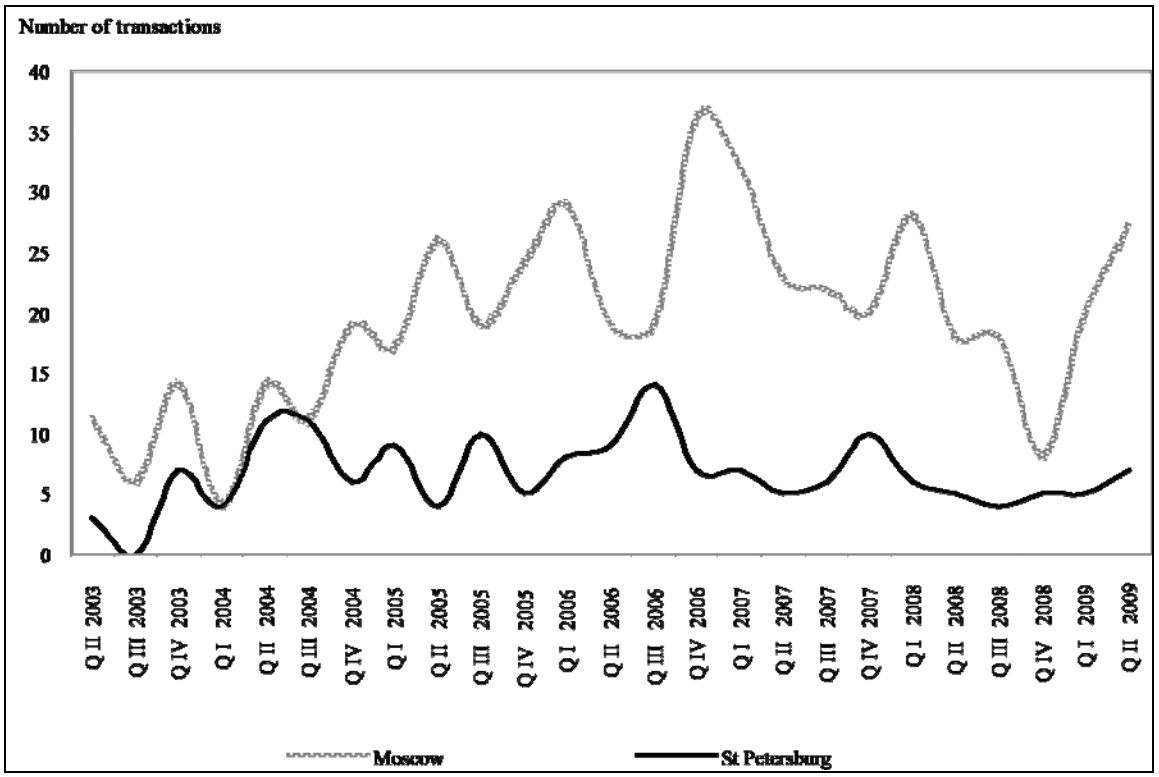

Fig. 5. Number of M&A targets on the Moscow and St Petersburg markets.

As regards an M&A target breakdown per federal district in the period under review, the leaders in terms of the number of targets are the Central and Northwest, followed by the Volga Federal District. The figure for the Central Federal District, including Moscow, was 646 targets; for the Northwest Federal District, including St Petersburg, 245; and for the Volga Federal District, 217 (*Fig. 6*). Despite an emerging trend towards a more even spread

of enterprises across Russia, Moscow and the Central Federal District still remain the most active regions.

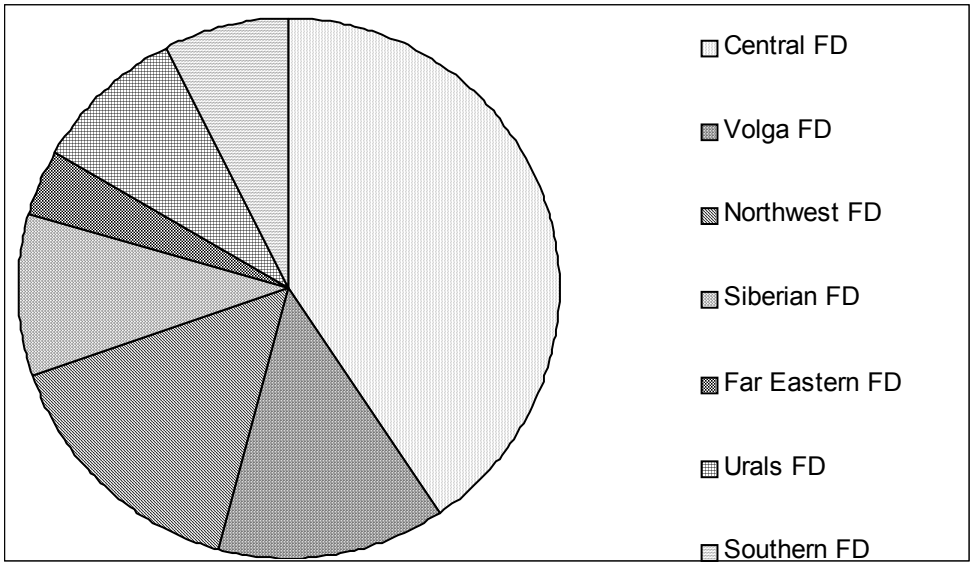

Fig. 6. M&A target share per Russian federal districts between Q2 2003 and Q2 2009.

The most widespread form of integration on the M&A market is sale/purchase of shares, accounting for over 50% of all acquisitions during the period under review.

The most active players on the M&A market are open joint-stock companies (OAO) (*Fig. 7*). They account for 44% of all transactions. They are followed by limited liability companies (OOO), accounting for 25% of all transactions. During the period under review, in six transactions the buyers were state unitary enterprises (GUP). GUPs bought companies operating in the following sectors: manufacturing, hospitality and catering, transport and communications, utilities, finance.

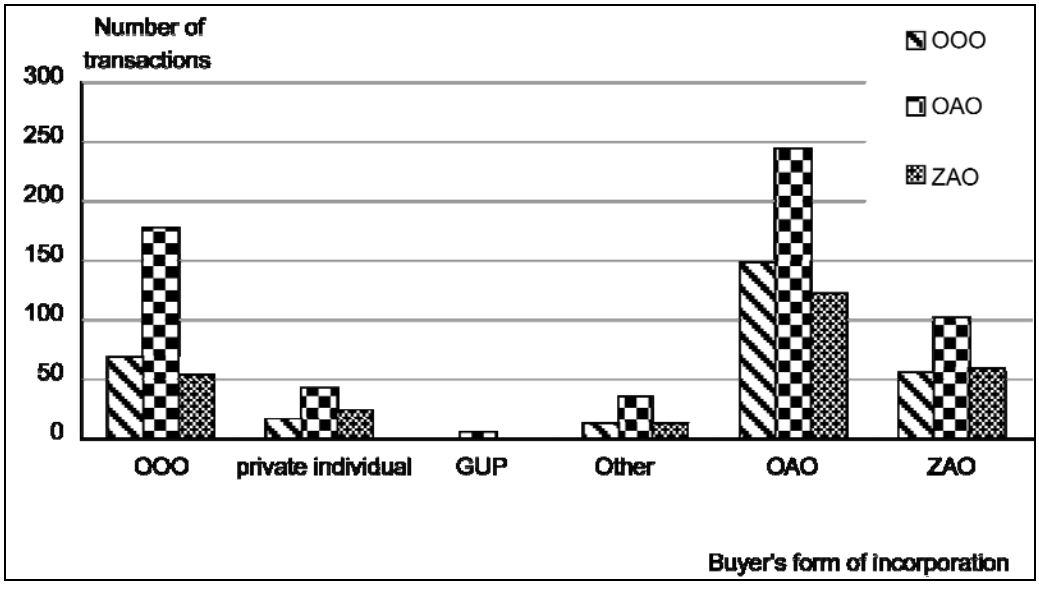

Fig. 7. Number of transactions between companies of different forms of incorporation between Q2 2003 and Q2 2009.

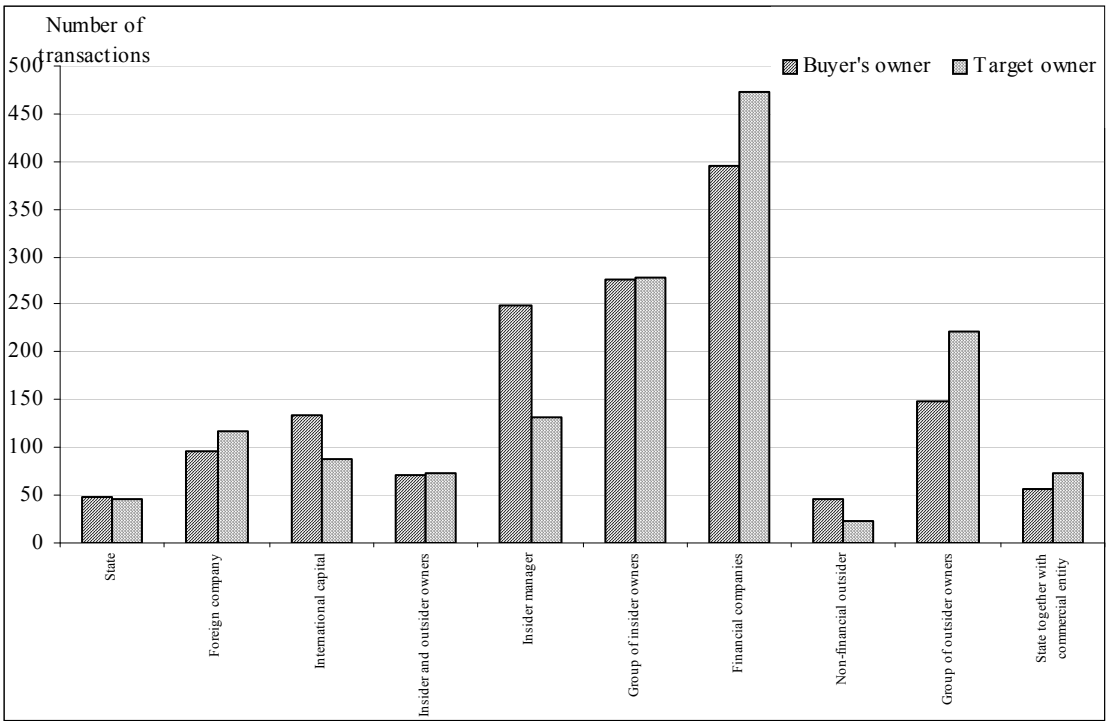

Fig. 8. Classification of M&A transactions per owners of companies involved, between Q2 2003 and Q2 2009.

Fig. 8 shows that most frequently buyers were entities owned by financial companies, accounting for 26% of all transactions (35% of the total amount of transactions) for which ownership information is available. M&A targets also most frequently were assets owned by financial companies, making up 31% of all transactions (33% of the total amount of transactions).

The state acted as the buyer and the seller in 3% of transactions. In terms of amounts involved, the sale of state-owned assets accounted for 2.3% of the total amount of transactions for the given period, whereas acquisitions by the state made up 6% of the total value of transactions.

Foreign companies acted as the buyer in 6% and as the acquisition target in 8% of the overall number of M&A transactions. Acquisitions of foreign companies made up 7% of the total amount of transactions. The biggest transaction involving a foreign target was the acquisition by PKN Orlen of 53.7% of shares in the Lithuanian concern Mazeikiu Nafta (MN) for US$ 1,492 mln from a Yukos subsidiary, Yukos International UK B.V., in May 2006.

International companies acted as the buyer in 9% and as the seller in 6% of M&A transactions. These transactions accounted for 13% of the total amount. The biggest transaction to have an international company as an M&A target was the sale of 50% plus one share in Sakhalin Energy Investment Company Ltd to Gazprom in February 2007 for US$ 7,450 mln. As a result of this transaction, Shell retained 27.5% and Mitsui and Mitsubishi, 12.5% and 10% in the company respectively.

Transactions to purchase companies in joint insider-outsider ownership made up 5% of the total number and 3.6% of the total amount. Companies with this form of ownership acted as buyers in 4.7% of transactions.

Companies owned by an insider manager were M&A targets in 6% of transactions, accounting for 5.5% of the total amount of transactions. Companies owned by an insider manager acted as buyers in 15% of transactions.

A group of insider owners acted as the M&A target and the buyer in 18% of transactions each. Purchases of companies co-owned by management and staff accounted for 5% of the total amount of transactions in the period under review.

Companies owned by non-financial outsiders acted in 3% of M&A transactions as buyers and in 1.5% as targets, accounting for 0.8% of the total amount of transactions between Q2 2003 and Q2 2009.

Acquisitions of companies owned by a group of outsiders made up 19.5% of the total amount of transactions in the given period, while in terms of numbers, companies like these acted as M&A targets in 15% and as buyers, in 10% of transactions.

Transactions in which acquisition targets were companies co-owned by the state and a commercial entity made up 5% of the total amount and 5% of the total number of M&A transactions. As buyers, companies like these appeared in 4% of transactions.

For Russia as a whole, the most frequent M&A targets were manufacturing companies, making up 30% of all targets. The trend was the same for Moscow and St Petersburg, where manufacturing companies were the most frequent M&A targets: 264 out of 1,023 and 27 out of 111 respectively.

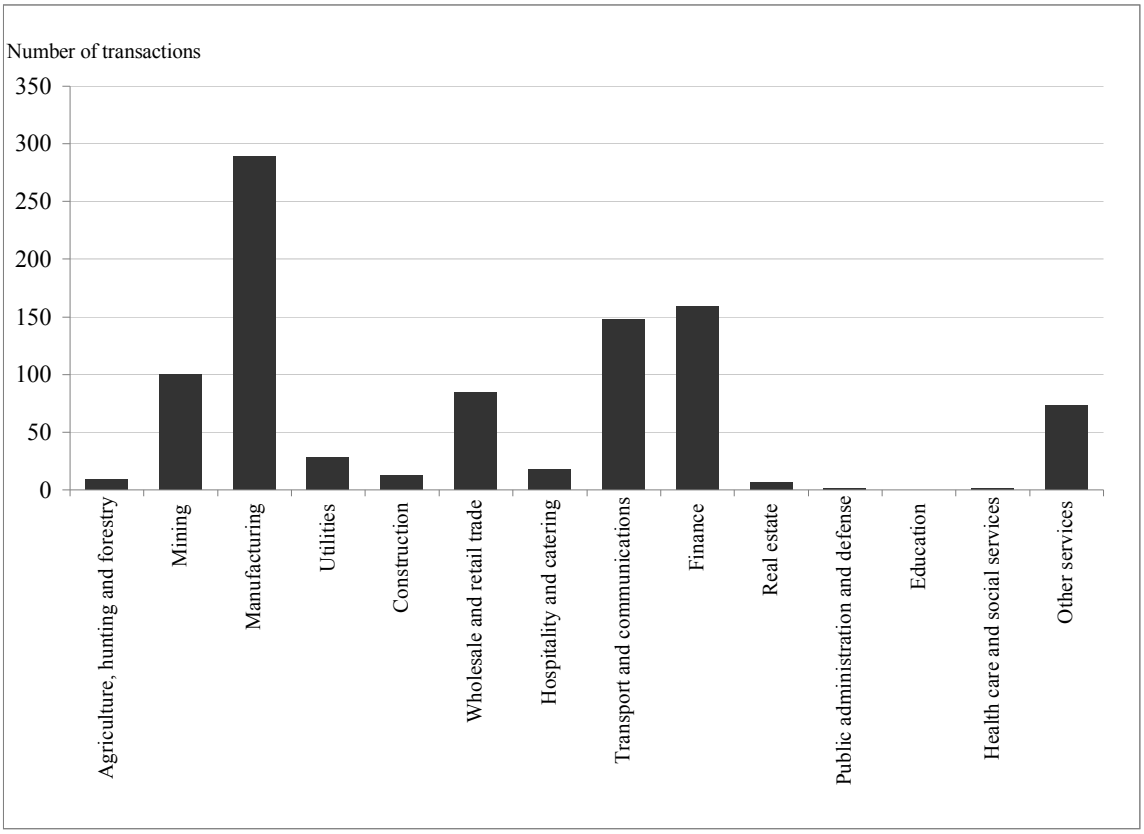

Fig. 9. Intra-industry transactions between Q2 2003 and Q2 2009.

Acquisitions within the same industry range from 8 to 87% between Q2 2008 and Q2 2009. For instance, agricultural and forestry companies purchased companies within their industries in 28% of cases in the given period. For entities dealing with public administration and military security, the share of transactions within their sectors was 8% of the total number of transactions. For utilities companies the figure was 41%, for construction companies, 16%.

Industries with the largest number of acquisitions within their own sector were finance (88%), transport and communications (64%) and services (61%).

The trend towards mergers and acquisitions between companies engaged in the same type of activity was also evident in wholesale and retail trade (67%) and in manufacturing (54%).

Among Russian buyers the highest demand was for companies in manufacturing (31% of all transactions in the period under review), mining (13%), transport and communications (13%) (*Fig. 10*).

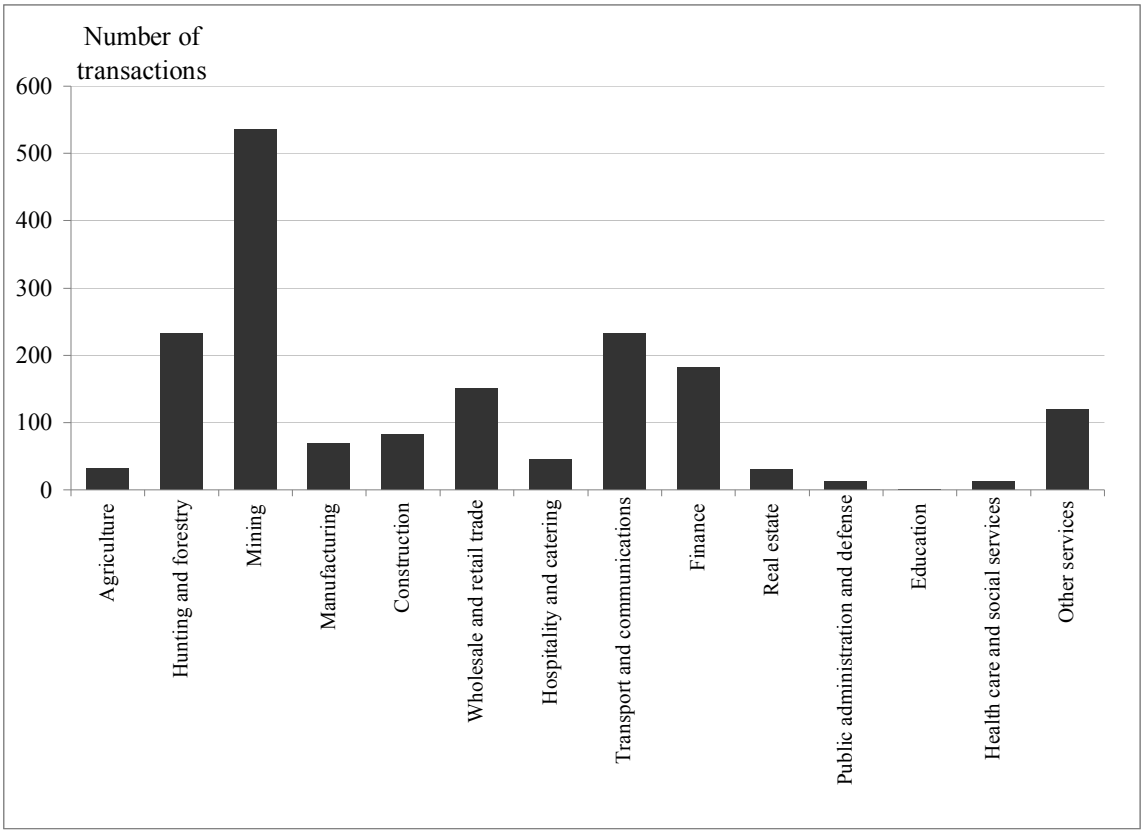

Fig. 10. Breakdown of M&A targets per industry, between Q2 2003 and Q2 2009.

Among agricultural companies the highest demand was for manufacturing and processing assets (65% of all transactions). In the Russian Classification of Types of Economic Activity, the Manufacturing and Processing group consists of 14 subgroups. Out of 26 transactions in which agricultural companies were the buyers, 14 targeted companies from the food, beverages and tobacco subgroup and 9, agricultural companies. There is a trend whereby companies producing raw materials are seeking to expand their circle of consumers by producing semi-finished and end products.

Some 62% of transactions carried out by mining companies involve assets in similar industries. For example, mining, including oil and gas, companies actively buy into manufacturing and processing, mainly metals: 23 out of 27 transactions in manufacturing and processing. In other words, the trend is the same as in agriculture: companies seek to control the whole production cycle in their segment. Given the high cost of this type of business and limited production facilities, this trend leads to monopolistic advantages for companies or businesspeople.

During the period under review, in 73% of cases manufacturing companies conducted transactions within their industry. Out of 395 transactions, 119 were in the food, beverages and tobacco subgroup, 61 in the machine engineering subgroup, 44 in the chemical production subgroup, and 39 in the metals and metal goods subgroup.

Among utilities companies, the highest demand was for assets within the same sector: 47%, or 28 out of 60 transactions. There were 18 transactions in mining, with companies purchasing their own sources of raw materials to reduce their production costs.

Entities dealing with public administration and military security, in five out of 13 transactions bought manufacturing and processing companies, including three machine engineering companies, one chemical and one metals company.

Buyers in wholesale and retail trade in 74% cases purchased companies within their sector, followed by manufacturing and processing companies.

Some 95% of transactions by hospitality and catering companies were to buy assets in the same sector, with the remaining 5% going to communal, social and personal services.

Financial companies bought assets within their sector in 41% of cases. In 21% of cases their targets were manufacturing and processing companies; in 8%, transport companies; in 5%, companies providing communal, social and personal services as well as mining companies; in 4%, construction, utilities and trade companies each; in 2%, hospitality and catering as well as agricultural companies each.

For companies providing communal, social and personal services, intra-industry transactions made up 69% of their transactions. Their second-largest group of targets were transport and communications companies (20%), followed by hospitality and catering and financial companies (6%).

Transactions in which buyers were real estate companies were spread between four sectors, excluding intra-industry acquisitions which made up half of all transactions: 17% of transactions targeted mining assets; 8%, agricultural companies; 8%, manufacturing and processing; and 8%, wholesale and retail trade companies.

For transport and communications buyers, intra-industry acquisitions made up 83% of all transactions, with 4% going to manufacturing and processing targets and 5%, to companies providing communal, social and personal services.

During the period under review, health care entities were buyers in three M&A transactions, with targets coming from the manufacturing and processing sector; utilities and health care.

Fig. 11 shows that foreign companies most frequently bought assets in the following sectors: manufacturing and processing, mining, finance, transport and communications.

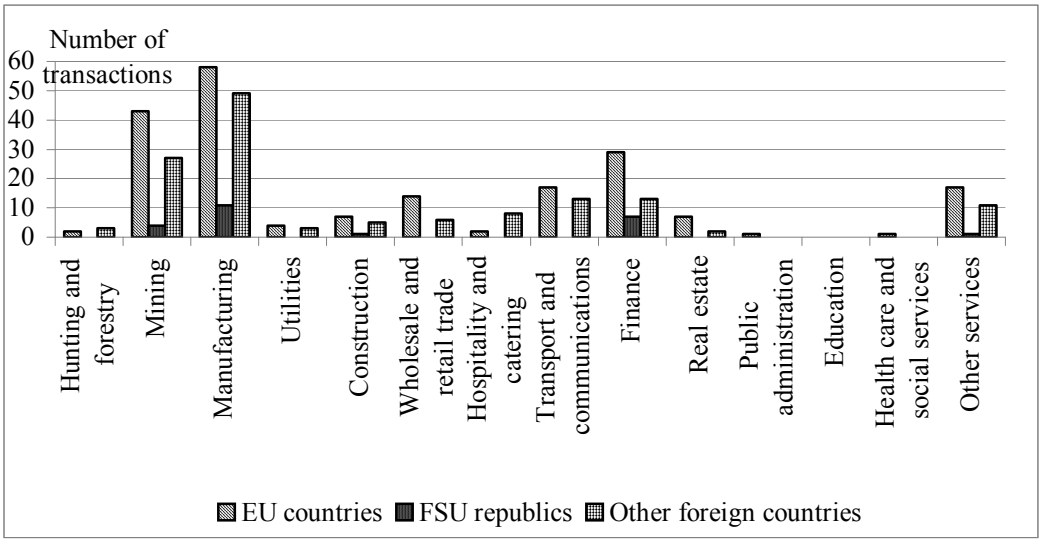

Fig. 11. Breakdown of targets acquired by foreign companies by sector, between Q2 2003 and Q2 2009.

Manufacturing and processing companies were most often a target for acquisition by buyers from EU countries (43 out of 74 of transactions with foreign companies in this sector). As a rule, irrespective of the acceptor's registration, transactions were conducted between Russian businessmen or their groups.

The largest number of transactions between Q2 2003 and Q2 2009 involved the acquisition of companies registered in the Central Federal District, with most targets coming from the manufacturing and processing, transport and communications and finance sectors.

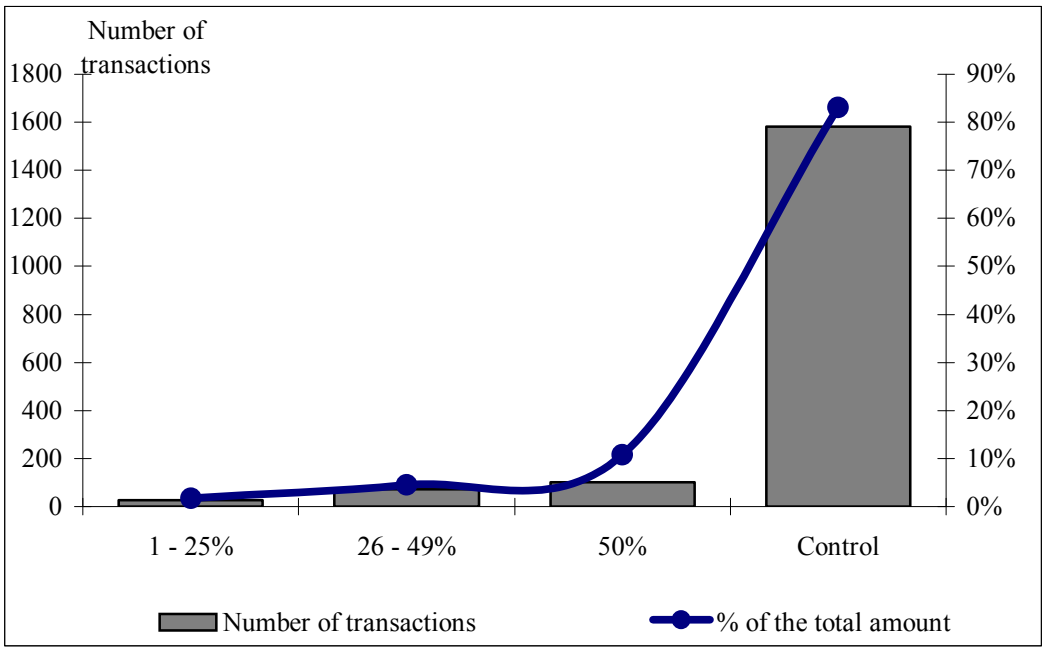

Fig. 12. Share bought in M&A targets, between Q2 2003 and Q2 2009. (Number of transactions; % of the total amount; Control)

In the Siberian Federal District, the majority of M&A targets belonged to the mining and manufacturing and processing sectors; in the Far Eastern Federal District, transport and communications; and in the Urals Federal District, manufacturing and processing and mining companies.

The most frequently used form of integration on the M&A market is gaining control over a company: these transactions accounted for 86.5% of all transactions during the period under review (*Fig. 12*) and made up 68.5% of the total amount of transactions. The term control is used to mean transactions to acquire 51% and more shares in a target company if it is a joint-stock company or full acquisition of companies with other forms of incorporation.

Acquisitions of half a target company – either 50% of shares or half in the company's authorized capital – make up 6% of the total number of transactions, or 11% of their total amount. Acquisitions of a blocking share, or 26-49%, in a company make up 4% of all transactions in the given period, or 5% of their total amount. Transactions to acquire a 1–25% share in a company accounted for 2% of all transactions between Q2 2003 and Q2 2009, or 2% of their value (*Fig. 13*).

When the target is a Russian company, the most frequently used form of integration is assuming control over a company: it accounts for 1,301 purchases of Russian companies out of 1,476, or for 58% of the overall transaction amount in the period under review.

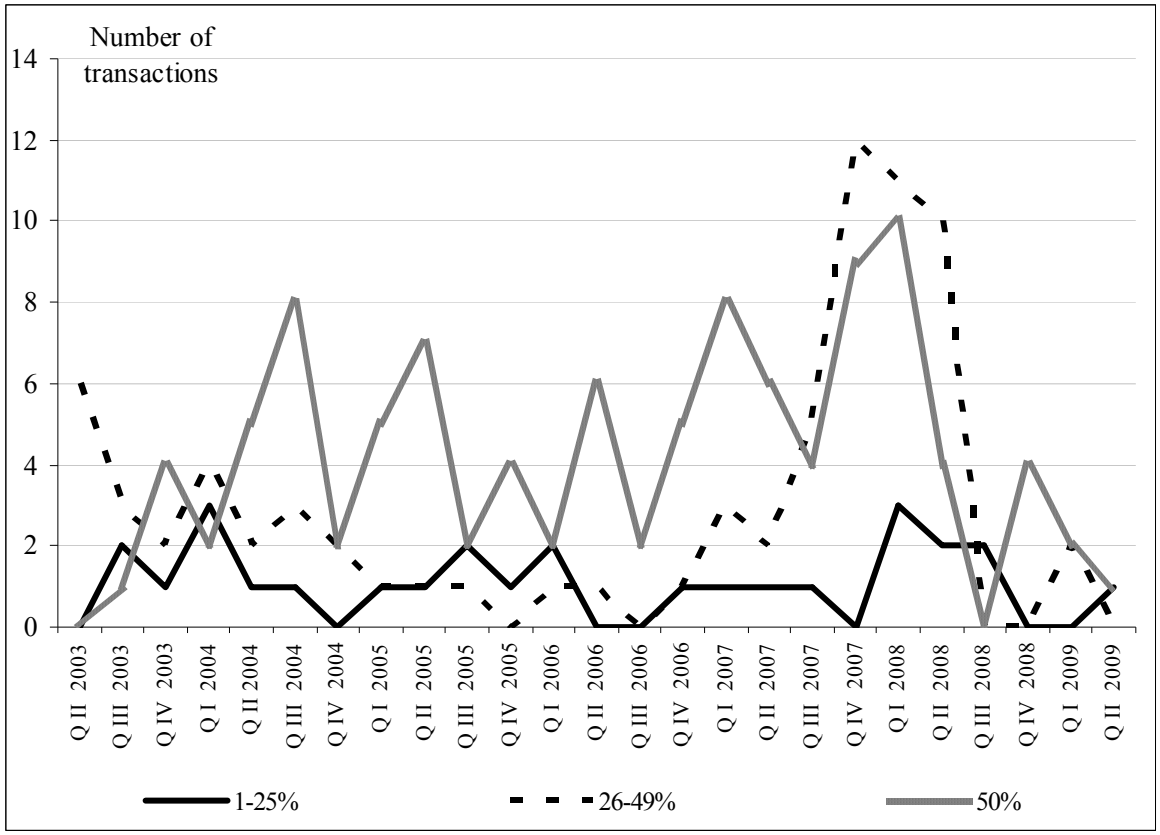

Fig.13. Dynamic of the number of transactions depending on the bought-out share, between Q2 2003 and Q2 2009.

During the period under review, when purchasing companies on the territory of Russia in 92% of cases corporate buyers from EU countries assumed control over the target; in 4% of transactions they bought 50% in the company; in 2%, they purchased a blocking stake, or 26-49% in the authorized capital.

During the same period when purchasing companies on the territory of Russia, buyers from former Soviet Union countries in 80% of transactions acquired a controlling stake and in 20% of transactions, 50% of shares in the target companies. Buyers from other foreign countries in 89% of cases acquired a controlling stake, in 6% of transactions, 50% in the target companies, and in 5%, up to 49% in the companies.

The majority of transactions in which foreign companies bought targets in Russia were controlling stake acquisitions by EU and former Soviet Union countries (*Fig. 14*).

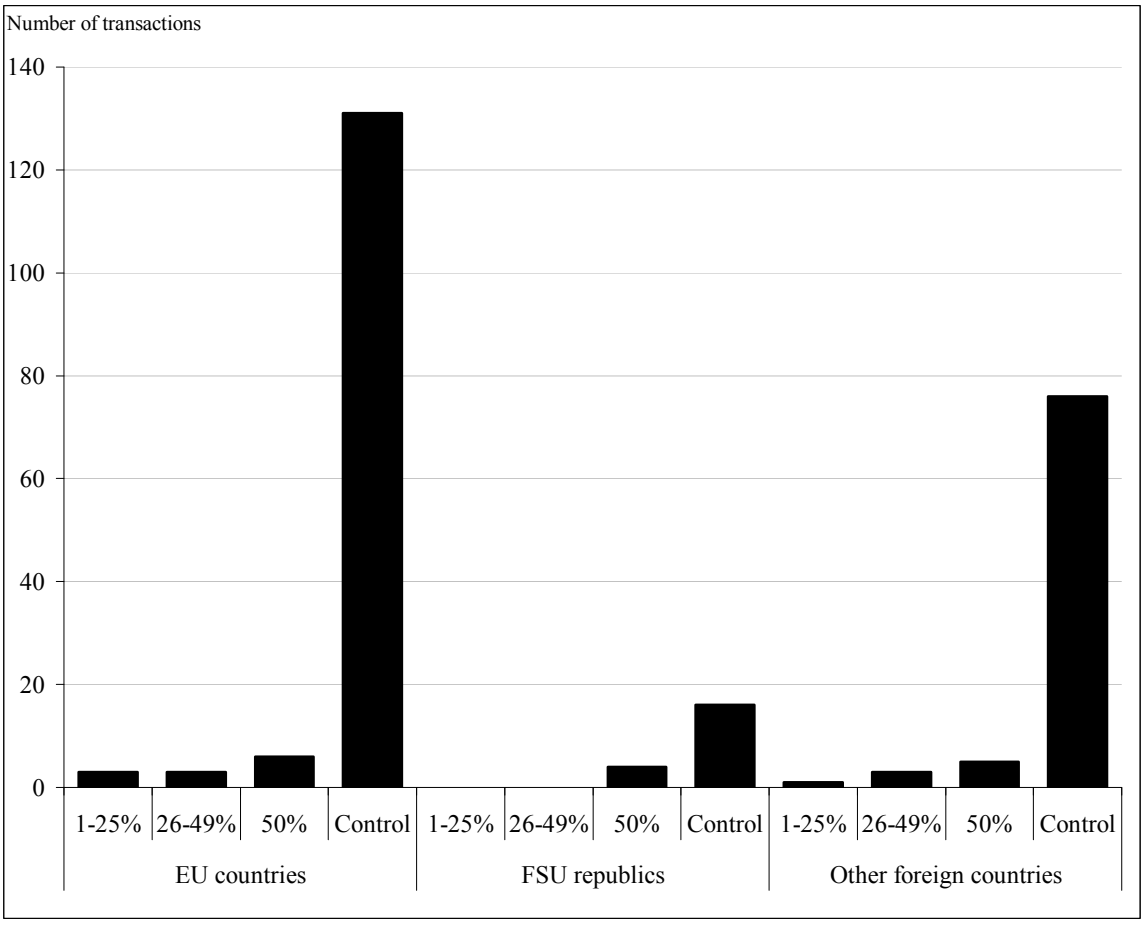

Fig. 14. Share in Russian M&A targets bought by foreign companies, between Q2 2003 and Q2 2009.

The most frequent transactions in the period between Q2 2003 and Q2 2009 were controlling stake acquisitions. The next phase in the development of this market will see the emergence of new technologies for conducting transactions, company expansions through industry concentration, consolidation into specialized holding companies.

Russian companies' attempts to enter the world M&A market are being made more difficult both by competition, which in recent years has become more fierce, and by the absence of

a clear and practicable program of support for Russian investment abroad. In addition to the lack of access to new assets inside the country and a growing competition on the domestic market from Russian and foreign companies, the drive towards acquiring assets abroad is largely informed by the desire to reduce dependence on the state and the tax base and to ensure the safety of assets.

According to available preliminary data, in the first nine months of 2009[1] a total of 546 completed transactions were recorded (including 24 transactions carried out within the framework of Russian Federal Property Fund auctions), which is 43% fewer transactions than in January – September 2008 (964). The decrease in the value of the Russian M&A market slowed down: in the first nine months of 2009 the value of the market dropped from $98.2 bln in 2008 down to $41.4 bln in 2009. According to the findings of the study, the aggregate data on the Russian M&A market look as follows:

- in terms of the number of transactions, the year 2009 (546 transactions) is comparable to 2003 results;
- in terms of the amount, the year 2009 ($41.4 bln) is comparable to 2006 results;
- the average transaction price was $97.7 mln;
- ratio to macroeconomic indicators (4.6% — ratio between the amount of transactions and Russian GDP) is comparable to 2004;
- 52 transactions worth over $100 mln;
- management buyouts (MBO) account for 2% of the market in terms of the amount and 3% of the market in terms of the number of transactions;
- transactions in the energy sector make up 68% of the market in terms of the amount and 10% of the market in terms of the number of transactions;
- controlling state acquisitions make up 37% of the market in terms of the amount and 19% of the market in terms of the number of transactions;
- 13% of transactions account for 90% of the value of the market;
- diversification transactions make up 18% of the market in terms of its value and 33% of the market in terms of the number of transactions;
- foreign companies' acquisitions of Russian companies make up 9% of the market in terms of the number of transactions and 18% of the market in terms of its value.

Below are the more significant features of the Russian M&A market that make it different from the Western practice of capital consolidation:

- weak direct control from state regulators over M&A processes in progress;
- little use of organized stock market instruments in M&A transactions (the majority of transactions involve not publicly listed but private companies, although there is some positive dynamics there);
- minority shareholders' inability to have considerable influence over company operations;
- lack of transparency as regards companies' ownership structure (end beneficiaries);
- single ownership of, on average, considerably larger blocks of shares than in Western companies;
- high level of transactions carried with the use of offshore entities;

[1] A study of the Russian M&A market conducted by ReDeal analytical group within the Mergers.ru project/ "Mergers and Acquisitions in Russia". The study covers completed processes of the transfer of corporate control rights (M&A processes) in Russia.

– continued prevalence of hostile takeovers[1] and criminal seizure of assets;
– lack of disclosure on a considerable number of M&A transactions caused by desire to maintain confidentiality both to conceal data on beneficiaries and to prevent undesirable transactions on the part of competitors, including hostile takeovers and seizure of assets (according to some estimates, at least 30-40% of the total amount of public transactions are shadow transactions);
– use of administrative resource and non-market methods to facilitate the acquisition of assets by the state, state corporations and state-controlled companies with mixed ownership.

Such factors as high concentration of ownership, insufficient development of market-economy institutions, low effectiveness of the judicial system, lack of transparency in ownership rights, and corruption have a systemic influence on all aspects of the Russian M&A market. At the same time, low transparency and little information on transactions, lack of professional intermediaries and active involvement of state companies suggest, among other things, that the corporate control market is experiencing efficiency problems.

5.5. Corporate Governance and Legislation on Legal Entities

In March 2009, submitted for the debate was the draft Concept of Development of the Legislation on Legal Entities (hereinafter, the Concept) which was developed in accordance with the Decree No. 1108 of July 18, 2008 of the President of the Russian Federation on Upgrading of the Civil Code of the Russian Federation and set the guidelines for development of the legislation on legal entities[2]. The document was expected to be submitted to the President early in summer 2009.

A typical complaint about the Law on Joint-Stock Companies of 2005 as amended since 2002 was the fact that it excessively reproduced the Anglo-Saxon scheme of protection of shareholders' rights (minority shareholders). The Concept of Development of the Corporate Legislation until the Year 2008 (prepared by the Ministry of Economic development of the Russian Federation) which became the main program document in the 2000s in that particular area is to some extent a manifesto favoring the scheme of protection of majority shareholders' rights. In fact, it suits to a great extent such actual economic processes in corporate governance as are typical of the most Russian companies (the continental European scheme). At the same time, radical changes in the regulating strategy should not result in new imbalances to the detriment of one or another group of entities of the corporate relations.

The draft Concept of 2009 is a new effort to carry out a system-based development of mechanisms of corporate governance and solve the most topical Russian problems in that

[1] In the West, the term "hostile takeover" is used to mean the acquisition of a company's assets without its shareholders' consent, often without paying an adequate compensation and/or with the violation of shareholders' other civil rights and interests. In Russia this term is often used to describe actions related to acquiring assets through committing criminal offences (fraud, forgery, share register theft, bribery, etc.). This approach appears erroneous. It is important to have a clear definition of the term since the authors propose countering criminal seizure of assets with the same measures that have been developed in the West to counter hostile takeovers and cannot be effective when applied to quite different phenomena.

[2] Draft Concept of Development of the Legislation on Legal Entities is an integral part of the general draft Concept of Development of the Civil Legislation of the Russian Federation which is being prepared by the Private Law Research Center under the President of the Russian Federation by order the Council for Codification and Upgrading of the Civil Legislation of the Russian Federation under the President of the Russian Federation.

area. From the conceptual viewpoint, it is important to understand if substitution (may it be a gradual one) of the corporate governance scheme and growth in level of responsibility of the business' actually take place.

5.5.1. "Corporate" Rights

A specific feature of the Russian scheme of corporate governance is a limitation of rights of participants in Russian economic entities, including shareholders as regards the company's property. Shareholders are recognized to have statutory rights – the right of demand to the company (Article 2 of the Federal Law on Joint-Stock Companies, the notion of a "share" set forth in Article 2 of the Federal Law on Securities). In accordance with the Civil Code, participants in economic relations are recognized to have either statutory rights to the company or proprietary rights to the company's property (Article 48 (2) of the Civil Code). Without elaborating on theoretical aspects of the issue, it is to be noted that statutory rights are relative to the extent that they are a sort of derivatives from proprietary rights which include the right of ownership which factor is reflected in every aspect of realization of such rights (including protection thereof).

The architects of the Concept suggest that apart from statutory rights participants in economic entities, including shareholders should be legally recognized the rights of participation in the company, and that would permit amendment of the status of founders and shareholders of the company. Participants' aggregate rights (statutory rights, that is, the right of demand to the company and the right of participation in it) are proposed to be called "corporate" rights of participants in economic entities.

In addition to the above, the Concept provides for the following:

– Introduction of a possibility for participants to dispute decisions passed by general meetings of shareholders and other collegial bodies, as well as conditions of withdrawal or exclusion from the number of participants (for all the types of legal entities) ;
– Inclusion in the Civil Code of a provision granting participants in any corporation the right to receive information.

5.5.2. Dependence of the Boards of Directors

Expansion of the rights of founders and shareholders is accompanied by efforts to change to some extent regulation of activities by boards of directors of joint-stock companies. By admitting the fact that the overlap of the management function and the supervision function is a key problem, the architects of the Concept propose "introduction of a more efficient structure of bodies of a joint-stock company" with an explicit division of the above functions between such bodies. However, the proposed measures, that is, a refusal to use the name "the Board of Directors" and call it instead "the Supervisory Council", as well as the ban on a simultaneous holding of offices both in the Supervisory Council and the Board of a joint-stock company are not enough to contribute to any resolution of the above problem.

The Russian corporate governance of joint-stock companies was modeled in 1990s after the US scheme where the structure of corporate governance is characterized by a higher dispersion of the equity capital which factor prevents the board of directors to be put under control by a single shareholder.

In Russia, the situation is quite the opposite: according to the outputs of the information transparency survey carried out in 2007 by the Standard&Poors Rating Agency out of eighty large Russian companies 74 companies had at least one major shareholder which owned more

than 25% of the equity, while 57 companies were controlled ones in which over 50% of the equity was owned by a sole shareholder or a group of shareholders which made an agreement between themselves. Such a breakdown of corporate ownership is a mirror reflection of the composition of boards of directors: 46% of directors surveyed are direct representatives of controlling shareholders, while another 21% of directors are made up of different insider-directors, including senior executives. Such a situation in leading companies (along with an empirical estimate) permits to assert that in other 180,000 Russian joint-stock companies which activities lack transparency the extent of control over the board of directors by major shareholders is much higher.

Controllability of the board of directors by a major shareholder or a group of shareholders often results in taking of such decisions which suit the interests of the controlling shareholder rather than the company. Due to a lack of mechanisms of settlement of disputes, conflicts between different groups of shareholders often overgrow into corporate wars and takeovers of corporate assets.

To reduce that extent of control over the board of directors by the controlling shareholder (which problem is the most topical in the Russian system of corporate governance), it is important to carry out the following:

1) Introduce changes in the composition of the board of directors and the decision-making procedure and legislative consolidate mandatory representation in the board of directors of minority shareholders and representatives of controlled entities along with the expansion of the range of issues on which the board of directors is required to take unanimous decisions[1]. The basic idea of adjustment of different interests within the frameworks of the board of directors should be supplemented by mechanisms which would prevent members of the board of directors from abusing their rights;

2) legislatively consolidate a provision under which controlling shareholders or a group of such shareholders are obligated to enter into such an agreement with minority shareholders as would make the former liable to buy sharers of the minority shareholders on their demand in specific cases. Such cases may include insufficient profit, such a change in the equity capital as would infringe the interests of minority shareholders and other;

3) for the purpose of fighting corrupt practices and raising efficiency of joint-stock companies controlled by the state (many of which are of strategic importance), it is necessary to introduce a ban on a simultaneous holding of a public office and an office in the governing bodies of a company whose equity is owned by the state or a state-controlled joint-stock company and legislatively consolidate a norm which would require members of governing bodies of such joint-stock companies to be independent directors.

It is important to establish specialized public control over both joint-stock companies with state participation and state-controlled joint-stock companies. At present, such companies cannot be controlled by authorities who set objectives to them because the same authorities take part in management of those companies. The existing system of relations is of an unofficial nature, so no actual supervision is exercised. Nor can it be carried out by the Auditing Chamber since such companies do not deal with budgetary funds.

It will not be easy to introduce and implement the above measures due to the fact that many Russian companies lack transparency and controlling owners, including the state are

[1] See in detail here and below: A. Radygin, R. Entov, E. Apevalova and other. Internal Mechanisms of Corporate Governance: Some Applied Issues. Moscow: IET, 2009.

unwilling to provide information on their company's activities (the company's expenditure, counterparties and other). Efforts to be taken in that area mean direct infringement upon the private property. To do so, the government should ensure inviolability and protection of private property from, in particular, a discriminatory use of measures of criminal prosecution and corporate takeovers. At the same time, it means a principally different level of fighting the corrupt practices, including those at the higher level because discrimination in that area would bring all the bona fides intensions to naught.

Consequently, introduction of such norms should be well thought-out, gradual and, probably, tested first on a small number of companies and both in analyzing of problems that arise and in development of mechanisms of settlement thereof. In addition to the above, to effectively separate the management function from the supervision function in corporations it is important to make quality changes in protection of ownership rights and reduce the extent of corrupt practices, including those at the higher level.

5.5.3. Legal Entities: Establishment of a System or Redistribution of the Spheres of Interest?

The Concept provides for establishment of a slender system of organizational and legal forms of legal entities, simplification of the legislation on legal entities and, as far as possible, uniform regulation of the main aspects of their activities. All the legal entities are proposed to be divided into:

– Corporations based on the principle of incorporation: economic entities (joint-stock companies and limited liability companies), partnerships, producers' cooperatives and most non-profit institutions;
– Other unincorporated legal entities: unitary enterprises, foundations and institutions.

Meanwhile, effort is being made on the legislative level to bring entities' activities into compliance with their legal status. Non-profit institutions' activities presently called entrepreneurial activities will be renamed as "activities bringing additional income". Such activities are to be auxiliary ones, and permitted types of such activities are to be listed in the entity's charter, while the charter capital in such a case is to be equal to that of a profit-making institution.

In addition to the above, it is proposed to consolidate legislatively the notion of 'a public company" which acquires its public status from the date of state registration of its securities prospectus for unlimited public offering. The status of a public company suggests that such a company has a higher level of charter capital, independent directors and a specialized registrar who keeps the register and carries out duties of the auditing committee at shareholders' meetings. Also, the company is liable to make its information public.

Furthermore, it is proposed to put an end to existence of closed joint-stock companies and state corporations and later, to unitary enterprises.

Closed joint-stock companies may become joint-stock companies (non-public) if they manage to increase their charter capital to two million rubles within a year or two, or be transformed into limited liability companies (with a charter capital of at least a million ruble) or, into producers' cooperatives.

Unitary enterprises which are authorized to deal in economic activities will be transformed into economic entities with the government holding a dominating interest in them. Such a situation will permit to influence the most important decisions those entities take. Only state-

run companies (not municipal ones) with the right of operating management are expected to remain.

It is proposed not to establish new state corporations in future while the existing ones are expected to be subsequently transformed, and the legal basis for creating of such legal entities will be eliminated. For that reason, Rosnanotekh, Rostekhnologii, Olimpstroi, Vneshekonombank and Deposit Insurance Agency are to become economic entities with 100% state participation. The Fund for Assistance in Development of Municipal Housing will be obligated to bring its founding documents in compliance with the requirements which are standard to all the funds, while Rosatom and Olimpstroi are to become the government's federal agencies[1].

As an instrument of such a transformation, "a reversal of restructuring" ("a reverse restructuring") is proposed. It permits to carry out in exceptional cases a mandatory restructuring on the basis of the court's decision (in case of an illegal merger of legal entities they will be split up, while in case of illegal break up they will be merged together and etc.) or in case the court has found that the company has failed to comply with its status (that is, the company has made serious violations which infringe upon the rights of participants in the restructured legal entity, for instance, in a situation where a corporate control over the legal entity has been lost).

Persons who have lost partially or completely their interest in the restructured legal entity as a result of illegal restructuring are provided an option to *restore their lost corporate control*. Persons who took advantage of such restructuring may be bound by the court's decision to give back the respective share of interest to the person whose rights have been infringed upon. Deals by legal entities which were established during restructuring that was later found illegal are, by general rule, valid, while legal entities which existed before the restructuring was found illegal are not. Invalid may be found only those deals which caused damage (or were designed to cause such damage) to the restructured legal entity provided that counterparties to such deals were found acting in bad faith.

Establishment of state corporations has provoked much debate as regards efficiency of their activities. It can be noted right now that state corporations have high resource potential while their place in realization of the government policy is not quite determined[2]; they have a considerable effect both on development of industries related to them and reduction of competition in such industries[3]; and they enjoy a privileged legal position which negatively affects interests of other market participants.

Consequently, the idea of transformation of state corporations and elimination of such organizational and legal forms is justified and can be reflected in the Civil Code of the Russian Federation. However, mechanisms of realization of the above idea (the reverse restructuring and a possibility of restoring the lost corporate control) are not to be adopted as general norms due to the following factors:

– Increase in instability on the market for corporate control;
– Reduction in protection of corporate proprietary rights;

[1] The State Duma planned to develop and pass the draft Law on State Corporations. Its approach was based on the idea that state corporations had been established for a certain period of time to solve specific goals.

[2] See in detail: A. Radygin, R. Entov, E. Apevalova and other. Internal Mechanisms of Corporate Governance: Some Applied Issues. Moscow: IET, 2009.

[3] The Federal Anti-Trust Service of Russia admits that abnormal growth in the number of large Russian companies poses a serious threat to competition. See in detail: the Report of the Federal Anti-Trust Service of Russia on the State of Competition in Russia (2007).

– Abuse of the rights of "former" shareholders whose approval was required for carrying out of restructuring (it does not refer to instances of administrative pressure or discriminatory use of criminal responsibility measures);
– Creation of a new mechanism which can be used in corporate takeovers.

Furthermore, in the existing judicial system there is a high risk that "exceptional cases" whenever the reverse restructuring is possible may often be determined by administrative means and/or through corruption. In addition to the above, such formal legal approach to evaluation of evidence as is widely practiced in arbitration courts at present overlooks both the economic content of the deals and consequences of such deals which situation prevents the mechanism of "the reverse restructuring" from being effective.

It appears that legal norms which are not aimed at development of general or special legal regulation but at solution of specific political goals (even such important as redistribution of control over the most significant Russian assets) are not to become a component of Russia's civil legislation basis[1]. Stagnation in development of the institutions of property, bankruptcy and etc. which situation is currently observed in civil regulation can be explained by use of the above approach.

Such legal norms included in the system of basic norms and aimed at solution of specific objectives:
– are inefficient in regulation of the respective sphere as regards other participants;
– cease to become topical once the specific problem has been solved;
– result in inconsistent and "patched" legal regulation in future;
– Provoke higher uncertainty about legal situation with a large number of people.

5.5.4. Raising of Responsibility of Managers and Founders of Legal Entities

Another line of development of the legislation on legal entities pursues *raising of the level of responsibility of mangers and founders*. Such a need to heighten responsibility of mangers, founders (participants) and other persons and bodies of legal entities has become long overdue. It is proposed to carry out the following measures:
– Introduce such property liability of members of the board of directors and other collegial executive bodies for the damage caused to the legal entity as provided for in respect of joint-stock companies (Article 71 (2) of the Federal Law on Joint-Stock Companies);
– Legislatively consolidate a provision that persons may be brought to responsibility before the legal entity for actions committed with gross negligence (indiscretion) or unjustified risk. (For example, sale of the legal entity's property at a much lower price in case of a conflict of interests and a lack of due discretion in selection of counterparties and/or preparation of the deal.);
– Annul a possibility of limitation or elimination of property liability of the body (manager) of the legal entity by means of an agreement between such a body and the legal entity (Article 53 (3) of the Civil Code of the Russian Federation);
– Introduce a subsidiary (additional) property liability of founders/participants, beneficiaries and other persons who have an opportunity to determine decisions by the legal entity on deals with its counterparties;

[1] Such objectives can be solved by means of legal documents of another level.

– Introduce a subsidiary liability of the founder (participant) of a one-man company for debts (deals) in case he/she lacks property and if the deal was carried out on instructions of the sole participant;
– Change the beginning of the limitation period as regards lawsuits brought by the legal entity against its former managers to the date new bodies of the legal entity learnt or were to learn about the respective damage, but it should not be in excess of the period set by the law (for example, 10 years).

However, it appears that the proposed measures cannot ensure more responsible behavior of the above persons for the following reasons:

1) such mechanisms of indirect lawsuits (Article 71 (2) of the Russian Law on Joint Stock Companies) as are proposed to be applied in respect of members of the board of directors and other executive bodies are rarely used in practice (only a dozen of such instance are known, and they mostly concerned managers of banks which were later found bankrupt);
2) due to the specifics of the Russian judicial system, evaluation by the court whether the entrepreneurial risk was justified is a highly complicated matter in arbitration proceedings. Both formal legal approach and lack by judges of sufficient economic knowledge prevent objective assessment of the cases where the extent of entrepreneurial risk needs to be determined. Furthermore, legislative regulation of the process of information disclosure in case of a conflict of interests is highly inefficient. Most conflicts are outside the legal sphere, and due to that fact a possibility of bringing of legal entities' mangers to responsibility will be rather limited;
3) Bringing of beneficiary parties and other persons who can determine the legal entity's decision-making is a serious problem. In Russia, since early 90s actual owners of a considerable volume of corporate assets have been known neither to the administrative authorities, nor to law-enforcement bodies, which situation can be explained by corruption and personal security reasons. Nor has the situation been changed by new measures related to mandatory disclosure of the information. As regards related deals, instances of disclosure of beneficiary parties are very rare, while such mechanism is the most inefficient in the existing corporate governance scheme;
4) The idea of establishment of a 10-year limitation period as regards lawsuits brought against managers of legal entities is rather dangerous as it can be used both for political purposes and in carrying out of soft re-privatization. Discriminatory bringing to justice of owners of large Russian assets in regions, as well as similar trends in regions is at present a common Russian practice. For the time being, there are no reasons to believe that the proposed legal norm would limit the "inventory" of state instruments employed in redistribution of assets and that it would not be used for the same purposes at a lower level of redistribution of assets (in corporate takeovers).

5.5.5. Change in Rules of Registration of Legal Entities

According to the architects of the Concept the main "ailment" of the Russian corporate sector, that is, takeover of corporate assets should be handled by means of amendment of the rules of registration of legal entities. However, unlike the Concept of Development of Corporate Legislation in the Period until the Year 2008 the Concept in question to that extent tends to system-based solutions.

It particular, it is proposed to carry out such upgrading of the system of registration of legal entities as would provide for:

- Introduction of rules of verification of the data required for registration of the legal entity;
- Legislative consolidation of the charter as the only founding document of the legal entities, including unincorporated legal entities;
- Mandatory legal expertise of the content of founding documents as regards compliance of such documents with the legislation (nonstandard charters); development of standard forms of charters;
- Transfer of the function of registration of legal entities and that of keeping of the unified state register to judicial authorities, for instance, to arbitration courts;
- Considerable increase in the amount of the charter capital to a million rubles, while for joint-stock companies, to two million rubles; in founding of the legal entity the charter capital is to be paid up by cash funds;
- A possibility for claiming damage from the legal entity if such damage resulted from a failure to provide or undue provision of the information to the state register of legal entities.

In general, the proposed measures appear *to be adequate and meet the existing needs*. However, they will entail considerable costs both on the part of the government and legal entities. Together with measures aimed at raising of responsibility of founders and managers of legal entities and promotion of the rights of founders and shareholders, the above measures will create such an additional pressure on the business as would be excessive and unjustified in the existing economic conditions. Such measures will eliminate both *"one-day" firms and a considerable bulk of small and mid-sized businesses*. The statement that entities which fail to pay an increase in their charter capital will be able to do business as the producers' cooperatives, while their founders, as individual entrepreneurs is only partially justified. Formally, they will, but in reality large enterprises which are rendered services to by a large number of small companies give preference to joint-stock companies or, at least, limited liability companies while selecting their counterparties. Consequently, as a result of the status change many companies would lose their customers, consumers etc., which situation is similar either to a loss of business or a considerable drop in business volumes.

Due to the above, introduction of the complex of such measures should be done on a step-by-step basis and in line with the economic situation of Russian companies. Apart from a period of a year or two proposed in the Concept for facilitating such a transfer, increase in the amount of the charter capital of the existing limited liability companies should be accompanied by introduction of mechanisms of reduction of the taxable base by the amount of an increase in the charter capital. Also, payment by installments within the above period is to be provided for. In that case, one can be sure that "a baby will not be thrown away with water".

Generally, the trend in development of the legislation on legal entities is correct. However, the quality of updating of the Concept, as well as efficiency of subsequent implementation thereof will depend to a great extent on the following:

- Practical experience in the sphere of legal entities' activities is to be taken into account;
- Mechanisms of implementation of the proposed measures are to be updated to the acceptable level from the practical point of view and be economically justified;

– There must be such a political will to solution of topical Russian problems which concern ownership as would overcome lobbyists' resistance on the one side and take into account the public opinion so that a justified compromise could be found, on the other.

5.6. Monopoly Price Regulation in 2008–2009

In monopoly price regulation, the time between revealing a breach of antimonopoly legislation and mitigating the damage caused to customers by a dominant company can sometimes be quite long. For instance, the investigation by the Russian Federal Antimonopoly Service (FAS) of monopoly prices for parking at Moscow air hub airports (Domodedovo, Sheremetyevo and Vnukovo) that was launched in mid-2007 made it possible to reduce the cost of an hour of parking at these airports from 150 to 100 rubles only in May 2009.

There are restrictions on how long the Russian antimonopoly regulator can take to consider a monopoly price case and to pass a decision on it. According to Law No 135 "On protecting competition", a monopoly price complaint can be considered within a month with the possibility of extending this period for two more months. After a case is opened, its investigation has to be completed within three months, after which it can be extended for six more months. Thus, it can take nearly 12 months from the time a complaint is lodged till the time FAS rules that it is a monopoly price case.

When a monopoly price case is being investigated, in addition to establishing that the company in question has a dominant position on the market, it is necessary to establish the level of costs and profits or the difference between the price in question and prices at a comparable market. Overall, despite the fact that the Russian Federal State Statistics Service records industry-average profitability indices for different types of production, it is difficult to use these data in establishing instances of monopoly prices because a particular production can be represented by a sole producer whose actions can constitute a breach of competition laws. In addition, there is no methodology for establishing the level of economically justified costs and profits.

After an antimonopoly regulator has established that a company charges high monopoly prices, it issues an injunction that sets:

– the amount of penalty;
– behavior requirements such as the requirement to stop abusing one's dominant position, to inform the regulator of a single price rise of more than 10%, to provide one's financial and statistical reports on a regular basis.

After that, a ruling passed by FAS can be contested in court. That is why a ruling by the antimonopoly regulator will have an impact on the market only if it has been upheld by a court or if an amicable settlement has been reached, reducing the amount of penalty and defining measures to be taken to reduce damage to customers.

Legal proceedings in connection with monopoly price instances revealed in 2008 are presented in *Table 1*.

Table 1.

Violations under para 1 Part 1 Article 10 (monopoly price) identified by FAS in 2008[1]

No	Company	Goods/Services	Legal proceedings in 2008–2009 in connection with monopoly price incident
1	OOO Gazprom Dobycha Orenburg (Gazprom Group)	Granulated sulfur	Ruling was contested, upheld by three levels of courts, came into force
2	OAO MMK, OAO Oskol Electrometallurgical Combine	Metal products used to manufacture bearings	FAS's ruling was accepted
3	ZAO Metallorukav, OOO Metallorukav Trading House	Metal braid for aircraft and rocket engines	Penalty was paid, injunction followed, ruling was not contested in court
4	OAO SUEK, OAO Yakutugol Holding Company	Thermal coal	No information available
5	OOO Sibuglemet Holding Company, ZAO Sibuglemet, OAO Mezhdurechye, ZAO Mezhdurechye, ZAO OF Mezhdurechenskaya, ZAO OF Antonovskaya, (Sibuglement Holding Company group)	Metallurgical coal concentrate	FAS's ruling was accepted
6	OAO KD avia	Office space rent in the air terminal building	Ruling was contested, upheld by three levels of courts, came into force
7	OAO Vnukovo-Invest	Parking outside airport terminal	Ruling was contested, confirmed by third-level court, came into force
8	OOO Alkoa RUS, OAO Samara Metallurgical Plant	Aluminum shapes	Penalty was paid, injunction followed, ruling was not contested in court
9	OAO Yuzhkuzbassugol	Coking coal	Penalty was paid, injunction followed, ruling was not contested in court
10	OAO Ruspolimet	Nickel alloy ring blanks	Penalty was paid, injunction followed, ruling was not contested in court
11	NK Rosneft	Motor gasoline, diesel fuel, jet fuel, fuel oil	Ruling is being contested in court
12	OAO LUKOIL	Motor gasoline, diesel fuel, jet fuel, fuel oil	Ruling is being contested in court
13	ZAO Domodedovo Aerohotel	Parking outside airport terminal	Ruling was contested, was upheld by third-level court, came into force
14	TD Mechel, OAO UK Yuzhnyy Kuzbass, OAO Yakutugol Holding Company, OAO Raspadskiy Ugol	Metallurgical coal concentrate	Penalty was paid, injunction followed, ruling was not contested in court
15	OAO Gazprom, TNK-BP Holding	Petroleum products	Ruling was contested and cancelled by third-level court
16	OOO Zhanr	Access to cable TV	No information available
17	OAO NK LUKOIL, OOO LUKOIL-Ukhtaneftepererabotka, OOO LUKOIL-AERO (LUKOIL Group)	Jet fuel	Ruling is being contested in court
18	ZAO Fuel Supply Company	Jet fuel	Ruling is being contested in court
19	OAO Dagestani Airlines	Air tickets	Ruling was contested, was upheld by three levels of courts
20	OAO LUKOIL-Nizhegorodnefteorgsintez, OOO LUKOIL-AERO	Jet fuel	Ruling was contested and cancelled by three levels of courts
21	ZAO BRK Invest Limited, ZAO Domodedovo Aerohotel	Parking outside airport terminal	Ruling was contested, out-of-court settlement reached
22	OAO Silvinit	Potassium chloride	Ruling was contested, out-of-court settlement reached
23	Bryansk Dairy Factory	Dairy products	Ruling was contested, upheld by three levels of courts, came into force
24	OAO Uralsvyazinform	Cable rent in telephone conduit	Ruling is being contested in court
25	Elektrostal Metallurgical Plant	Ring blanks	Penalty was paid, injunction followed
26	Magadan Center for Standardization, Metrology and Certification	Equipment testing services	Ruling was contested, is currently being considered by court of cassation
27	Bread-Baking Factory No 1	Bread	Ruling was contested, upheld by three levels of courts, came into force
28	OAO Uralkali	Potassium chloride	Ruling was contested, out-of-court settlement reached

An interesting example was the Federal Antimonopoly Service's investigation into a several-fold increase in the cost of granulated sulfur in Q2 2008 (ruling was passed in December

[1] Data have been systematized on the basis of press releases for 2008 posted on the Federal Antimonopoly Service's official website www.fas.gov.ru and a data bank of rulings by courts of arbitration http://kad.arbitr.ru/.

2008). The ruling was contested in court but upheld by courts of three levels in December 2009. In six out 28 cases, court rulings on monopoly prices passed in 2008 were still not in force in 2009. An analysis of monopoly price cases in 2008 has revealed that in only six cases out of 28, commercial companies in questions followed FAS's injunctions (*Fig. 1*).

Practice shows that the most difficult to regulate are petroleum product markets, specifically jet fuel and gasoline. Out of six rulings passed in 2008 in connection with high monopoly prices for petroleum products, two were overturned by courts at three levels while the remaining four are being considered by courts at different levels.

For example, the Chelyabinsk Region court of arbitration overturned a ruling passed by the Chelyabinsk Region directorate of FAS in connection with high monopoly prices for jet fuel set by the Chelyabinsk airport supplier.

The court did not contest the fact that OAO "LUKOIL-AERO" enjoyed a dominant position on the market that Chelyabinsk airport is part of. However, it noted that there were currently no regulations setting pricing mechanisms for jet fuel since jet fuel had not been included on the list of products and services which fell under state regulation of prices and tariffs, as approved by the Russian government's resolution No 239 of 7 March 1995 "On measures to streamline state regulation of prices (tariffs)".

This reasoning shows that, on the one hand, a court may erroneously interpret the establishment of the amount of necessary costs and profits as compulsion for setting a certain price level. On the other hand, it shows that antimonopoly regulators have little methodology support in proving instances of high monopoly prices.

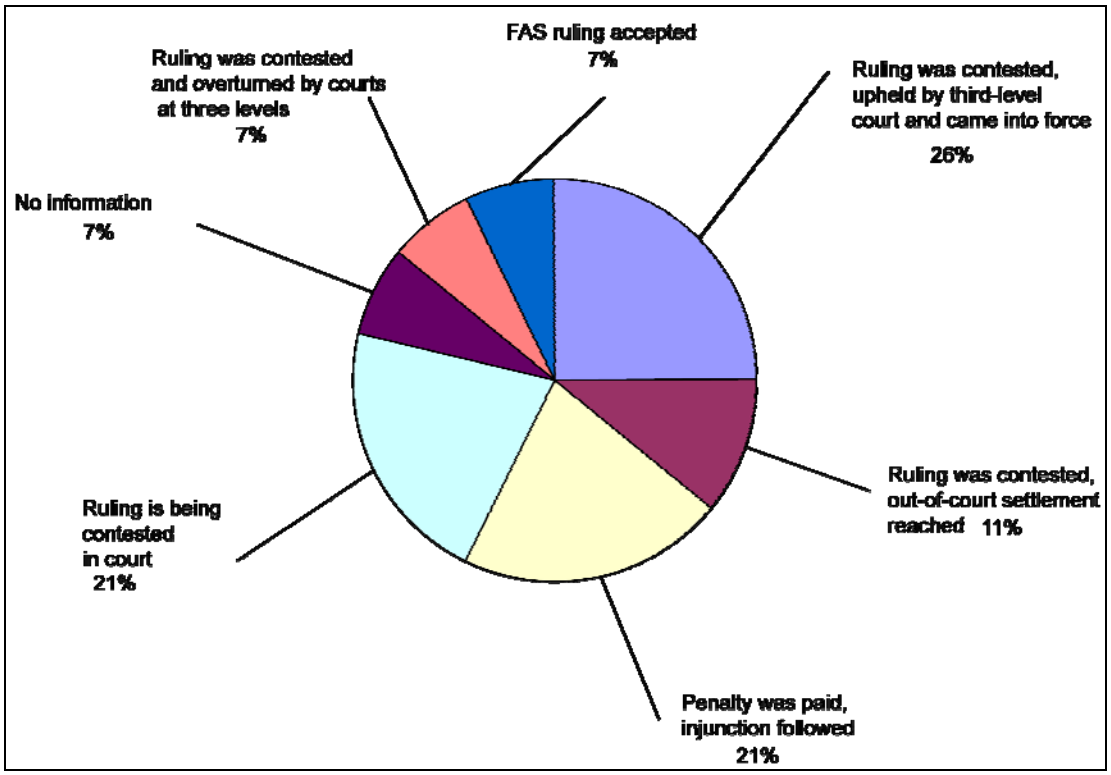

Fig. 1. Legal proceedings on monopoly price rulings passed by antimonopoly regulators

Thus, the length of time that monopoly price regulation takes depends, first and foremost, on how long it takes to contest FAS rulings in courts.

To make the task of identifying instances of high monopoly prices easier, amendments to Federal Law No 135-FZ of 26 July 2006 "On protecting competition" were adopted in 2009, providing a more specific definition of what a high monopoly price is. Conditions for identifying instances of high monopoly prices include:

a) the costs necessary to produce and distribute the goods in question remained unchanged or their change does not match the change in the price of the goods;
b) the list of sellers or buyers of the goods remained unchanged or changes in it are insignificant;
c) terms of goods circulation on the market, including those driven by state regulation, including taxation and tariff regulation, remained unchanged or changes in them are not comparable to changes in the price of the goods in question.

It is worth noting that, under the new version of the law on protecting competition, the price of a product that results from innovation activities, i.e. activities that lead to the creation of a new, not interchangeable, item or a new interchangeable item with reduced production costs and/or improved quality, is not considered to be a high monopoly price. In addition, the term "comparable market" against which the comparable price level is determined can now include markets outside the Russian Federation.

However, these changes have not resulted in a clearer definition of a high monopoly price. For instance, the fact of economically justified costs and rate of return is in each case proved differently: through comparison with the industry-average level of profitability, through comparison of costs with the similar costs of a manufacturer who uses the same type of equipment and so on.

Amendments passed in the "second antimonopoly package" make it more difficult to prove the fact of a monopoly price for a particular product because in the process of establishing this fact it is necessary to analyze the existence of comparable markets not only in Russia but also abroad. In addition, there are no restrictions on the time during which surplus profits from setting high monopoly prices for innovation products can be received. That means that any company, with the exception of producers of commodities, can prove that it has introduced considerable innovations to a product and set any price for that product without the risk of being subject to antimonopoly regulations.

According to press releases posted on the Russian Federal Antimonopoly Service's official website, in 2009 instances of setting high monopoly prices were established in 19 cases (*Table 2*). The length of time during which the revealed violations remained in place varied from 21 days to 18 months, the smallest share of market dominance was 42%, while the minimal difference between the monopoly price and the industry-average price was 10.7%.

Table 2

Instances of high monopoly prices revealed in 2009

	Company	Goods (services)	Market	Probe initiated by	Violation
1	OAO Gazpromneft-Omsk	Petroleum products	Regional	FAS	Unjustified price rise
2	OOO LUKOIL-Volganefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
3	OAO Gazpromneft-Ural	Petroleum products	Regional	FAS	Unjustified price rise
4	OAO LUKOIL-Permnefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
5	OOO Kurskoblnefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
6	OOO Energiya Holding Company	Power generation	Regional	Consumers	Comparatively high price level
7	OAO Vorkutaugol	Transport services	Regional	FAS	Unjustified price rise
8	FGUP Main Center of Special Post	Postal services in relation to materials containing state secrets	National	Consumers	Unjustified price rise
9	OAO Sibirtelekom	Internet access	National	Consumers	Comparatively high price level
10	OAO Ryazannefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
11	OAO Russkiy Solod	Brewers malt	National	Customers	Unjustified price rise
12	OAO LUKOIL	Petroleum products	National	FAS	Unjustified price rise
13	OOO RN-Vostoknefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
14	ZAO FosAgro AG	Ammophos	National	Prosecutor's office	Unjustified price rise
15	OOO LUKOIL – Zapad-Nefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
16	Sole trader Y.V. Kistanov	Liquefied gas	Regional	FAS	Comparatively high price level
17	OAO Sakhaneftegazsbyt	Petroleum products	Regional	FAS	Unjustified price rise
18	OAO Belgorodnefteprodukt	Petroleum products	Regional	FAS	Unjustified price rise
19	ZAO Tambovnefteprodukt	Petroleum products	Regional	FAS	No reduction in price despite a reduction in costs

The 2009 practice is different from the 2008 one in that all product markets (petroleum products, ammophos mineral fertilizer and brewers malt) are commodities markets, whereas in 2008 there were instances of high monopoly prices for such high-tech products as metal braids for aircraft and rocket engines, nickel alloy ring blanks and metal products used in the manufacturing of bearings (*Table 3*).

Table 3

Instances of high monopoly prices in 2008 and 2009

	2008		2009	
	No of cases	%	No of cases	%
Number of revealed instances of high monopoly prices	28	100	19	100
Including:				
on the local market	8	29	1	5

	2008		2009	
	No of cases	%	No of cases	%
on the regional markets	8	29	13	68
on the national market	12	43	5	26
In the following sectors:				
energy sector	10	36	14	74
food industry	2	7	1	5
chemical industry	3	11	1	5
services market	8	29	3	16
industrial production	5	18	0	0
Probes initiated by:				
FAS	13	46	14	74
consumers	15	54	4	21
prosecutor's office	0		1	5
Type of violation:				
comparatively high price level	19	68	15	79
price maintenance	6	21	3	16
failure to reduce prices following a reduction in production costs	3	11	1	5

The year 2009 saw the investigation of a large number of cases on regional petroleum product markets. Violations in the energy sector make up 74% of all investigations and 68% of probes conducted on regional markets (*Fig. 2,3*).

The effectiveness of passed decisions can be only assessed on the strength of court rulings in 2010, since – according to the established practice – all of FAS's decisions taken in relation to companies belonging to the energy, chemical and food industries are contested in court.

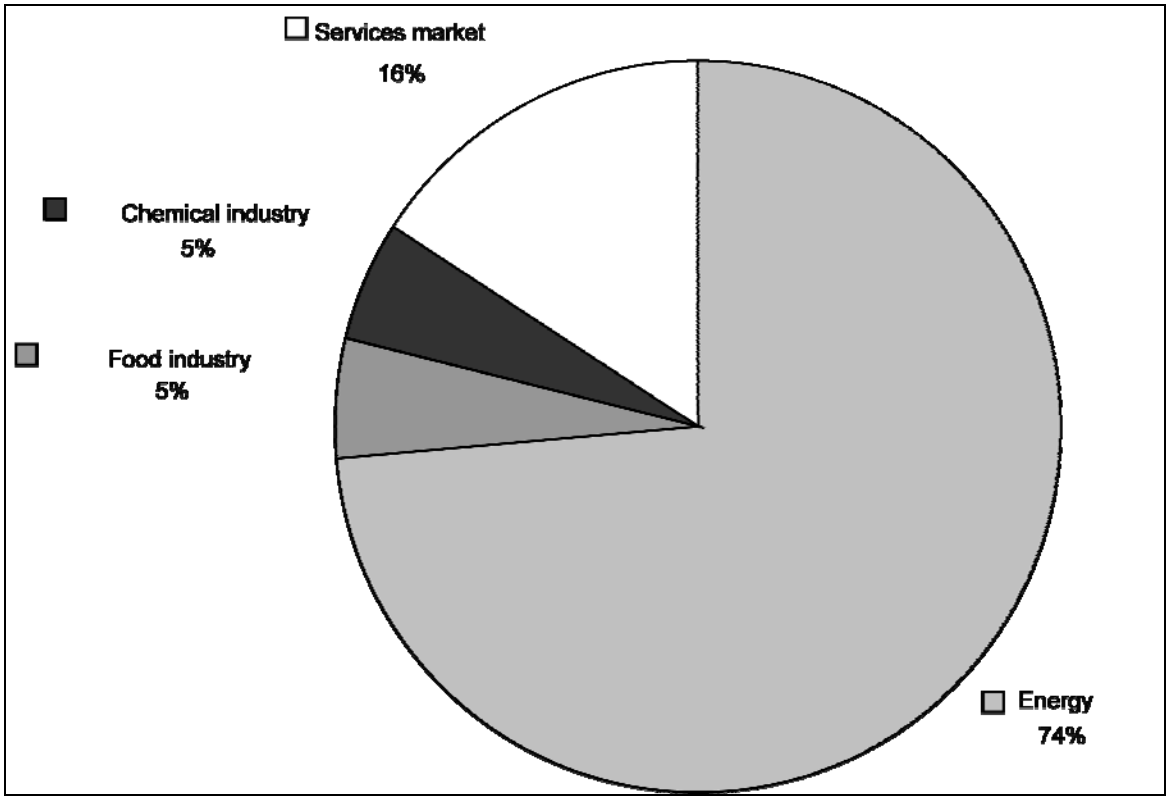

Fig. 2. Sectors in which instances of monopoly prices were revealed in 2009 (Services market, Chemical industry, Food industry, Energy sector)

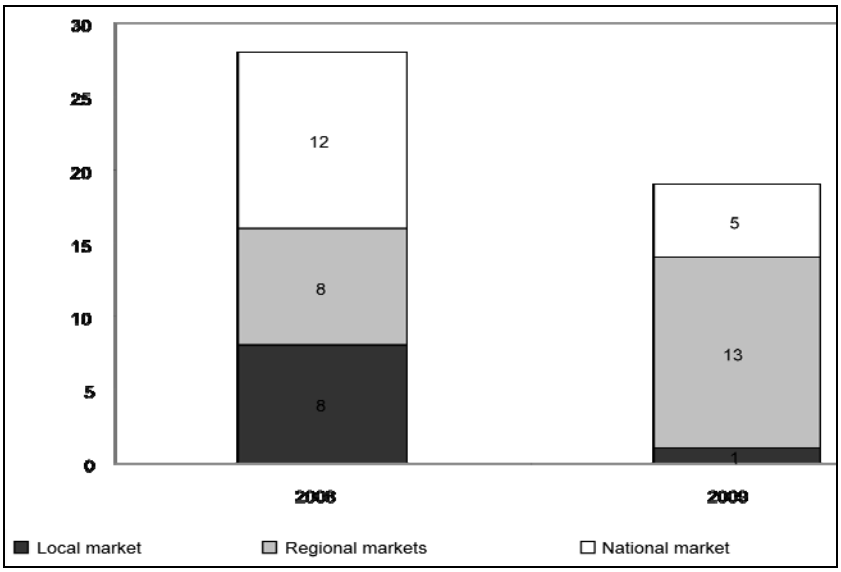

Fig. 3. Breakdown of instances of monopoly prices by size of market, in 2008 and 2009

While comparing who different investigations were initiated by, it is worth noting that the year 2009 saw a drop in the number of cases of high monopoly prices identified on the strength of consumers' complaints (*Fig. 4*). This may be attributed to a slowdown in the rate at which prices for manufactured goods were growing and fewer opportunities for dominant companies to set high monopoly prices given a slump in demand. For example, the producer price index in manufacturing in December 2009, as compared with December 2008, was 105.2%.

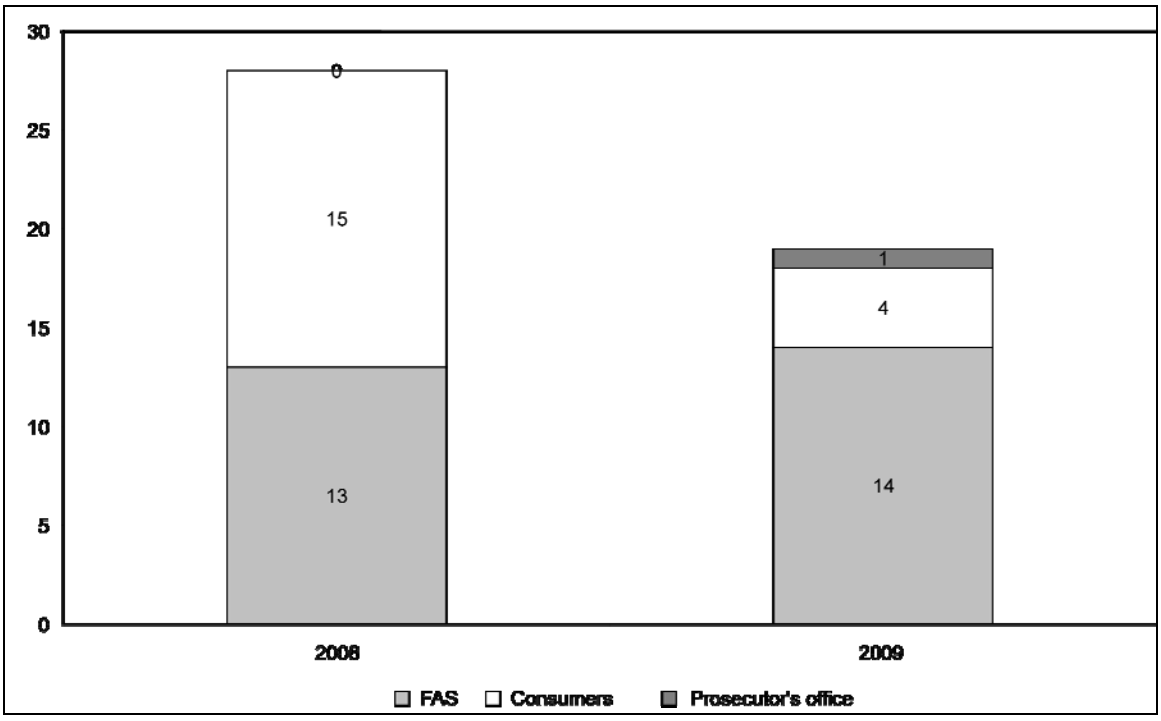

Fig. 4. Breakdown of monopoly price instances by who initiated probes, in 2008 and 2009

On the strength of established instances of monopoly prices in 2008 and 2009, antimonopoly regulators' efforts at monopoly price regulation had an impact on just 16 markets (six local markets, three regional and seven national ones).

An analysis of the practice of monopoly price regulation in 2008 and 2009 shows that the main problem as far as increasing the effectiveness of regulation and reducing the impact on consumers are concerned may be insufficient methodological support for the process of proving the establishment of economically justified costs and profits.

It was expected that amendments to the definition of a high monopoly price adopted in the "second antimonopoly package" in 2009 would make the process of establishing an instance of a high monopoly price considerably easier. However, in reality the procedure of establishing an instance of a high monopoly price became much more complicated, especially when studying markets other than commodities ones. The introduction of the requirement to search for a comparable foreign market also makes the process of investigation considerably more difficult. All that, in turn, limits the capabilities of antimonopoly regulators to defend in court their decisions that the actions of dominant companies on some markets constitute instances of high monopoly prices.