

The London School of Economics and Political Science

*State-led coercive takeovers in Putin's Russia: explaining the
underlying motives and ownership outcomes*

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Declaration

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Abstract

Since Vladimir Putin first became Russia's President in 2000, the state has played an increasingly active and interventionist role in the economy, including through its involvement in a large number of coercive takeovers of privately-owned businesses. The best known case is the Yukos affair, but there have been many other, less prominent takeovers. These have largely been explained as predatory acts by state officials seeking to enrich themselves or increase their power. This has contributed to the perception that Putin's Russia is a kleptocracy, with the state given free rein to engage in economically-destructive attacks on property rights.

This thesis studies a number of state-led coercive takeovers in Putin's Russia, including the Yukos affair, and argues that they cannot be explained as predatory acts initiated by rent-seeking state officials. Instead, they were the work of state officials attempting to pursue economic development while countering perceived threats to state sovereignty.

The Yukos affair resulted in the company's de facto nationalisation and heralded a broader trend of expanding state ownership in the economy. But two other coercive takeovers studied here instead resulted in the companies being transferred to new private owners. In other cases where nationalisation was the clear goal, the state-owned companies who emerged as buyers chose indirect forms of ownership over their new assets. The varying ownership outcomes are found to have been determined by institutional factors which constrained the behaviour of the state, contributing to its preference for takeovers that were negotiated rather than entirely coercive, and turning each case into a bargaining game between state and targeted business owner. Thus Russia is some way from kleptocracy, not only because of the developmental aspirations of its political leadership, but also thanks to partial progress towards institutional checks on arbitrary state coercion.

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“Today I am absolutely sure that the main reason for the Yukos affair was the wish of four or five individuals to gain control of a large and successful oil company. Politics in general and state policy in particular were used as a pretext in order to convince the country’s leadership to use the whole might of the state to redistribute the assets”

Mikhail Khodorkovsky (2005)

“The crux is that in Russia, there is a kleptocracy run by Putin, and all the guys around him. They’re not in their job for the execution of public service; their job is to steal money”

Bill Browder, quoted in Bohlen (2013)

“States can sometimes act on behalf of developmental goals, but they are always imperfect instruments”

Peter Evans (1995)

Chapter 1: State-led coercive takeovers in Putin's Russia

On 25 October 2003, Mikhail Khodorkovsky, the Chairman, CEO and largest single shareholder of the flourishing privately-owned Russian oil company Yukos, was arrested on board his chartered plane at Novosibirsk airport. In the months and years that followed, he and his associates either fled the country or were imprisoned on charges of questionable validity, and the company was broken up and sold off to pay inflated demands for back taxes. The majority of these assets were sold to the state-owned oil company Rosneft', often for sums of money that did not approach their market value.

The "Yukos affair" has been analysed from many different perspectives, including as a demonstrative act aimed at warning Russia's "oligarchs" to stay out of politics, or as an attack on autonomous social forces by an increasingly authoritarian and corporatist state. But one of the most common themes has been to highlight the predatory nature of the attack. In other words, as the quotation from Khodorkovsky indicates above, the company is seen as having been singled out as a lucrative target by a group of state officials intent on self-enrichment and/or self-aggrandisement. There is widespread consensus that the attack on Yukos and individuals associated with it involved abuses such as the arbitrary and selective application of the law, fabricated criminal charges and manipulation of the courts. It is therefore taken to be evidence that contemporary Russia is essentially a kleptocracy, and this impression is only reinforced by high-profile cases such as the death in prison of lawyer Sergei Magnitsky¹. The

¹ Magnitsky worked for a law firm named Firestone Duncan, and was tasked by hedge fund manager Bill Browder with investigating the theft of subsidiaries of his company Hermitage Capital by individuals linked to the Russian Interior Ministry. In response to criminal complaints lodged by Magnitsky and Hermitage, police arrested Magnitsky on charges that he was director of two Hermitage companies that had failed to pay taxes in 2001. He died in prison of severe pancreatitis in November 2009, having been singled out for inhumane treatment by the prison authorities. See Weiss (2012).

above quotation from Bill Browder echoes a widespread perception of contemporary Russia as a country that is both rife with corruption extending to the highest levels of government, and lacking the institutions that might provide an effective constraint on state predation². The fact that Russia's economy has nevertheless enjoyed strong rates of growth since Putin assumed the presidency in 2000 has been explained by reference to benign external conditions, particularly high world prices for oil, gas and other basic commodities that Russia can offer to the world market (Gaddy & Ickes, 2010, p. 284).

The Yukos affair has also come to symbolise two prominent trends of business-state relations in Russia since Vladimir Putin became President in 2000: expanding state ownership in the economy and an assault on property rights through takeovers of privately-owned businesses using state coercion. Not all of the increase in state ownership has arisen from coercive takeovers such as the Yukos affair: much of it has arisen from the *voluntary* sale of private business to state-owned companies. But this trend is nevertheless often associated with the notion that Russia's state officials are mainly interested in enriching themselves and their associates. There is some justification for this: not only is state ownership typically seen as having negative implications for economic performance (Boardman & Vining, 1995)³, but there are also allegations that state-owned companies have overpaid substantially when buying companies from "favoured" private businessmen (Belkovsky, 2010)⁴, while using state coercion and other forms of administrative pressure to drive down the price of other purchases (Heinrich, 2008). In weak institutional environments, state-owned companies create opportunities for corruption and rent-seeking by insiders (Tompson, 2008, p. 8). It is also assumed that state officials are able to use directorships of state-owned companies to enrich

² The pioneering investigative work of another lawyer, Aleksei Naval'ny, has helped to bring to light some of the worst examples of high-level corruption and misuse of public money. The English-language version of his blog is available at <http://navalny-en.livejournal.com>.

³ Though see Hertog (2010) for an examination of the circumstances under which state-owned companies have enjoyed successful performance even in "rentier" states.

⁴ The best-known example is Gazprom's purchase of oil company Sibneft' in September 2005 for \$13bn.

themselves; this is no doubt true to a significant extent, although the precise mechanism by which they do this is rarely explained⁵.

The two trends of expanding state ownership and state-led coercive takeover have tended to be conflated in the minds of analysts, but they are in fact analytically quite distinct. Not only has some nationalisation arisen from voluntary purchases, but some state-led coercive takeovers have *not* led to nationalisation. For example, the owners of the oil companies Russneft' and Bashneft' came under substantial pressure from the state to give up their businesses, but the situation was resolved when they sold instead to a different private business actor who was apparently more acceptable to the Kremlin⁶.

Why, having taken the trouble to force a change of ownership, do state officials not always claim the spoils for themselves? This question is not necessarily a genuine puzzle: it may be that the private business actor who stepped in as buyer to resolve the situation was colluding with the state officials responsible for the coercion, and that afterwards they intended to share the spoils. Alternatively, these cases may represent attempts at nationalisation that failed for one reason or another. But if the evidence does not bear out either of these explanations, then the cases may present a serious challenge to the view that such takeovers were the actions of predatory, kleptocratic state actors.

Accordingly, the thesis examines closely these and numerous other cases of state-led coercive takeover. It does so with *two* related central research questions in mind. Firstly, what was motivating the Russian state (or a particular group of state actors) to instigate such takeovers?

⁵ "The innocent westerner may ask how being on the board of a state company can bring the sort of wealth acquired by the Yeltsin-era 'oligarchs'. The question will be greeted with a pitying smile" (Hanson, 2007a, p. 881). The answer does not lie in dividends and official salaries, the details of which are publicly disclosed; it may instead lie in the relationships between a state-owned company and the suppliers and trading companies it favours.

⁶ Granted, in the Russneft' case, the original buyer, Oleg Deripaska, was not welcomed by some elements within the Kremlin. But, as will be explained in Chapter Two, the subsequent sale of Russneft' to *another* private businessman, Vladimir Yevtushenkov, brought an end to Russneft's problems with the authorities.

Secondly, what causal factors were determining whether such takeovers end with the target company being nationalised, or alternatively end with its transfer to a new private owner?

With respect to the first question, the task is to consider whether the evidence from these particular cases supports the view that state actors (in line with the “kleptocracy” hypothesis) were prompted by predatory and venal motives to instigate the takeovers, or whether an alternative hypothesis, which is elaborated below and is based on state actors having broadly “developmental” motives, fits better with the evidence.

Specifying and naming the domain of cases

Because the project asks the question of what the state was trying to achieve by forcing a change of ownership at particular privately-owned businesses, it requires a term to describe such takeovers that does not imply any preconceived ideas regarding the state’s motivations.

One term that is commonly used to describe coercive takeovers is “expropriation”. This term can be misleading, however, in that expropriation by the state implies taking an asset into state ownership or otherwise confiscating it for the material benefit of the public⁷. Moreover, its use in the political economy literature extends to cases where the property rights of a private business owner are attacked without the business itself changing hands, such as through arbitrary or excessive taxation⁸.

When coercion is used to deprive a private business owner of his assets without any suggestion that this has been done in favour of the state, and without even a pretence that this was done for the public good, then in the Russian context this is often labelled *reiderstvo*.

⁷ In the Shorter Oxford Dictionary, the first of three definitions given for “expropriate” is “take out of the owner’s hands, esp. for one’s own use; *spec.* (of a public authority) take away (land) for public use or benefit.”

⁸ e.g. Markus (2008, p. 75 fn. 3) defines expropriation as “the transfer of corporate value among stakeholders, which is (a) not consensual and (b) not transparent or generally applicable. Hence, contractual deals, or a universal application of a standard tax rate, do not count as ‘expropriation’; arbitrary applications of criminal law or ‘company-specific’ taxation do”.

Firestone (2008) defines *reiderstvo* in terms of three criteria: 1) it is illegal (and linked to organised crime), 2) it uses ostensibly legal means, and 3) unlike less “ambitious” protection racketeering, it seeks to take over an entire business rather than just a share of the profits⁹. By all accounts, *reiderstvo* is a widespread phenomenon which contributes to citizens’ insecurity regarding property rights. It commonly includes actual or threatened physical force, which during the 1990s typically provided by *private* (i.e. criminal) actors, but has since then increasingly been provided by state actors (Gans-Morse, 2011, 2012; Volkov, 2004). But such force is not always employed, and Firestone rightly excludes it as a defining characteristic of *reiderstvo*.

Both “expropriation” and *reiderstvo* are terms that imply actions intended to be for the material benefit of the state on the one hand, or of corrupt individuals on the other. Because the present thesis argues that other considerations are behind some of the state’s coercive takeovers, it requires a more neutral term to describe the phenomenon of interest. Furthermore, neither of the more commonly used terms have a scope that matches the present project’s specific focus on coercive takeovers in which the state plays a leading role. Hence the decision to use the more unwieldy but more exact term “state-led coercive takeover”. For ease of use, this term will henceforth be abbreviated to “SLCT”.

Figure 1 illustrates how the set of cases that can be correctly termed SLCTs relate to cases of “expropriation” and *reiderstvo*. The areas shaded blue are not the focus of this project (either they did not involve a change of controlling owner, or they did not involve the state). As the areas of intersection indicate, some SLCTs are simultaneously cases of *reiderstvo* (involving state agencies for the material benefit of certain predatory individuals) or expropriation (intent on boosting state revenues or otherwise citing the public good as justification). The domain of

⁹ While this definition is undoubtedly correct, its application in the Russian context is problematic. Deciding whether a specific takeover was “illegal” despite using “ostensibly legal means” is particularly difficult in a country whose legal system is subject to corrupt influence and influence from the executive. It is natural for the victims of takeovers to cry *reiderstvo* and for the media to use the term to sensationalise takeovers.

takeovers that qualify as SLCTs, and therefore as valid cases for study, is everything inside the orange circle. Depending on the answer to the first research question, cases will either fall inside the clear orange space (i.e. not explained by reference to the material gain of the state or individual state actors), or in one of the intersecting areas (which would indicate that they are *both* SLCTs and cases of expropriation or *reiderstvo*).

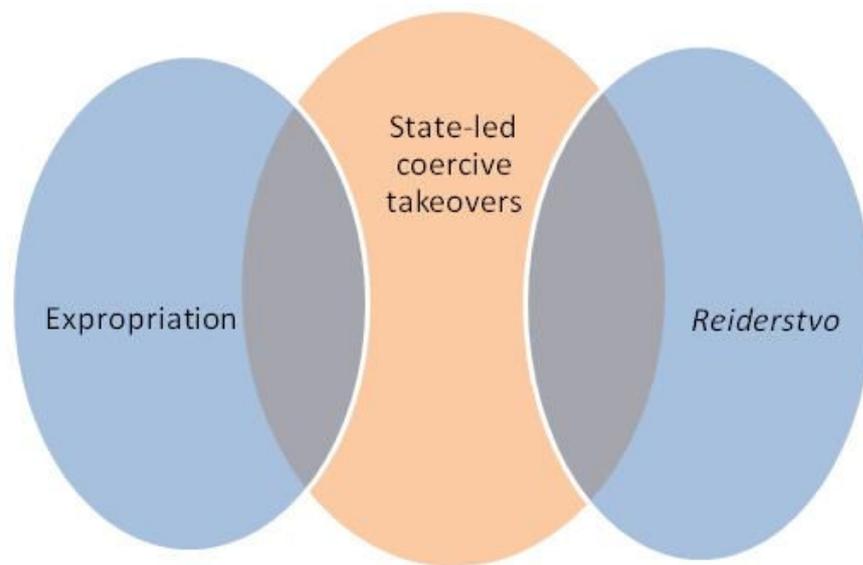


Figure 1. State-led coercive takeovers, expropriation and *reiderstvo*

Research question 1: what motivates state actors to instigate state-led coercive takeovers?

Although reinforced in the Russian case by considerable evidence of high-level corruption, the notion that state actors are inherently venal and predatory by nature, and that states make predatory interventions in the economy unless constrained or incentivised not to do so, is one that in any case has a strong tradition in the comparative political economy literature. The neoliberal strand of economics that rose to prominence in the late 1970s views interventions by the state as creating distortions in what would otherwise be a purely efficient, self-

regulating free market. Such distortions in turn are believed to generate rents¹⁰. As Evans (1995, p. 25) observes, the state is viewed in this literature as merely “an aggregation of individual maximizers”, and economic interventions are seen as deliberate attempts to distort the economy on the part of state actors keen to capture the ensuing rents, either for their own financial benefit or to buy support from constituents. The key to development, in this view, lies in reducing to a minimum the scope and scale of the state, and its ability to engage in inherently destructive economic intervention.

North (1990) sought to correct this reductive view of the state’s role by emphasizing the importance of institutions as “the underlying determinant of the long-run performance of economies”. He also noted that the state is needed as a third-party enforcer of contracts in the modern world’s increasingly impersonal markets. The starting-point for his theory of institutions is an attack on some of the assumptions of rational choice theory that are strongly associated with neoliberal economics: he says that individuals may be utility-maximisers, but they respond to their environment based on limited information, and consequently ideology and institutions are vitally important factors when modelling their behaviour and that of societies. Nevertheless, North displayed a continuing wariness regarding the state’s role in the economy: “if the state has coercive force, then those who run the state will use that force in their interest at the expense of the rest of society” (North, 1990, pp. 58–9). This is a reference to the “commitment problem”, which takes as its starting point the notion that “a government that is strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens” (Weingast, 1993, p. 287). Thus, although the “new institutionalist” school represented by North, Weingast and others saw a more extensive role for the state in the economy and society, it still saw the state as a serious threat to economic

¹⁰ For a thoughtful definition of the term “rent”, see Gaddy and Ickes (2010, pp. 310–311). They argue that, although the “textbook” definition equates rent with profit, corrections should be made in the Russian case because of two ways in which that country’s economy deviates from “an efficient market economy”: firstly, “resources are not used efficiently”, and secondly, production is for various reasons (including the prevalence of side-payments) more costly than in an efficient economy. Benchmarking Russia against an ideal-type efficient market economy is therefore central to their use of the term.

development. Unless the “commitment problem” was solved, the state would confiscate the wealth of its citizens through excessive taxation or asset seizure, either to raise state revenues (which are in turn required to sustain the incumbent regime), or for the greed of the ruler who makes no distinction between state revenues and his own wealth.

Various suggestions have been made as to how the “commitment problem” is solved in practice. Olson (1993) has argued that leaders of autocratic countries who feel secure enough in power behave like investors who enjoy long time-horizons. These wealth-maximising “stationary bandits” calibrate their stealing by setting taxation and expropriation at an optimal rate that still allows for economic development, thus yielding a higher overall income in the long term. The alternative “institutionalist” explanation (e.g. North & Weingast (1989), Weingast (1993)) involves “limited government” through a set of “coercion-constraining institutions” which ensure that the state’s predatory appetites (or those of individual state actors) are kept in check.

Haber, Razo and Maurer (2003) were (rightly, in this author’s view) dismissive of Olson’s explanation, in part because it is entirely based on what the “ruler” decides independently to do¹¹. Regarding the “limited government” explanation, they pointed out, firstly, that the number of countries where this can truly be said to pertain is small, and secondly, that the economic data do not confirm the negative correlation that is implied between political instability (i.e. the absence of limited government) and economic growth. They instead presented the model of “vertical political integration” (VPI) to explain how state predation might be kept in check and satisfactory rates of economic growth achieved in a country where property rights are fragile at best. Under VPI, authoritarian political leaders who are interested in economic development establish a narrow rent-seeking coalition with trusted business leaders so that the property rights of the latter are guaranteed, even if lawlessness and

¹¹ They also pointed out that Olson’s model implies that other factors (such as approaching old age or illness) would reduce time-horizons and prompt rulers to engage in a last-gasp frenzy of predatory activity.

predation dominate outside of this coalition. The fortunate few who are inside the coalition can then think with long time-horizons and invest accordingly, providing the impetus for economic growth. Notably, the VPI model retains the assumption that rulers are motivated to a large extent by harvesting rents (which they do in collusion with their business allies). The model therefore offers a different form of institutional solution (besides limited government) to the problem of wealth-maximising, predatory rulers and states.

What unites the literature discussed above is a narrow conception of the state's role in economic development. The extreme neoliberal view is that the state should be reduced as far as practicably possible, while the "new institutionalist" vision of the state extends only as far as submitting to institutional constraints on its own predatory appetites, providing some public goods such as national defence, protecting individual property rights from other (non-state) threats, enforcing contracts between private citizens and putting in place the appropriate institutions of a market economy. By contrast, the "developmental state" writers (e.g. Amsden, 1989; Evans, 1995; Johnson, 1982; Wade, 2004; Waldner, 1999) explore what types of active economic intervention by the state, and under what circumstances, have historically been successful in playing an instrumental role in economic development. They have been inspired by the work of Gerschenkron (1962), who argued that "late developing" countries would not be able to catch up with the economic performance of developed countries *unless* the state intervened, including by assuming the role of "investment banker" when insufficient private investment was forthcoming. Another inspiration is Polanyi, who argued that free markets were (contrary to the views expounded later by the neoliberals) in fact created and maintained through "continuous, centrally organized and controlled interventionism" by the state (Polanyi, 2001, p. 146). At the same time, the literature reflects an awareness that even good developmental intentions on the part of rulers can descend into kleptocracy when they translate into concrete policies and implementation. Following Weber, Evans argues that one crucial factor in determining whether states can translate development-minded policies into

successful outcomes is the quality of the bureaucracy. Success requires that the bureaucracy be united by a sense of corporate coherence, without which bureaucrats will behave much as the uncoordinated group of venal interest-maximisers envisaged by neoliberals (Evans, 1995, p. 28).

Rent-seeking, kleptocracy and the “sovereign development” hypothesis

Given the corruption that has been discussed above, it is perhaps not surprising that the literature on business-state relations in Russia has mainly favoured explanations based on kleptocracy and rent-seeking. The Yeltsin-era state is said to have been “captured” by the vested interests of big business, which preferred to block further economic reforms so that they could maximise the rents they were enjoying under “partial reform equilibrium” (Hellman, Jones, & Kaufmann, 2003; Hellman, 1998)¹². The Putin regime is seen as having been able (through demonstrative actions against big business, most notably its crackdown on Yukos) to put big business back into a subordinate position vis-à-vis the state. But the result was simply “state recapture” by a new set of rent-seekers (Podplatinik, 2005). The “oligarchs” are described as having been supplanted by the new *siloviki*¹³-oligarchs or “silovarchs” (Treisman, 2007), as well as some St Petersburg-based businessmen from civilian life who are commonly referred to as “Putin’s friends” (Partiya Narodnoi Svobody, 2011). According to Gaddy and Ickes (2010), Putin has put in place a management system to maintain, secure and distribute the rents from oil and gas, to which the economy remains addicted; this rent management system, also known as “Putin’s Protection Racket”, is “key to the entire political economy”¹⁴. If not a “protection racket”, then the new system is seen as a more-or-less exact

¹² See also Aslund’s description of Russia as one of the “outstanding examples” of the “rent-seeking state” in the post-Communist region (Aslund, 2002, p. 3).

¹³ The term used to describe Russians with a background in the security services, armed forces or law enforcement.

¹⁴ See also Holmberg (2008), Rochlitz (2010) and Wilson (2012).

analogue of the aforementioned VPI model based on rent-seeking (Volkov, 2010). Alternatively, Putin is thought to be hostage to rival rent-seeking factions, and survives in office only by deftly maintaining the balance of power between them (Mehdi & Yenikieff, 2013).

Crucially, however, widespread corruption does not negate the possibility that the state apparatus contains within it a group of individuals who seek development and take active steps in pursuit of it with the approval of the head of state. As Leftwich notes, “The politics of transition in some developmental states have displayed extraordinary mixtures of patrimonialism, centralisation, technocratic economic management, coercion and corruption” (Leftwich, 1995, p. 407). Markus (2007, p. 290) suggests a way to reconcile the co-existence in Russia of predatory corruption and some genuine efforts in pursuit of economic development: there is a lack of coordination between individual government departments, each of which may be variously predatory or developmental and may change their stance over time. But the present author would argue that corruption and the pursuit of development are not mutually exclusive opposites even at the level of the individual state official. Olson’s “stationary bandits” and other models based on wealth-maximising state actors provide a crude caricature of how individuals make choices and rationalise and justify those choices. The same can be said of the aforementioned description by Bill Browder of Putin and his associates as “not in their job for the execution of public service; their job is to steal money”. Olivier De Sardan (1999, pp. 34–35) has observed that “the practices that come under the complex of corruption, while being legally culpable and widely reproved, are none the less considered by their perpetrators as being legitimate, and often as not being corruption at all [...] In one sense, ‘corruption is someone else’ [...] Whoever practices corruption auto-legitimises his own behaviour, by presenting himself, for example, as the victim of a system in which he is bound to this kind of practice [...] And at any rate, doesn’t everyone do it?”. Thus it is possible for lofty ideals of altruism and patriotism to coexist comfortably with

corrupt behaviour inside the minds of those who practice such behaviour. Corrupt behaviour certainly undermines and at times will negate the positive effect of any action taken in pursuit of economic development. But this does not mean that any talk of developmental goals on the part of such officials is nothing more than a smoke-screen for their true, thieving nature. In making this point, the present author does not in any way intend to justify corruption or act as an apologist for the Yukos affair or other excesses of the Putin regime. But an undue focus on rent-seeking as the central motive of state actors risks obscuring our understanding of how and why states attempt to shape economic processes.

There have without doubt been many cases in recent years where the Russian state's coercive resources have been effectively "hired" by private predators in order to take over business assets. State officials sometimes also initiate such takeovers themselves in order to materially benefit from it, either by taking ownership or by some other means (Gans-Morse, 2012). However, it is argued in the following chapters that the case studies therein demand an alternative explanation.

The literature of the "developmental state" provides a promising analytical framework for such an alternative approach, as it allows for the possibility that factors other than rent-seeking can influence state policies and their outcomes. The suggestion that Russia might be a form of "developmental state", rather than a kleptocracy, is a minority view, but it is one that has gained ground in recent years (Barnes, 2006b; Markus, 2007; Wengle, 2012). For instance, Barnes describes Putin as an "economic nationalist" who does not seek "the passive sort of integration into the global economy that too many policymakers and journalists (and not a few scholars) seem to expect"¹⁵. Putin is in Barnes's view a (probably unconscious)

¹⁵ cf. Olcott's view that Putin "does not believe in relying on global market forces to provide the economic opportunities and social supports necessary for the Russian people to make a successful transition from communist rule to a modern, European-style economy and political system. Instead, he believes that premature globalization of the Russian economy will lead to greater hardship for the majority of Russian people and that it will lead to the concentration of vast wealth in a relatively limited number of hands of people with little or no incentive to reinvest in the Russian economy" (Olcott, 2004, p. 16).

follower of Gerschenkron, Hamilton and Baldwin. He believes that “private businesses can be an important part of Russia’s development”, but his support for private business actors is conditional on their participating in his *dirigiste* plan to achieve economic growth and international influence. If they actively undermine this plan, they can expect to meet a fate similar to that of Khodorkovsky and Yukos.

Analysts who argue that the Putin regime has any genuine developmental ambitions still need to explain away the apparently negative implications of expanding state ownership for economic performance, and the undoubted impact on investor sentiment of shocking and legally dubious state “expropriations” of private businesses. Wengle (2012) stresses that the Russian state under Putin began its developmental push with certain significant disadvantages over the Asian and Latin American countries that are held up as successful examples of state-led development. Firstly, Russia had to tackle simultaneously the “fragmentation of state sovereignty” that resulted from the collapse of the Soviet Union approximately a decade earlier. Secondly, it had negligible prior experience in its role as regulator of a market economy, and the requisite institutions had to be created from scratch. Thirdly, while other “developmental states” began as largely agrarian economies and pursued *de novo* industrialisation, Russia inherited a huge Soviet industrial legacy, much of which, for geographical and/or technological reasons, was unable to adjust overnight to market conditions.

Wengle’s point is that these initial conditions make the task of state-led development particularly complicated in the Russian case. Many of the same initial conditions are cited by Tompson (2008) as factors explaining the expansion of state ownership in the 2000s. State ownership, in his view, was used as a developmental tool by a state that was struggling to achieve its goals through indirect methods such as regulation. Acquisitions by state-owned companies were in part used to correct ‘market failure’, some of which was down to the inability of inherited Soviet enterprises to adjust to market conditions. And state ownership

was also a response to the perceived political threat from the ‘oligarchs’, the source of whose political power was the highly concentrated ownership of industrial assets, which had in turn arisen from the Soviet industrial legacy and the way this was privatised in the 1990s. Tompson notes that the state possessed both money and coercive power, and accordingly the expansion of state ownership had taken place both through voluntary sales and coercive takeovers. It is therefore all the more significant to point out that not all of the coercive takeovers have had nationalising outcomes: engineering the transfer of a privately-owned business to a new, less threatening private owner has been an alternative response to the same factors which Tompson sees as leading only to state ownership. Thus both nationalisation and coercive takeover, despite their negative direct impact on the economy, can be consistent with developmental motives in the specific circumstances of post-Soviet Russia.

The rhetoric of Russia’s state actors supports the hypothesis that they perceived Russia’s sovereignty to be fragile, viewed this as of direct relevance to economic policymaking and treated powerful business interests inside the country as one of the principal threats to that sovereignty¹⁶. In his 2004 presidential address to parliament, Putin stated that “in the last decade of the last century – in conditions of a destroyed economy and lost positions on world markets – Russia was obliged to restore its statehood and create a market economy that was new to us” (Chadaev, 2006, pp. 151–152). At the same event a year later, he called the collapse of the USSR at the end of 1991 “the largest geopolitical catastrophe of the century” and noted that the “epidemic of collapse extended to Russia itself” in the 1990s, posing a threat to the country’s territorial integrity (Putin, 2005). These concerns were echoed by Putin’s influential deputy chief of staff Vladislav Surkov in a 2005 speech to the business association *Delovaya Rossiya* (Sokolov, 2005). He noted that globalisation was making the term “sovereignty” look old-fashioned, but that people were deluding themselves if they

¹⁶ cf. Krasner’s (1999, p. 4) definition of “domestic sovereignty” as “the formal organization of political authority within the state and the ability of the public authorities to exercise effective control within the borders of their own polity”.

thought that this meant sovereignty could be ignored. Many of the threats to sovereignty that he listed (including terrorism and the alleged role of the United States in Ukraine's Orange Revolution) were not economic in nature. But he implied that sovereignty was the principal reason for the Yukos affair, saying that "we will not allow a small group of companies to be the centre of power [*vlast*'] in our country". And he argued that "concern for sovereignty entails certain economic restrictions [...] we see that national capital must either be in control or dominate in certain sectors." In an article on economic issues published in the run-up to the 2012 presidential elections, Putin wrote that "at the very beginning of my first presidential term we encountered persistent attempts to sell key assets into foreign hands. The preservation of strategic resources in the private hands of a few individuals meant that in the next five to ten years control of our economy would be exercised from outside" (Putin, 2012).

The same arguments have been made by Surkov and others in defence of what they term "sovereign democracy". Ostensibly a brand of democracy intended for Russia's specific conditions of fragile sovereignty, "sovereign democracy" has rightly been dismissed as little more than the illusion of democracy (Wilson, 2005). What the present author would call "sovereign development", i.e. the Russian political leadership's pursuit of economic development in the specific conditions of fragile sovereignty, is quite different in that development is a genuine aim, for the sole reason that it enhances the power and prestige of the Russian state. But when a state is less than confident of its ability to exercise effective control within its own borders, and sees politically powerful economic actors ("oligarchs") as one of the groups undermining such control, its developmental task is considerably more complex and fraught with conflict. Relying on privately-owned businesses as agents of development would risk augmenting their power further and worsening the perceived threat to sovereignty. The Russian developmental state was following two vectors: the strengthening of state sovereignty and state capacity on the one hand, and the pursuit of economic growth on the other. Occasionally, as when big business began to involve itself directly in policymaking

areas normally reserved for the state, these two vectors pulled in opposite directions. State actors could then justify the seizure of Yukos (at least in their own minds), even if the impact on overall economic development was likely to be negative (and was certain to be negative in the short-term). As Tompson (2008, pp. 6–7) notes, state ownership presented an appealing option, despite the likelihood that it would lead to inferior economic performance, because of the apparent political threat posed by domestic and foreign private capital. But while simplistic models of interest-maximising state actors stress the importance of threats to *incumbency*, the political threat posed by private capital to the Putin regime exclusively related to diminished *sovereignty* rather than any credible danger that Putin would be unseated¹⁷.

The Soviet-era industrial legacy also contributed towards making Russia's "developmental state" necessarily different in nature from its more successful counterparts. The latter have tended to focus on a few sectors that, with the right kind of targeted state assistance, are believed to hold the greatest potential to provide a major developmental breakthrough (Evans, 1995, p. 58). Because many of Russia's inherited industrial enterprises were both vast and located in towns where there was no other significant source of employment, simply giving them up to the forces of creative destruction would have had negative social consequences that even an authoritarian leadership ignored at their peril. But if a concern for the welfare of citizens will seem to some observers an unlikely motivation for Russia's state actors, there were also pressing technical reasons why allowing much of the Soviet industrial legacy to fail would have had dire consequences. As Wengle (2012, p. 104) notes, "While the Russian state promotes nanotechnology and seeks to create high-tech industrial clusters that imitate Silicon Valley, its development strategy cannot afford to lose track of infrastructure and other sectors that form the backbone of regional economies". The preoccupation with sovereignty included concerns regarding *technological* sovereignty, i.e. an unwillingness to permit the collapse of

¹⁷ See Chapter Two for an elaboration of this argument.

strategically-important domestic industries because this would mean an unacceptable level of economic dependence on trade with foreign partners¹⁸. The SLCT and nationalisation of the giant Soviet-era car plant AvtoVAZ at the end of 2005 (Fedorinova & Stolyarov, 2006) was almost certainly driven by an unwillingness to see an end to Russia's history of truly domestic automobile production on the one hand, and concern on the other hand that the plant's collapse would have serious social consequences in the local town of Togliatti and the surrounding Samara region. Chapters Three and Four include additional cases where such considerations, if they were not the primary factor behind the decision to instigate the SLCT, certainly affected how the state and its allies managed the assets *after* they had taken control. Indeed, the way these assets were managed by the new owners provides powerful supporting evidence of the underlying developmental motives. When rent-seeking motives are central to coercive takeovers, one expects the new owners to engage in asset-stripping, or at best (if they feel secure enough to think in terms of long time-horizons) to invest in their acquisitions only insofar as it makes commercial sense to do so. Chapters Three and Four include cases where the new owners, by contrast, chose and invested in their acquisitions in ways that at times defied commercial logic, continuing to search for ways to keep the companies alive when they looked increasingly unviable¹⁹.

Although the above structural factors go some way towards explaining why the Putin regime pursued "sovereign development", it would be wrong to portray the latter as merely a spontaneous and unmediated reaction to objective conditions. As North (1990, p. 17) observed, "individuals make choices based on subjectively derived models that diverge among individuals and the information the actors receive is so incomplete that in most cases these

¹⁸ As discussed in Chapter Four, the preoccupation with "technical sovereignty" and the economic rationale behind it was made explicit in a 2010 government strategy document regarding the need to preserve the country's heavy engineering capability.

¹⁹ See, in particular, Gazprom's decision to take over the entirety of Zapsibgazprom (Chapter Three) despite the fact that the only asset of value was the gas field licence which it no longer owned; and Gazprombank's continuing to lend to OMZ (Chapter Four) after serious doubts had arisen as to its ability to continue as a going concern.

divergent subjective models show no tendency to converge.” What mattered more than the objective threats to sovereignty were the subjective *perceptions* of those threats on the part of state actors. These are mediated by ideology, and it is likely that the security service backgrounds of Putin and many of his associates gave rise to an exaggerated sensitivity to perceived threats to sovereignty and national security²⁰. However, Putin’s speeches and writings also contained indications that he sympathised with more liberal conceptions of economic development. The increasing role of the state in the economy “was nowhere and never announced openly—and it could not have been announced alongside declarations made about moving onwards to a competitive market economy, de-bureaucratisation and administrative reform” (Radygin, 2008). In the aforementioned 2012 article on the economy, Putin *did* talk openly of the importance of the newly-created state corporations²¹, and of targeting certain promising sectors for state-led development (“are we prepared to put Russia’s future at such great risk for the sake of the purity of economic theory?”); but at the same time he denied that such policies amounted to “state capitalism” and pledged to reduce the state’s presence in numerous sectors. This is typically taken as a sign that Putin’s speeches (as well as his decisions on appointments relevant to economic policy) sought to maintain and reflect the balance of power between the “liberal” and “siloviki” factions. But it could equally well reflect his ambivalent attitude towards the appropriate role of the state in economic development: on the one hand, a belief that state intervention was a necessary corrective to the negative effects more liberal economic policies would have on Russia’s fragile sovereignty, and on the other, support for greater liberalisation as an engine of economic growth.

²⁰ For anecdotal evidence of this mindset, see the remarks made by Vladimir Yakunin, a close associate of Putin’s, former diplomat and head of state-owned Russian Railways, to the effect that the overthrow of Ukrainian President Viktor Yanukovich in February 2014 was the work of a “global financial oligarchy” aimed at destroying Russia as a geopolitical opponent (Belton, 2014). See also the discussion of the *siloviki* world-view in Kryshchanovskaya and White (2005, pp. 1071–4).

²¹ For a discussion of the state corporations and their significance, see Volkov (2008b).

Research question 2: ownership outcome of state-led coercive takeovers

As noted earlier, the fact that two of Russia's recent SLCTs (at Russneft' and Bashneft') did *not* result in nationalisation does not on its own negate the possibility that rent-seeking motivates state actors to instigate such takeovers. It does, however, suggest the need for further investigation in order to understand exactly what led to these non-nationalising outcomes.

An alternative explanation starts with the explanation given by Tompson (2008) for the expansion of state ownership in Putin's Russia. As noted earlier, Tompson sees state ownership as a developmental response to the particular conditions Russia found itself in at the beginning of Putin's first presidency, but also as the only option that remains when the state no longer trusts foreign capital or domestic private capital. He also believes that rent-seeking forms part of the explanation, noting that the developmental motive "dovetails" neatly with the effect of providing patronage opportunities for the elite.

Hanson (2009) was the first to note (with Russneft' as his main example) that some SLCTs have private ownership outcomes, and to discuss the implications of such outcomes for our understanding of the trend towards greater state ownership. Going back to first principles, he breaks down the possible motivations of state actors engaging in "micro-targeted state interventions" into 1) the pursuit of economic growth, 2) neutralising threats to their power, and 3) self-enrichment. He suggests that, at least for the oil industry, Russian state actors are likely to be driven by a combination of the two self-interested motivations rather than economic development. For either of these motivations, state-owned and privately-owned companies are, in his view, of roughly equivalent value: the rent-seeking potential in private

companies is approximately the same as for state-owned companies²², and if the state actors are instead in the business of undermining potential political adversaries, then this can be achieved without the need for nationalisation.

Hanson does not, however, offer an explanation that would help us to answer the second research question of the thesis, i.e. to understand what causal factors determine whether a particular SLCT results in nationalisation, transfer to a new private owner, or some kind of half-way “quasi-state” ownership. For the purposes of this second research question, the dependent variable “ownership outcome” is operationalised along similar lines to the approach taken by Pappe and Galukhina (2009, p. 162). “State ownership” of a business is defined as possession of a majority of voting shares in that business²³. Importantly, the state can own these shares either directly, or indirectly via entities that it controls on the same basis. For example, if the state directly owns a majority of the voting shares in a company, and that company then buys a majority voting stake in a previously privately-owned business, that business is itself considered to have been transferred to state ownership²⁴.

Correspondingly, “private ownership” of a business is defined as a situation where no state ownership pertains. Thus even if no individual private actor controls a majority of shares in a company, it is still considered to be under “private ownership” if there is no majority state ownership.

Between these two outcomes there are also situations where a company is only *de facto* under state control, i.e. where state control pertains despite the absence of a formal majority voting stake. For example, Chapter Three discusses the situation at Gazprom in the early 2000s,

²² Hanson cites the example of Leonid Reiman, who while serving as Russia’s Telecoms Minister is alleged to have been the hidden beneficial owner of a Bermuda-registered company which held stakes in two of Russia’s three main mobile operators.

²³ Also under “state ownership” are those state-owned enterprises that have not issued shares (e.g. the Russian legal form state unitary enterprise, or GUP). But since the companies discussed in this thesis are primarily joint-stock companies, the emphasis is on control through possession of voting shares.

²⁴ Also in common with Pappe and Galukhina, the term “nationalisation” is used to describe this transfer into state ownership, irrespective of how it is brought about.

where the state did not control a majority of voting shares in the company but was able to cobble one together through *ad hoc* agreements with other shareholders. The state was unhappy with this situation, and went to considerable effort to increase its stake to above 50%. The fact that it saw this as so important underlines the extent to which voting control is crucial in Russian corporate governance, and hence the appropriateness of voting control as the criterion for operationalising ownership outcomes.

Towards a theory of the ownership outcomes

Four Russian experts—Pappe and Galukhina (2009, pp. 161–5) and Radygin and Mal’ginov (2006)—have compiled a set of considerations that might prompt a particular company to be taken into state ownership. These can be synthesised as follows:

- 1) a government-level decision that a certain enterprise or sector should be state-dominated, either
 - a) in order to simplify the task of administration in that sector and the wider economy,
 - or
 - b) to protect the enterprise or sector (and that section of society which is particularly dependent on it) from global competition or market failure, or
 - c) to capture for the state the “rents” from that enterprise or sector, or
 - d) for reasons of national security;
- 2) a decision taken at the level of the state-owned company, acting on purely commercial considerations. This can be at the state-owned company’s initiative (with the existing owner either cooperating or resisting) or at the seller’s initiative.

The above framework applies to any M&A activity, however. In the specific context of SLCTs, the likelihood is reduced that they have been undertaken for purely commercial considerations at the initiative of a state-owned company, though that is still possible in principle. All of the proposed explanations in the above framework assume that nationalisation was the intended outcome of the takeover. How to incorporate private ownership outcomes into the model, to arrive at an explanation that helps predict which outcome will result from a particular SLCT?

In the cases studied in Chapter Two, it is argued that the primary concern of the state was to deprive the existing owners of their assets: whether those assets were transferred to state or private hands was a matter of secondary importance. Understanding which of these outcomes resulted starts with viewing the takeover process in SLCTs as a form of bargaining game.

The Yukos affair involved the full-scale use of the state's coercive resources to effectively seize the company and pursue criminal convictions against a large number of shareholders, managers and other associated individuals. Although there have been many "mini-Yukos" cases subsequently, and some similar cases came before it, the scale of the coercive operation against Yukos has not come close to being repeated in any other case. All of the case studies in the following chapters have one important element in common that promises to explain why the Yukos affair has not been repeated: they all (including Yukos) saw the state first making an offer to end the coercion if the existing owner agreed to sell.

What prompted the state to first make such a "carrot-and-stick" offer²⁵, instead of simply seizing the companies from the outset, was the fact that full-scale coercive methods are a substantial drain on bureaucratic resources. As the discussion of the Yukos affair in Chapter Two will demonstrate, they involve coordination across government departments and coercive agencies, and large teams of lawyers and accountants.

²⁵ For the use of the term "carrot-and-stick" in bargaining in an international relations context, see Greffenius and Gill (1992).

The case studies will also highlight significant institutional constraints that mean SLCTs are not just a one-way trampling of private business owners' property rights by the state. Various legal and institutional factors, both domestic and international in nature, provide business owners with important defensive tactics. These tactics may not prevent a determined state from pursuing full-scale asset seizure once it has resolved to do so. But they offer a way to increase the costs of such an approach, and to reduce the material benefits to the state; as a result, they contribute to the state's preference for a negotiated solution, which gives the targeted business owner the opportunity to bargain for a less-bad outcome.

One such defensive tactic, which plays a part in many of the case studies, is the internationalisation of the targeted business. Within Russia's jurisdiction, corners can be cut by the state: judges ordered to hand down a certain verdict, defence lawyers intimidated, criminal charges fabricated and assets physically seized. If a company has offshore ownership and an international banking infrastructure, it can move to transfer a large proportion of the business's value out of the reach of the Russian state (if it was ever physically located inside Russia's borders in the first place). If the state wants to pursue international asset seizures through the courts, it can no longer rely on fabricating the charges that form the legal basis for such seizures. The state's own international assets become vulnerable to legal counter-claims brought by the business owner.

The existing literature indicates that Russian companies defend their property rights from expropriation by enlisting foreign minority shareholders who can apply pressure on the government at the diplomatic level (Markus, 2008), forming horizontal alliances through business organisations (Markus, 2007), or investing in public goods to increase the reputational costs to the state if it decides to "expropriate" (Frye, 2006). But the internationalisation and offshoring of ownership and financial flows is arguably far more important as a defensive tactic. The case studies will also show, however, that it is not just international exposure that constrains the behaviour of the state actors involved in SLCTs:

significant domestic legal and institutional factors also shape the specific ownership outcomes of the cases.

Figure 2 represents the takeover process as a bargaining game between state and existing owner. With the carrot-and-stick offer as the starting point, the numbers represent the payoffs to the business owner (the first number of each pair) and the state (the second number of each pair). The number 3 represents the optimal outcome.

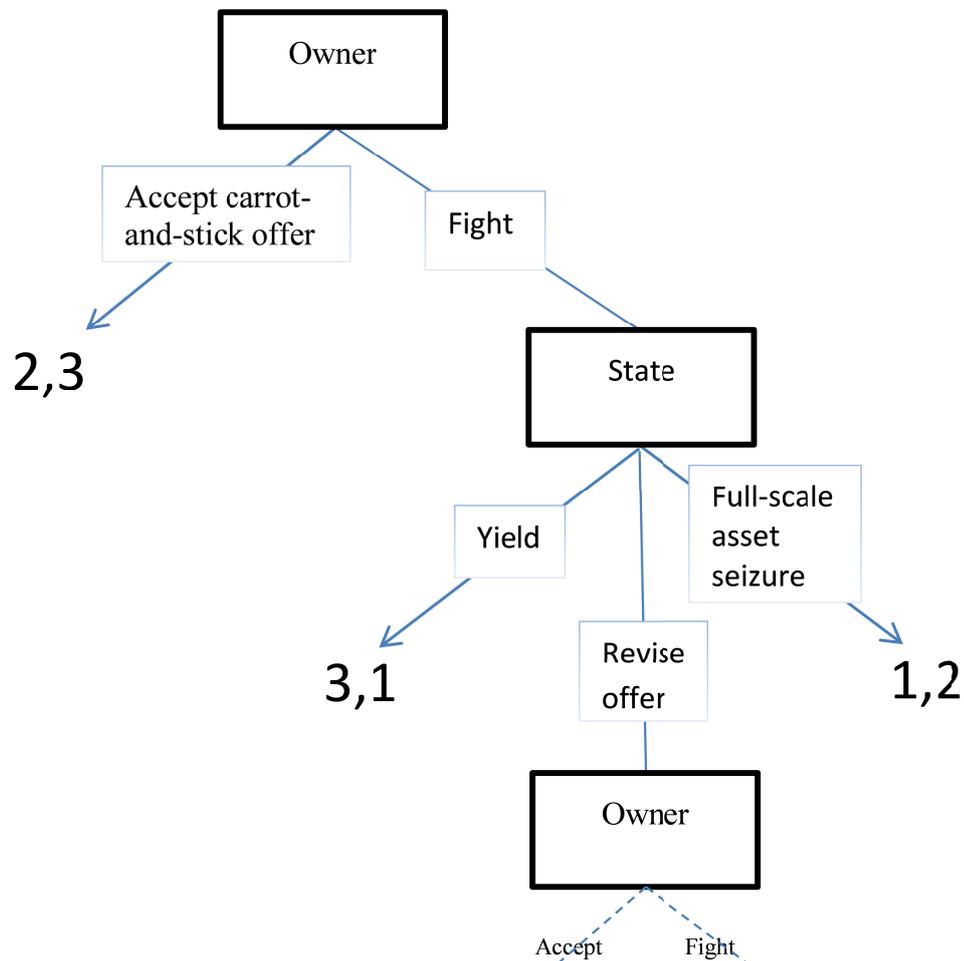


Figure 2. The takeover as bargaining game

It should be stressed that this is intended not as a formal model to be solved by backward induction, but rather as an illustration of the bargaining process involved²⁶. As discussed earlier, the basic payoffs given above are altered in practice by defensive tactics available to the existing owners, and by certain institutional constraints on the state's ability to seize assets at will. The case of Bashneft', where the bargaining process dragged on for many years, will highlight the fact that the state is not forced to choose immediately between full-scale asset seizure and abandoning the takeover when faced with a recalcitrant owner: it can choose instead to restart the process on the basis of a revised offer.

Some SLCTs will undoubtedly take place with a specific ownership outcome (e.g. state ownership, or even ownership by a specific state-owned company) in mind. But others may not, and it is suggested that the cases in Chapter Two are among them. Either way, the argument is that the ownership outcome is affected by the outcome of the takeover as bargaining game, as follows:

- 1) If the state pursues full-scale asset seizure following refusal of the carrot-and-stick offer, then nationalisation is likely to result.
- 2) Acceptance of the carrot-and-stick offer can lead to either ownership outcome, depending on which kinds of company have the means and appetite to make the acquisition. However, private buyers can be favoured because they can act as intermediaries between state and existing owner, thereby increasing the likelihood of the negotiated solution that the state prefers.

The review of the thesis structure, at the end of this introductory chapter, shows how this argument is developed and justified over the course of the case studies that follow.

²⁶ cf. Przeworski (1991) for similar use of game trees to illustrate interactions without subscribing fully to formal game theory models.

Do institutions constrain state coercion in Russia?

Categorising Russia as a kleptocracy implies not only that state actors are intent on stealing from citizens, but that there are few or no meaningful constraints on their doing so. As mentioned earlier, the central argument of the “commitment problem” literature is that states that are strong enough to *protect* property rights are also strong enough to *attack* them, unless there are “coercion-constraining institutions” in place to keep state predation in check. In the cases that follow, this central argument of the “commitment problem” still pertains, despite the fact that the state is shown to be attacking property rights for reasons other than self-enrichment or self-aggrandisement.

Frye (2004) notes that “we have little knowledge about which specific institutions are especially important” in ensuring the security of property rights. From his survey of Russian businesses aimed at addressing this problem, he concludes that the state is a major threat to property rights, and that the main coercion-constraining institution (or set of institutions) required to address this problem is a legal system and judiciary that is independent of the executive.

The term “telephone law” (or “telephone justice”) is commonly used to describe how Russia’s political leadership can influence the outcomes of court cases, by issuing direct or indirect instructions to judges (e.g. Hendley, 2009; Ledeneva, 2008). “Telephone justice”, then, denotes the lack of independence of the legal system from the executive, i.e. the absence of the main set of institutions necessary to prevent attacks by the state on property rights. But while there is consensus among scholars that “telephone justice” is an important characteristic of Russia’s legal system, there is an ongoing debate regarding whether the entire system can be dismissed as having no independence from the executive. Ledeneva (2008, 2011) uses survey evidence to support her claim that “telephone justice” best characterises the

relationship between the executive and the legal system²⁷. However, she also calls for further research to be undertaken before this can be confirmed. Hendley (2006, 2009) does not dispute the existence of “telephone justice” and cites the Yukos affair as the most infamous example; but importantly, she argues that there is a functioning legal system operating in parallel that is free from political influence. She notes that this was the case even in Soviet times, but also that there has been considerable progress in post-Soviet Russia in some areas of the law. She therefore describes Russia’s legal system as ‘dualistic’, arguing that it is “better seen as an equilibrium that somehow balances ‘rule by law’ and ‘rule of law’” (Hendley, 2009). Hendley has also offered the most plausible explanation for how these two contrasting legal domains coexist in one jurisdiction: while ‘telephone justice’ holds sway in cases where the Kremlin or regional leaders have taken a specific interest in the outcome, outside that sphere the courts operate with a reasonable degree of professionalism and largely free from political influence²⁸.

The Yukos affair is rightly cited as an example that confirms the lack of adequate constraints on the Russian state’s ability to attack property rights through “the selective enforcement of laws and the arbitrary use of state power” (Frye, 2004, p. 455 fn. 3). Indeed, in none of the cases that follow is the state *prevented* by institutions from applying arbitrary coercion in the first instance (if there were no state coercion involved, the takeovers would not qualify as cases). However, as the discussion in the previous section suggests and the case studies will demonstrate, legal considerations featured heavily in influencing the Russian state’s preference for a negotiated outcome over full-scale coercive seizure. In other words, there *are*

²⁷ Ledeneva defines telephone justice as “the practice of making an informal command, request, or signal in order to influence formal procedures or decision-making”. While ‘corruption’ implies that decision-makers are given monetary incentives to act in a particular way; ‘telephone justice’ uses other means of influence, such as threatening to damage the decision-maker’s career prospects if they fail to act in a particular way.

²⁸ Hendley also portrays Russians as ‘savvy consumers’ who instinctively understand which kinds of legal dispute can be taken to court with the expectation of a fair trial, and conversely which will never receive a fair trial because of the powerful interests they would be up against (Hendley, 2009). Hendley (2012, p. 169) notes that “not only has the Kremlin used the courts to go after its enemies, but it has looked the other way when regional leaders have done the same.”

constraints on the state's appetite for coercive seizure of assets, and this helps to improve the outcome for the existing owner who is targeted for SLCT. The finding that not all of these constraints are international in nature supports Hendley's argument that some progress has been made towards "rule of law" in Russia. Chapter 5 will return to this topic and discuss how the case studies add to an understanding of where the dividing line runs between "rule of law" and "telephone justice" in Russia.

Method

The two research questions require a method which makes it possible to discern the motivations and decision-making processes that prompt state actors to instigate SLCTs, and the motivations and institutional constraints which determine the ownership outcomes of those takeovers. As a result, they do not lend themselves to quantitative methods, which tend to treat as a "black box" the decision-making processes of individuals and organisations that lie between the inputs and outputs of social phenomena (George & McKeown, 1985, p. 41). Furthermore, it will become clear from the case studies that attempts to determine the value of the dependent variable for a particular takeover can be fraught with difficulty: for example, in Chapter Four, extensive investigation is required in order to establish who owned the company OMZ after the coercive takeover, and what relationship that owner had to the state. The new beneficial owner went to considerable lengths to keep its identity secret. Through careful research it is possible to identify this buyer, but it then emerges that the entity in question is of a kind that has no owners according to Russian law. It becomes necessary to engage in what might be dismissed as "Kremlinology" in order to choose between the two opposing theories in Russia's media and expert commentary concerning whether this mysterious entity had effectively been 'privatised' in favour of a business actor linked to Putin, or was in fact still under the management control of state-owned Gazprom. The difficulty in establishing the value of the dependent variable of individual cases poses an

insurmountable challenge to any researcher attempting to apply quantitative methods to answer the research question regarding the ownership outcome.

Process-tracing offers an approach that enables the researcher to tackle complex reality at a granular (rather than abstracted) level, while still aspiring to scientific validity. As George and McKeown (1985, p. 24) point out, process-tracing is distinct from quasi-experimental methods in that it allows for theory *formation* as well as theory testing (whereas statistical analysis is reserved for the latter). It is therefore an appropriate choice for research questions that begin, as this project began, without a clear hypothesis (besides a suspicion that theories based on rent-seeking and kleptocracy were inadequate for the purposes of explaining the cases).

Gerring (2006, p. 185) suggests that it may not be appropriate to describe process-tracing as a scientific method, because “it may be impossible to arrive at a set of standardized methodological rules”. But he argues that with sufficient documentation, process-tracing accounts become verifiable “by those intimately familiar with that region, policy area, or historical era”. Accordingly, the case studies that follow take seriously the need to cite evidence for every substantial assertion that is made, and to note any concerns when the evidence that has been found is not enough to be entirely confident of the assertion. What kind of data sources are used as evidence is discussed in the following section.

Various scholars (George & McKeown, 1985; Hall, 2003; Van Evera, 1997) have made significant contributions towards the formation of an appropriately scientific and standardised approach to process-tracing. In addition to the emphasis on documentation, the present author has sought to heed the following guidelines aimed at making the process-tracing approach as robust as possible:

- In order to deflect criticism that process-tracing is indistinguishable from historical narrative, “description must be combined with some making, testing or application of a theory” (Van Evera, 1997, p. 53).
- Explicitly stating a causal hypothesis, then systematically checking whether or not the case evidence derived from the data sources is consistent with that hypothesis. Thereby checking each of the several links in the chain of cause and effect that goes to make up the causal explanation. Seeing whether the statements public and private made by actors are in line with the “image of the world implied by each theory” (Hall, 2003; Van Evera, 1997).
- Crucially, considering also whether the case evidence fits better with alternative hypotheses.
- Use of counterfactuals to gain explanatory leverage (Fearon, 1991; Gerring, 2006, p. 182)²⁹.
- Ensuring that theories derived from process-tracing are simple enough to be easily “arrow-diagrammed”. If this cannot be done, the theory itself is likely to be too “muddy” (Van Evera, 1997).

Much of the criticism of small-n, case study methods holds true only when those methods are used to make inferences that are widely generalizable. As Hall (2003) notes, “if we see the central enterprise of social science, not as one of finding correlations between an outcome and a few independent variables, but as the more central one of devising and testing causal theories, small-n comparison and single case-studies constitute viable research designs with important roles to play in causal inference.”

²⁹ This technique proved particularly useful in developing explanations for the ownership outcomes in Chapter Two.

The task of answering the first research question (the motivations behind the takeovers) is not to develop a general theory explaining the causes of SLCT in Russia. Instead, the goal is to demonstrate that *some* SLCTs cannot be explained by reference to rent-seeking and kleptocracy (i.e. do not fall inside the intersecting areas of the venn diagram in Figure 1), and to test the alternative (“sovereign development”) hypothesis for these cases. It may be that only a handful of relatively high-profile cases are better explained in this way, while a much larger number of smaller-scale cases are better explained as *reiderstvo*³⁰. It would be unsurprising if the finite capacities of the state limited its interest in changing ownership at particular businesses to those which are of special political or economic significance.

Gans-Morse (2012, p. 264) focuses instead on a much larger domain of threats posed by state actors to “ordinary, non-oligarchic firms”, and argues that the focus on higher-profile cases offers a skewed and unrepresentative portrayal of modern-day Russian business practices. The aim of this thesis, however, is not to portray such business practices, but to gain insight into the reasons for, and methods of, the Russian state’s interventions in the economy. The high-profile cases chosen for examination are of significant inherent interest from this perspective, as well as arguing against the use of rent-seeking as the primary analytical framework for explaining economic interventions by states.

With regard to the second research question (the ownership outcomes of SLCTs), the project *does* seek to provide an explanatory theory that accounts for the variance in the “ownership outcome” dependent variable. Accordingly, the within-case approach of process-tracing is used here in conjunction with complementary *comparative* case study methods, namely the Mill’s “method of agreement” and “method of difference” (Mill, 1904). Accordingly, cases were in part chosen according to the values of the dependent variable, i.e. similar and different forms of ownership resulting from the takeovers. The drawbacks of Mill’s methods for small-

³⁰ This is the argument made by Gans-Morse (2012). It may be that further cases of “political” SLCT are found at the sub-national level.

n studies (including the problem of “omitted variable bias”) are well documented, and arguably they are close to useless on their own. But they can be effective when used in conjunction with careful process-tracing (George & McKeown, 1985, p. 153; Hall, 2003, p. 381). Mill’s methods can suggest causal relationships between independent and dependent variables, while process-tracing can help to confirm or reject those relationships through “close inspection of causal processes”, verifying whether the proposed explanatory variables are really affecting the dependent variable in the way that was predicted.

Data sources

The project has mainly relied on the following data sources:

- media reports, primarily from the Russian business press;
- companies’ official announcements and disclosures.

There is a widespread perception that the Russian media lacks professionalism and objectivity, in particular because of censorship and self-censorship. While this is true for many areas of the media (notably television), it does not hold for the business press, some sections of which are an island of professionalism largely untouched by censorship or self-censorship (except, occasionally, when it ventures into sensitive political terrain). Russian business journalists, particularly in the leading papers *Vedomosti* and *Kommersant*, and the magazines *Forbes* and (with some qualifications) *Ekspert*, ask penetrating questions of the business owners and managers they interview. Perhaps surprisingly, they often receive substantive answers to those questions. It will hopefully become clear from the case studies that follow, and the way that articles from the business press are used as evidence, that the level of insight and intrusion into the affairs of the country’s companies and business actors places Russia’s business journalism on a level perhaps even higher than its Western counterparts.

Granted, there are also poor-quality news sources in the Russian business press, and a discerning approach to those sources is essential to the quality of the overall analysis. The author is confident that long years of familiarity with the Russian media give him an appropriate sense of which outlets to give a measure of implicit trust, the appropriate limits of that trust, and how to spot the tell-tale signs of unprofessional journalism. By surveying the bibliography, readers with sufficient expertise of their own can judge for themselves whether this confidence is well-placed.

There are naturally some pitfalls to a reliance on media reports for evidence. For example, two different newspapers each citing an unnamed source (as they often do) may in fact have spoken to the same individual; the fact that the stories corroborate each other does not constitute independent verification. As another example, where a newsworthy event is about to happen, it goes heavily reported; but if for some reason the interesting event fails to come to pass, then no news outlets deem it sufficiently newsworthy to merit a mention (Pappe, 2000, p. 20). All the more reason, as Pappe argues, to seek confirmation elsewhere before assuming that media reports are accurate.

Fortunately, disclosure requirements that have been put in place in the past two decades for Russian companies in general (but particularly for the open joint-stock companies that make up the majority of Russia's big businesses) mean that a wealth of detail is often publicly available that ranges from the state of company finances, biographical details of its managers and directors, ownership structure, credit history, through to timely disclosure of events that are set to have a material impact on the company's value³¹. Many large companies have additionally begun publishing accounts to International Accounting Standards (IAS). These give a consolidated picture that represents the state of affairs at the group as a whole rather

³¹ Such information is typically available in the "about us" or "for investors and shareholders" sections of Russian company websites. Furthermore, certain specialist websites (such as Interfax news agency's www.e-disclosure.ru) offer searchable databases of Russian company disclosures, including archived copies of disclosure documents that are no longer available from company websites.

than one specific entity³², and are meant to provide details of beneficial ownership. The value of these disclosures as evidence is that they are typically signed off by the company's chief executive and chief accountant, placing a legal responsibility on them for the accuracy of the information disclosed. In addition, quarterly and annual reports are independently audited, though there are of course questions over whether auditors are truly independent in practice in some cases.

Official disclosures therefore make a vital contribution to this project as a way to verify information that comes to light in the business press, and as a source of some detail (e.g. the precise date of a transaction, the precise amount paid for an asset, and often crucial information regarding ownership) that may not have been sufficiently newsworthy to have featured in media reports.

One notable omission from the data sources listed above is that of interviews conducted by the author. The people best placed in principle to answer many of the questions posed by the case studies are those state actors, company managers and business owners who were directly involved in the takeovers. However, there were several serious obstacles that prevented interviews with such individuals becoming a significant data source for the case studies. The main one was access. Only a small group of individuals were party to information that was both crucial to the case studies and above and beyond what was already publicly available. Where it was possible to find and approach these individuals, persuading them to talk was a major challenge. Western academic researchers' access to Russia's business and political elite has become increasingly restricted since the heady days of the early 1990s. But the challenge was also to persuade such individuals, if they were prepared to talk at all, to provide the specific points of detail that were required, rather than boilerplate answers. Much of this detail

³² Companies continue to publish entity-specific accounts to Russian Accounting Standards (RAS), which are also publicly available via the statistics agency Rosstat, and additionally (for those entities which have issued securities) in quarterly reports whose publication is required by the securities regulator.

constituted commercially sensitive information, and there was little upside for potential interview subjects to give it away to a doctoral researcher who could offer little or nothing in return.

The quality of coverage provided by Russian business journalists has compensated somewhat for the lack of interviews. Russian business journalists have a level of access to the nation's elite that a foreign doctoral researcher can in most cases only dream of. They also tend to ask questions that this researcher would have asked, if he had the same level of access. As a result, the project has "piggybacked" at times on the work of journalists who interviewed the principal actors in the case studies, or who have cited "sources close to" a deal or a company that has played a role in those case studies.

In the final analysis, however, it must be acknowledged that the data sources used in this project are less than ideal; this and the relatively small number of cases leaves some room for uncertainty regarding the findings. For example, it is possible that hidden "patrons" among state officials were both pulling the strings behind the scenes in some of these takeovers, and drawing "rents" from the businesses afterwards by methods that simply do not register in the data sources available for study. It would be surprising, though, if these entirely unseen processes were playing a more significant causal role than the ones whose evidence can be traced in the sources that were available. A definitive answer has not been provided as to whether or not a genuine "carrot-and-stick" offer was ever made by the state to resolve the Yukos affair peacefully. But there are certainly credible grounds for believing that there was such an offer. Such uncertainty is inherent in the study of politics, particularly in the Byzantine world of Kremlin politics. The best way to deal with it is to do what we can in as honest and as scientific a way as we can, rather than simply giving up and going in search of phenomena that are more amenable to scientific analysis.

Structure of the thesis

This thesis is weighted heavily towards the case studies that form the basis of the three substantive chapters that follow.

Chapter Two examines the Yukos affair and two later cases from the oil industry, involving the smaller companies Russneft' and Bashneft'. In these cases, it was the "sovereign" side of "sovereign development" that provided the main motivation for the SLCTs. It is argued that the perceived threats to sovereignty posed by the existing business owners were the main reason for instigating the takeovers. The main goal was depriving the owners of their businesses, and what ownership outcome resulted was of secondary importance. In each case, a "carrot-and-stick" offer was made to the existing owner, and a private (potential) buyer played a part as intermediary who could facilitate a negotiated solution (Abramovich and Sibneft' in the case of Yukos, Deripaska and later Yevtushenkov at Russneft', and Yevtushenkov at Bashneft'). Once the Kremlin had concluded that Khodorkovsky was refusing such an offer, full-scale seizure and nationalisation were all but guaranteed. In the other two cases, the existing owners were more amenable to a negotiated solution. They sold their businesses to the private buyers for amounts approaching their market value, and, in stark contrast to Khodorkovsky, they remained at liberty.

Chapter Three goes back chronologically to 2002, the year before the Yukos affair began. It examines how *de facto* state-controlled Gazprom used state coercion to take back into its ownership three companies that had been lost (or were at risk of being lost) under its previous management. Taking back one of these companies was important for the strategic objective of bringing state ownership of Gazprom up to a direct majority stake, thus turning its *ad hoc* control into consolidated *de jure* control. This was in turn driven by the importance of Gazprom as a tool of domestic economic policy and of foreign policy. Some of the

motivations behind the decision to take back the other assets (and what was done with those assets subsequently) involved using Gazprom as a tool of economic development.

A state ownership outcome was pre-determined by the state's objectives for Gazprom's SLCTs. But Gazprom used an intermediary figure of its own to negotiate with the targeted owners, in the shape of a businessman named Alisher Usmanov who was chief executive of a Gazprom subsidiary named Gazprominvestholding. In addition to this role, he was a major private businessman in his own right, as well as someone who had worked with the former management of Gazprom, with which the existing owners of the targeted assets had had close ties. Usmanov actively played on this dual status to help persuade the existing owners to accept the carrot-and-stick offer. This reinforces the argument that the state prefers a negotiated outcome over full-scale asset seizure, and the suggestion that a "state ownership" outcome is problematic from this perspective.

Examination of how the takeovers proceeded highlights further the state's concerns about embarking on full-scale asset seizure. Some of the reasons for this reluctance include *domestic* considerations: Gazprom initiated bankruptcy proceedings, only to discover that it risked losing to rival Russian creditors much of the value of the targeted businesses. In a kleptocracy, it is unlikely that a state-owned company would face any such dangers when embarking on "expropriation" with the full support of its masters in government.

The case studies examine why the Gazprom subsidiary Gazprominvestholding acted as buyer rather than ownership being taken directly by the parent company. Part of the answer lies with Usmanov's role as intermediary, but it also becomes clear that domestic regulations relating to corporate governance prevented Gazprom from acting swiftly in response to the developing situation of the takeovers. It used its subsidiary to bypass these constraints. Though these constraints did not prevent the SLCTs, they clearly shaped Gazprom's behaviour in ways that

reinforce further the argument made by Hendley (2009) that “rule of law” and “telephone justice” somehow coexist in Russia.

Chapter Four examines the takeover in 2004 and 2005 of two companies involved in heavy engineering for the nuclear industry, namely Atomstroiekспорт and OMZ. These were strategic enterprises that were essential to Russia’s indigenous capability to build nuclear power stations at home and abroad, and had come under the control of private businessman Kakha Bendukidze. For reasons of national security, international trade relations and technological sovereignty, the state was determined to bring them back into state ownership.

Although sufficient evidence of state coercion is found to include these takeovers as valid cases, they met with little resistance from the existing owner, who was in any case contemplating an exit. The focus of the case studies is therefore, firstly, on how institutional constraints shaped the specific ownership outcome. The way the Atomstroiekспорт and OMZ acquisitions were executed, and the precise way in which ownership was structured, were clearly influenced by regulations which dictated the need to gain approval for acquisitions above a certain size from the domestic antitrust regulator. Additionally, legal considerations prompted the buyer, Gazprom, to conceal its involvement in the OMZ purchase, and it did so using the peculiar legal status of its pension fund, Gazfond, which acted as the buying entity. Gazprom effectively bypassed these institutional constraints to achieve what it wanted. It did so primarily by finding loopholes in the law, but occasionally it also flouted it. This mixed picture reflects the patchy but increasing powers of the antitrust body to sanction non-compliance with the relevant legislation.

The story of how the buyers managed their new assets centres around their relationship with the government agency, Rosatom, which was prepared to spend billions of dollars on new equipment for its planned expansion of nuclear energy capacity. The Gazprom-linked buyers were under state control but were not subordinate to this government agency. Both sides

claimed to be committed to working together to help realise the government's developmental plans for the industry, and the evidence shows that this was no empty rhetoric. But they failed to cooperate, thereby putting in danger the entire government programme. Part of the explanation for this failure lies in a lack of coordination between government agencies, leaving them to pursue their own institutional agendas. The account underlines the important role played by a coordinating "pilot agency" in successful state-led development (Johnson, 1982), and illustrates how corruption need not be central to explaining how government developmental strategies can fail in the absence of such a pilot agency.

Chapter Five concludes by pulling together the evidence in support of the "sovereign development" hypothesis, and returning to the theory of the ownership outcomes in order to incorporate the points discussed during the case studies. It summarises what these cases tell us about the "commitment problem" and the literature regarding coercion-constraining institutions, given the importance of institutional constraints in the causal explanations of the ownership outcomes. The evidence suggests ways in which we can improve our understanding of how "rule of law" and "telephone justice" coexist in contemporary Russia.

The main conclusion is that the Russian state under Putin is better understood as a "flawed developmental state" than as a kleptocracy. Its political leadership has an interest in pursuing economic development and has sought to achieve it through *dirigiste* state interventions in the economy. But the effectiveness of such efforts has been undermined in two ways. Firstly, the pursuit of development has frequently been trumped by an overriding preoccupation with countering perceived threats to sovereignty. Secondly, the government's commitment to development has not been backed up by an institutional design that would permit a single "pilot organisation" to devise and implement a coherent strategy of state-led economic development.

Chapter 2. Yukos, Russneft' and Bashneft'

Introduction

This chapter provides a comparative study of three companies in the Russian oil sector, namely Yukos, Russneft' and Bashneft'³³. In all three cases, the authorities took action against the existing owners and sought to bring about a takeover. The outcome of the takeover differed across the cases in terms of the new form of ownership (i.e. the value of the dependent variable for the second research question): Yukos was effectively nationalised, Bashneft' was taken over by a private business group named AFK Sistema, while in the case of Russneft' an attempted takeover by privately-owned company Basic Element was held in limbo for many months pending regulatory approval, before it was ultimately unwound and the company returned to its original private owner.

The aim of the study is to shed light on why the state intervened in each case, and why the ownership outcomes differed. Tompson (2005, 2008) has explained the Yukos affair and the company's *de facto* nationalisation by identifying causal factors which prompted the Russian government to increase the level of state ownership in strategic sectors, of which the oil industry is arguably the most important. As noted in the opening chapter, the ownership outcomes of the Russneft' and Bashneft' cases present a puzzle in this context. If there were good reasons for bringing the oil industry into state ownership, why was the opportunity not seized to ensure Russneft' and Bashneft' also ended up in state hands?

³³ The name "Bashneft'" is here used to refer to a loose grouping of companies in the Russian republic of Bashkortostan, of which the oil producing company Bashneft' was in fact just one. Other companies in the group included four oil refineries and a chain of petrol stations. A more typical Russian label for this grouping was "Bashkirskii TEK", but for simplicity's sake "Bashneft'" is used here instead.

In line with the “sovereign development” hypothesis that was explained in the previous chapter, it is argued here that the Russian government was driven by political factors to force the existing owners of these three businesses to part with their assets. These were cases where the drive for development was trumped by the need to act against perceived threats to sovereignty posed by the owners. In the Yukos case the threat was to sovereignty at the federal level: its owners were becoming involved in policymaking areas that the government considered to be its sole prerogative. At Russneft’ and Bashneft’, the owners were seen as threatening the Kremlin’s ability to project its authority in the Russian republics of Ingushetia and Bashkortostan respectively.

The case studies demonstrate that the ownership outcomes of the takeovers were strikingly contingent in nature. There was a credible alternative scenario whereby Yukos might instead have been sold to a different private owner, and Russneft’ and Bashneft’ might instead have been nationalised. The conclusion that is drawn from this is that the state did not have a specific ownership outcome in mind when it initiated the takeovers. They were instead aimed primarily at depriving the existing owners of their assets in order to neutralise them as a threat to sovereignty.

In some other cases of state-led coercive takeover (SLCT), including those undertaken by state-owned Gazprom in Chapter Three, the state *does* have a particular ownership outcome in mind. But when this does not pertain, the “takeover as bargaining game” model introduced in the opening chapter provides a particularly appropriate framework for a causal explanation of the varying ownership outcomes. To recap, the state begins by applying a measure of coercion aimed at persuading the existing owner to sell. The state’s preference is for the situation to be resolved through the owner’s acceptance of its “carrot-and-stick” offer. A full-scale campaign to seize the company’s assets is the alternative, but is a last resort that is pursued only if the existing owner flatly refuses to sell.

In the Russneft' and Bashneft' cases, the owners did accept the state's offer, and as a result their fates differed greatly from that of Khodorkovsky and his allies. It so happens that both of these cases resulted in private ownership, whereas Yukos was nationalised. But the correlation between the "bargaining outcomes" (a "negotiated" settlement or full-scale asset seizure) and the *ownership* outcomes is not as straightforward as this suggests. There is no reason in principle why the existing owners in other SLCTs might not accept a "carrot-and-stick" offer to sell to a state-owned company. As Figure 3 illustrates, there is therefore equifinality in the "state ownership" outcome: it can arise either from full-scale coercive seizure or from acceptance of the "carrot-and-stick" offer. By contrast, full-scale asset seizure is very unlikely to result in private ownership, for reasons that will be explained in detail below.

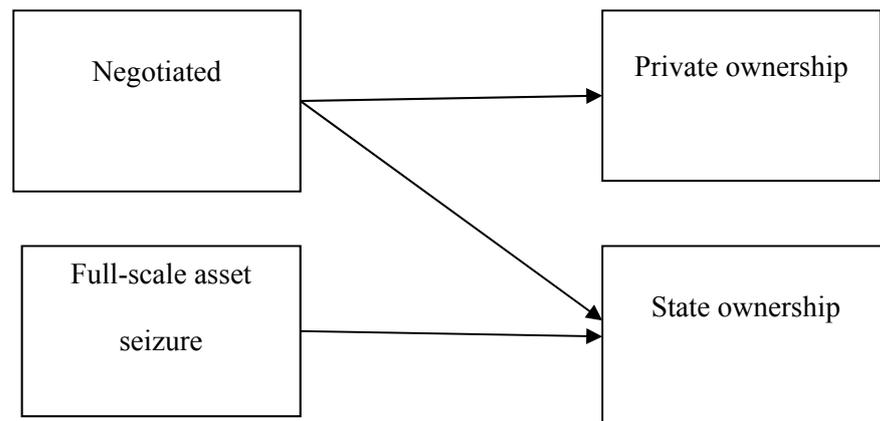


Figure 3. Equifinality in the state ownership outcome

The above theoretical framework provides an alternative to the more common interpretation of these takeovers as essentially cases of *reiderstvo*, i.e. of illegal takeover for private gain. Such interpretations are equivalent to explanations based on "rent-seeking", and potentially provide answers to both of the research questions of this project: the people who instigate the takeovers are motivated by private gain (question one), and (unless something goes wrong)

the targeted company will end up under their direct or indirect ownership (question two). In line with the process-tracing method, the validity of this hypothesis is given due consideration as a rival to the theory presented above.

Outline case narratives

Yukos

The main narrative of the Yukos case has been covered by several scholars in other publications (e.g. Goldman, 2004; Gustafson, 2012; Kononczuk, 2006; Sakwa, 2009; Sixsmith, 2010; Volkov, 2008a), and need only be recapped in brief here.

Having transformed itself in the early 2000s into a supposed model of Western-style transparency and corporate governance (Markus, 2008, pp. 79–80; Tompson, 2005, p. 7), the company was enjoying a greatly improved market capitalisation in the first half of 2003³⁴; it appeared to be on the verge of enacting a merger with a similar private competitor, Sibneft' (Vin'kov & Sivakov, 2003)³⁵, and was in talks with two US majors interested in buying a stake (Sixsmith, 2010, pp. 124–6).

The first signal of the authorities' attack on the company came on 21 June 2003, when its head of security Aleksei Pichugin was arrested (Butrin, Sapozhnikov, Gerasimov, & Skorobogat'ko, 2003) and later charged with organising up to five contract killings (Sakwa, 2009, p. 93). The arrest was followed on 1 July by the Prosecutor General's Office (PGO) conducting a search of Trust Bank (part of the group of companies headed by Menatep, which represented Yukos's core shareholders) in Moscow. The next day saw the arrest of Menatep's Chairman Platon Lebedev, on charges relating to the privatisation of a fertiliser company back in 1993-1994 and alleged tax evasion in Tomsk region (home to Yukos subsidiary Tomskneft'

³⁴ This peaked at over \$30bn in June 2003 (Semenenko, 2003).

³⁵ Management control of the merged company was to lie with Yukos.

VNK) (Osetinskaya, Lysova, Bushueva, & Lemeshko, 2003). This was followed by the arrest on 25 October 2003 of Yukos CEO, Chairman and main shareholder Mikhail Khodorkovsky (Bushueva, Nikol'skii, Karpov, & Ivanov, 2003). Five days later came the resignation of Aleksandr Voloshin, the head of the Presidential Administration who reportedly opposed Khodorkovsky's arrest (Bulavinov, 2003; Silaev, 2003; Sixsmith, 2010, pp. 151–2). In November, the proposed Yukos-Sibneft' merger was halted at the initiative of Sibneft's management (Tutushkin, Bushueva, & Lysova, 2003).

At the end of February 2004 Prime Minister Mikhail Kasyanov, who had defended Yukos both in public and privately, was dismissed and a new government was formed under Mikhail Fradkov (Dugin, 2004).

In July 2004 the trial of Lebedev and Khodorkovsky began in earnest (Sakwa, 2009, p. 207)³⁶. It was also announced that Yukos's main asset, Yuganskneftegaz, was to be put up for sale in order to repay the company's debts to the state budget (Sapozhnikov & Skorobogat'ko, 2004). These debts were increasing dramatically as a result of reviews of the company's tax payments for previous years, which led to enormous new demands for back taxes and fines for non-payment (Sakwa, 2009, pp. 171–173). An international arrest warrant was issued against a key business associate of Lebedev and Khodorkovsky named Leonid Nevzlin, who had fled Russia in the month after Khodorkovsky's arrest. Nevzlin was accused of ordering the contract killings that were allegedly organised by Pichugin (Nicol'skii, 2004).

In October 2004, the PGO opened a new investigation into allegations that Khodorkovsky and Lebedev had illicitly gained and laundered \$11bn (Sakwa, 2009, p. 222).

19 December 2004 saw the promised auction of Yuganskneftegaz, which was acquired by a shell company for \$9.35bn. State-controlled Gazprom Neft', which also sent representatives to

³⁶ To be more precise, the trial resumed on 11 July 2004 after a preliminary hearing on 16 June 2004 ("Timeline of events," n.d.).

the auction, declined to bid (Bushueva & Reznik, 2004). The shell company was sold on to state-owned Rosneft' three days later (Reznik, Derbilova, & Yegorova, 2004).

The trial of Khodorkovsky and Lebedev on the first set of charges ended on 11 April 2005 (Zapodinskaya, 2005), and in May they received a sentence of nine years in a general regime penal colony, minus the 18 months already served in pre-trial detention (Lepina, 2005). Lebedev's sentence was later reduced on appeal by one year (Sakwa, 2009, p. 212 fn. 100).

Yukos was declared bankrupt by the Moscow *Arbitrazh*³⁷ Court on 1 August 2006 (Reznik & Kornya, 2006). This was not the end of the saga, however: new charges were brought against Khodorkovsky and Lebedev in February 2007, focussing on their alleged involvement in embezzlement and money-laundering between 1998 and 2003. The amount of money allegedly involved was now \$30bn (Lokotetskaya, 2007; Sakwa, 2009, pp. 249–254).

Following on from its purchase of Yuganskneftgaz, Rosneft' acquired the two other main producing assets of Yukos at auction in May 2007. Thus state-controlled Rosneft', of which Igor' Sechin (deputy chief of the presidential administration and a major player in all three cases in this chapter) became Chairman in July 2004, emerged as buyer of the vast majority of the Yukos assets that were sold at auction (Rebrov, Grishkovets, Grib, & Paramonova, 2007; Surzhenko & Mazneva, 2007).

Khodorkovsky, Lebedev and other individuals associated with Yukos and Menatep continued to languish in prison, long after Yukos ceased to exist as a company and its assets had been transferred into the hands of state-controlled Rosneft'. In December 2013, Khodorkovsky received a pardon from President Vladimir Putin and was released from jail. He left Russia for Germany soon afterwards. In January 2014, Lebedev was also released, by order from the Russian Supreme Court (Alpert, 2014). Although these events in many ways drew a line under

³⁷ The *arbitrazh* courts are civil courts tasked with handling all economic disputes involving legal entities. For more details, see Chapter 4.

the “Yukos affair”, many issues remained unresolved, including tax claims against Khodorkovsky and Lebedev, and the arrest warrant for Nevzlin.

Russneft’

The Russneft’ case follows on chronologically from the main developments in the Yukos case. Russneft’s problems with the authorities began in late 2006, three years after the arrest of Khodorkovsky and a few months after Yukos had been declared bankrupt.

Unlike Yukos, Russneft’ was a relatively minor player in the oil sector. It was founded by Mikhail Gutseriev in September 2002. Gutseriev, who had previously been CEO of state-owned Slavneft’ until his dismissal in May 2002 (Reznik, 2007c), had created Russneft’ from scratch and built it up by acquiring small assets scattered around the country (Reznik & Nikol’skii, 2007). By 2006 it was responsible for 3% of Russia’s overall oil production³⁸.

On 15 November 2006, the PGO opened criminal cases against the heads of three Russneft’ subsidiaries, which were accused of extracting oil in excess of the quotas granted by their licences (Medvedeva, Nikol’skii, & Sunkina, 2006)³⁹. In January 2007 the Interior Ministry’s investigative committee opened a criminal case involving tax evasion at Russneft’ (Reznik & Nikol’skii, 2007). In April 2007, the same body conducted searches of Russneft’s offices and those of four affiliated banks in connection with the tax evasion case (Karacheva, 2007). In May it emerged that the Interior Ministry had charged Gutseriev, Russneft’s Vice-President Sergei Bakhir and the heads of two Russneft’ subsidiaries with non-payment of taxes and illegal entrepreneurial activity (Nicol’skii, Reznik, & Rozhkova, 2007; Sergeev, 2007). In the following month it was revealed that the Federal Tax Service (FTS) had applied to the Moscow *Arbitrazh* Court to annul certain transactions involving Russneft’ shares that

³⁸ Russneft’ produced 14.7m tons of oil and condensate in 2006 (Reznik, 2007a). The figure for total Russian production in 2007 was 491m tons, and this was a fall of 2.3% on the previous year (source: OAO “Russneft’”, Annual Report for 2007 (Russian), p. 3). The figure for 2006 was therefore 502.5m tons, giving Russneft’ an overall 3% share of total Russian production.

³⁹ The subsidiaries were ZAO Nafta-Ul’yanovsk, OAO Ul’yanovskneft’ and OAO Aganneftegazgeologiya.

allegedly had involved tax evasion, invoking article 169 of the Civil Code in a bid to have these shares expropriated in favour of the state (Reznik, Simakov, & Kornya, 2007). Russneft's shares were frozen by the courts pending a final ruling on the lawsuit (Rebrov & Pleshanova, 2007).

In July 2007, Gutseriev fled abroad, eventually settling in London. At around the same time reports emerged that the Kremlin was prepared to let him sell Russneft' to Oleg Deripaska's company Basic Element (Rebrov, 2007). At the end of the month Gutseriev and Deripaska announced that they had agreed on this sale, and Gutseriev received approximately \$3bn soon afterwards (Fyodorov, Kiseleva, Rebrov, & Orlov, 2007; Grib, 2007; Reznik, 2007c). The deal was structured in a way that would allow Deripaska gradually to take over management control of the company before taking ownership. The transfer of ownership was conditional on the deal's receiving approval from the authorities (Rebrov, 2010)⁴⁰. The Russian authorities issued an international arrest warrant for Gutseriev on 24 August 2007 (Mazneva & Nikol'skii, 2007). Apparently resigning himself to long-term exile, Gutseriev sold his stakes in other businesses inside Russia, including Binbank (formally majority-owned not by Gutseriev himself but by his nephew Mikhail Shishkhanov) (Kudinov, 2008), coal company Russkii Ugol' (Usov & Cherkasova, 2007) and chemicals firm Russkaya Sodovaya Kompaniya (Ravinskii, 2007). Meanwhile, Basic Element announced on 27 July 2007 that it had made a formal application to the Federal Antimonopoly Service (FAS) for approval of the Russneft' acquisition (Grib & Pleshanova, 2007). However, the approval process was delayed repeatedly, first by the FAS and later by a government commission on strategic investments that was chaired by Putin (who had become Prime Minister in May 2008). In March 2009

⁴⁰ The change of management in favour of Deripaska took place as follows. In September 2007 a Russneft' EGM elected a new board of directors, headed by Aleksandr Korsik (former President of independent gas company Itera). The remaining four directors were all Cypriot lawyers who were believed to represent the investment banks acting as purchasers on Basic Element's behalf (Grib, 2007). February 2008 saw the first major appointment of a Basic Element representative to Russneft's executive management.

reports emerged that Basic Element, which had been left heavily indebted following the global financial crisis, was looking to back out of the deal (Mazneva, 2009a).

The next major development in the Russneft' case was the rehabilitation of Gutseriev: at the end of October 2009 the Interior Ministry dropped the international arrest warrant against him, and soon afterwards it was reported that he might regain his ownership of Russneft' (Derbilova & Tutushkin, 2009). At around this time it became known that privately-owned conglomerate AFK Sistema was interested in buying a stake in the company (Tutushkin & Tsukanov, 2009), and the company's head Vladimir Yevtushenkov clarified in December that this would be up to 49% (Mazneva, 2009b)⁴¹. It later emerged that Yevtushenkov had helped persuade "senior officials" at the Kremlin that Gutseriev should be allowed to return to Russia and resume his business activities (Malkova, Berezanskaya, & Igumenov, 2012).

In January 2010 the Basic Element acquisition was fully unwound and Gutseriev regained his 100% stake in Russneft' (Rebrov, 2010). The company was now heavily in debt⁴² and with this in mind the sale of a 49% stake to AFK Sistema went ahead in April 2010. This time, there was no objection from the authorities (A. Levinskii & Sokolova, 2010b). In the same month, all remaining criminal charges against Gutseriev were dropped (Rubnikovich, Rebrov, & Muradov, 2010), making him only the second major Russian businessman who had succeeded in being rehabilitated⁴³. He returned to Russia soon afterwards, becoming Russneft's President at the end of June (Muradov, 2010; "Vkrattse," 2010). In September

⁴¹ AFK Sistema's rationale for limiting its acquisition to a 49% stake was that any further shares in Russneft' would mean Sistema having to include Russneft's debt in its own accounts (Mazneva, 2009b).

⁴² Before unwinding the deal, Basic Element had transferred onto Russneft's balance-sheet the \$3bn it had borrowed from state-owned Sberbank to make the acquisition, essentially making this acquisition a leveraged buyout. The unwinding of the deal did not entail Gutseriev repaying the \$3bn he had been paid by Basic Element, but the transfer of the debt to Russneft's balance sheet meant that Basic Element was no longer out of pocket. The end result was therefore that Russneft' had borrowed \$3bn from Sberbank and handed the money to Gutseriev.

⁴³ Oleg Kiselev, the former head of Renaissance Capital, was accused in 2005 of committing fraud to obstruct the acquisition of the Mikhailovskii GOK mineral enrichment plant by Alisher Usmanov and his business partner Vasily Anisimov. Kiselev left Russia for London in advance of the issuing of his arrest warrant. The criminal case against him was dropped in autumn 2007 (according to Kiselev), amid speculation that he had managed to mend fences with Usmanov (Igumenov & Kozyrev, 2009).

2013, Gutseriev again took sole ownership of Russneft', having bought back AFK Sistema's 49% and a 2% stake that had been sold to state-owned Sberbank (Yegorov, 2013).

Bashneft'

The group of companies labelled in this chapter as "Bashneft'" consisted of the largest petrochemical and oil refinery complex in Europe, as well as the upstream producer Bashneft' and a chain of petrol stations. Unlike Yukos and Russneft', the Bashneft' group consisted of assets that had not undergone privatisation during the 1990s. After the collapse of the Soviet Union, the Bashkortostan republic – like its neighbour Tatarstan – had managed to leverage declarations of sovereignty into a power-sharing treaty that gave it ownership over the local oil industry (Speckhard, 2004, pp. 170–3). This remained the case until they were privatised under controversial circumstances in April 2003, drawing criticism from the federal Audit Chamber (Bushueva, Khrennikov, & Voronina, 2003). They ended up in the hands of the family of Murtaza Rakhimov, who had been Bashkortostan's President since December 1993. Specifically, controlling stakes in all the enterprises came under beneficial ownership of Rakhimov's son, Ural (A. Levinskii & Sokolova, 2010b)⁴⁴.

In the December 2003 republican presidential elections, elements within the Kremlin backed an opposition candidate named Sergei Veremeenko in the first round, but Rakhimov succeeded in retaining support from the ruling United Russia party. The Kremlin switched to full support of Rakhimov in the second round of the elections (Gal'perin, 2008; Yartsev & Vadimova, 2005).

⁴⁴ Ownership of the petrochemicals companies had been transferred by the Bashkortostan Property Ministry to state-owned holding company Bashneftekhim in 1993. Then in 1999, ownership of these assets was transferred to a new company, Bashkirskaya Toplivnaya Kompaniya (BTK), which was also given a controlling stake in the oil producer Bashneft'. In 2001, Ural Rakhimov became the head of BTK. The April 2003 transaction that became the subject of the Audit Chamber investigation involved BTK selling its assets to seven limited liability companies, which then passed them on to a single company named Bashkirskii Kapital, which was controlled by Ural Rakhimov (Surnacheva, 2010).

Between late 2005 and early 2006, a subsidiary of AFK Sistema, the same company that would later buy a stake in Russneft', bought blocking stakes (25% plus one share) in the Bashneft' companies for \$600m. The seller was Ural Rakhimov's company Bashkirskii Kapital (Khannanova, 2005; A. Levinskii & Sokolova, 2010b).

In October 2006, Rakhimov senior secured a new presidential term under a new system of appointments of regional leaders. His nomination by President Vladimir Putin won approval from the Bashkortostan parliament (Khannanova & Gainullin, 2006b).

In 2007, a Moscow court ruled in favour of the Federal Tax Service, which was attempting to use Article 169 of the Civil Code to expropriate shares in the Bashneft' companies as well as in Russneft' (see above). The Bashkortostan authorities appealed (Pleshanova & Zanina, 2009). Rakhimov reportedly met with Putin face to face and was given an ultimatum: if he did not sell his stakes in Bashneft' to an appropriate buyer, they would be expropriated (A. Levinskii & Sokolova, 2010a).

In 2008, the use of Article 169 in such cases was brought to an end by a ruling of the Supreme *Arbitrazh* Court. Nevertheless, at the end of March 2009, AFK Sistema reached agreement with Ural Rakhimov to bring its stakes in all the Bashneft' companies to controlling (50% or above) (Mordyushenko, Khannanova, & Rebrov, 2009).

On 15 July 2010, Rakhimov tendered his resignation at a face-to-face meeting with President Dmitry Medvedev. The fact that he was able to do so in this fashion was seen as a concession from the Kremlin in exchange for his having agreed to go quietly (Kostenko & Tsvetkova, 2010). Medvedev appointed as Rakhimov's successor Rustem Khamitov, who as the former head of the Federal Agency for Water Resources was seen as aloof from the rival political factions of the republic (Khannanova, 2010).

Research question 1: causes of the state-led coercive takeovers

Ordered from the top

The cases in this chapter share an important feature: there is ample evidence in each that Putin himself either personally ordered the takeovers or took a close interest in them. While some have argued that Putin kept his distance from the Yukos affair until after Khodorkovsky's arrest (Stanislav Belkovsky quoted in Sakwa, 2009, p. 159; Woodruff, 2003), this is contested by the Yukos camp (Sixsmith, 2010, pp. 155, 175, 241), and few would question Putin's involvement *after* that arrest. As noted above, the crackdown at Russneft' reportedly came after a meeting at the Kremlin between Ingushetian President Murat Zyazikov and Putin, in which the political activities of Gutseriev and his family were blamed for the deteriorating security situation in the republic⁴⁵. And it was Putin who reportedly met with Rakhimov in the Kremlin in 2007, telling him he must either agree to sell controlling stakes in the Bashneft' companies or have them taken from him by court order (A. Levinskii & Sokolova, 2010a).

Furthermore, the same state officials were involved as the main executors of the crackdowns, with Igor' Sechin having played a leading role in each case⁴⁶. He is thought to have masterminded the campaign against Yukos and was from July 2004 Chairman of state-controlled Rosneft', which acquired most of the Yukos assets; he is also thought to have been behind the legal efforts of the Federal Tax Service (FTS) to have controlling stakes in Russneft' and Bashneft' expropriated by the state. The same senior lawyers represented the FTS in court against both Yukos and Russneft', and went on to work for Sechin in different capacities afterwards (Gudkov, 2008; Pleshanova & Gritskova, 2008).

⁴⁵ This point is discussed in greater detail below.

⁴⁶ See e.g. Yaroshevskii (2008) for Yukos, Kharat'yan (2007) for Russneft'. For Bashneft', Gal'perin (2008) claims that "Rakhimov's manoeuvring particularly angered Deputy Prime Minister Igor Sechin's group. Dmitry Medvedev, as Chairman of Gazprom, was more favourably inclined towards the Bashkir authorities."

There are indications that Putin might have changed his attitude to the Yukos and Russneft cases over time, possibly under the hard-line influence of Sechin, who was deputy head of the presidential administration for most of the period covered⁴⁷. At Russneft, Gutseriev's rehabilitation from late 2009 appears to have been thanks not least to the persuasive powers of the more liberal Putin ally Dmitry Medvedev (then Russia's President). But Putin was making the ultimate decisions regarding the fates of the companies and their owners.

This fact provides some weight for arguing that the takeovers had "political" considerations as their motivation, rather than being merely cases of *reiderstvo* with underlying rent-seeking motivations. Putin's involvement is not entirely incompatible with the latter explanation, but it raises the stakes when making such an argument. These were not the sort of illegal takeovers depicted by Rochlitz (2013), in which the state tolerates predation by regional officials or their underlings in exchange for the latter's ability to deliver pro-Kremlin votes; neither were they cases where a "principal-agent problem" prevented the Kremlin from reining in the predatory inclinations of the bureaucracy (Markus, 2012)⁴⁸. Instead, Putin was either colluding with those who instigated the takeovers, or was instigating them himself. If these were cases motivated by rent-seeking, then either Putin was seeking to benefit from them personally, or, conceivably, he was enabling one particular faction to benefit as part of the "rent management system" on which his political survival depended (Gaddy & Ickes, 2010). These are the explanations that need to be considered as rivals to the "sovereign development" hypothesis. With this in mind, we now turn to the individual cases in search of evidence regarding their causes.

⁴⁷ Sechin was appointed deputy head of Putin's presidential administration on 31 December 1999, when Putin was still only acting President. In May 2008 he was instead made Deputy Prime Minister with responsibility for the oil and energy sectors ("Sechin, Igor," n.d.).

⁴⁸ To be clear, Markus suggests that this mechanism might explain some cases of "expropriation" in Russia, but he does not claim that it explains the Yukos affair or the other cases in this chapter.

Yukos

As noted above, there is no serious doubt among analysts regarding Putin's personal involvement in the Yukos affair. However, there is some debate as to whether he became involved at the outset or only some time after the crackdown on Yukos had begun.

The events prior to October 2003 (including the arrest of Pichugin and Lebedev) are seen by some analysts as qualitatively of a different order from what followed (including the arrest of Khodorkovsky). Woodruff (2003) has argued that Yukos's early problems prior to October 2003 were the manifestation of a business dispute between the company and state-owned Rosneft', which prompted the latter to lobby the PGO to apply pressure on Yukos. There are plenty of other cases of law-enforcement being recruited by one or both sides in a business dispute, as Barnes (2006a) has ably documented. According to Woodruff, only in October 2003 did Putin "[throw] his full weight behind the anti-Yukos campaign", and Khodorkovsky's determination to escalate the business dispute into a political conflict was the likely cause. Similarly, Belkovsky has claimed that Putin was kept in the dark about the Khodorkovsky arrest until after the fact: it was deliberately timed for the middle of the night so that Putin could be presented with a *fait accompli*. As his interviewer puts it, "If [Putin] had ordered Khodorkovsky's release he would look weak and an instrument in the hands of others, but to accept the arrest and all that it entailed brought him into the silovik camp on this issue, and set Russia and his presidency on a new path" (Sakwa, 2009, p. 158). Khodorkovsky's statements, which were "careful to explicitly absolve Putin of involvement"⁴⁹, might lend credence to this view, as might the fact that Putin's chief of staff Aleksandr Voloshin told Western journalists in July 2003 that Putin did not know about the Yukos campaign until it was already underway.

⁴⁹ Woodruff (2003, p. 5). Khodorkovsky maintained this line at least as late as 2005 ("Interv'yu: Mikhail Khodorkovskii," 2005).

If Putin was persuaded to get fully behind the Yukos affair only in October 2003, this implies an intriguing power-dynamic between the President and his subordinate Sechin, who had apparently been coordinating the Yukos affair on his own initiative prior to October. However, it seems at least as plausible that Putin was involved in launching the PGO's crackdown against Yukos from the outset – and that it was Voloshin, not Putin, who was being kept in the dark about the real nature and extent of that crackdown. The fact that many of the best analysts believed Putin was only a late convert to the Yukos affair may simply be the result of the adroitness with which Putin presented himself as being above the fray (while tacitly supporting and overseeing Sechin's actions), combined with the fact that Khodorkovsky had no choice but to appeal to the highest office in the land (the 'good tsar') in his quest for justice.

In contrast to Khodorkovsky's statements at the time (and for some years afterwards), his Menatep allies interviewed in Sixsmith (2010) appear to concur on the following points:

- 1) they knew that the company would face serious problems from the state after a meeting of business leaders with Putin on 19 February 2003, at which Khodorkovsky accused Rosneft' of corruption over the acquisition of oil producer Northern Oil (in Russian: Severnaya Neft')⁵⁰;
- 2) very soon after this meeting the PGO was casting far and wide for evidence to build up a criminal case against the company and its owners⁵¹;
- 3) Putin was involved in this from the very beginning⁵².

⁵⁰ Viktor Gerashchenko (Chairman of Yukos between 2004 and 2007) claims that Khodorkovsky was told after this meeting that he should leave Russia (Yaroshevskii, 2008). Leonid Nevzlin claims that Putin instructed Sechin and others to begin gathering evidence against Yukos as a result of the meeting (Sakwa, 2009, p. 144). Mikhail Brudno claims that "none of it might have happened" if Khodorkovsky had not said what he said (Sixsmith, 2010, p. 64).

⁵¹ The same message was conveyed to the present author in conversation with a public relations professional close to the Menatep camp, September 2012.

⁵² Aleksandr Temerko claims that "Putin gave the management of the affair to Sechin and I was trying to negotiate with him [...] Sechin was Putin's weapon [...] The Yukos affair was one of the few

On this last point, it is possible that the Menatep insiders changed tactics over the years, initially pointing the finger at Sechin and the siloviki exclusively, but then pinning the international blame squarely on Putin once it became clear that he could not be appealed to for clemency. It is also possible that the prosecutors' search for evidence against Yukos from February 2003 was a relatively spontaneous phenomenon aimed at pleasing superiors, rather than a response to a direct instruction from above. However, the weight of evidence nevertheless seems to be that the Yukos intervention was initiated at the very top. This impression is reinforced by the fact that at Russneft' and Bashneft' also, the pressure on the existing owners began with a frenzy of investigative activity from prosecutors, with indications that this was triggered by an instruction from the Kremlin. The fact that these early stages of the SLCT did not match the full-scale coercive action that was directed at Yukos later should not be mistaken for a sign that the case began as a mere business dispute. Rather, these early activities formed the coercive basis on which the state then made its "carrot-and-stick" offer to the existing owner.

Sixsmith (2010, pp. 76–82) suggests that another trigger besides the February meeting was the fact that Yukos was in talks on the planned sale of a blocking stake (and possibly greater) in the company to either ExxonMobil or ChevronTexaco. It had not consulted the Kremlin on the issue in advance, therefore challenging the government's right to determine its own strategy regarding the appropriateness of foreign capital in the oil sector. Sixsmith suggests that Putin might have been in favour of the sale of a minority stake to Chevron, but was aghast at information that Yukos was also talking to ExxonMobil about the sale of a controlling

projects that Putin supervised personally" (Sixsmith, 2010, p. 155). Bruce Misamore believes Putin was directing or personally approving "every major action in the destruction of Yukos" (Sixsmith, 2010, p. 175). Mikhail Brudno insisted that "It was [Putin], from the beginning to the end. From the very beginning to the very end. Nothing that was done was done without his permission. Now, maybe he was led to making certain decisions by certain people [...] But, however it may have been, he made those decisions" (Sixsmith, 2010, p. 241).

stake⁵³. This information came to light at the beginning of October 2003. Thus it is possible to argue that the first phase of the Yukos affair was triggered by the February meeting, and the second phase (the arrest of Khodorkovsky) by the information about an imminent sale to a US company. However, to suggest that this news was the deciding factor in Khodorkovsky's arrest (rather than altering the timing of what was going to happen in any case) would be to underestimate the extent to which he and his company were already in serious trouble. A more convincing deciding factor in the escalation of the Yukos affair was the Kremlin's realisation that Khodorkovsky was not going to be cowed by the pressure that was being placed on him and his company into accepting the "carrot-and-stick" offer.

Underlying causes

"I could not have imagined that state bureaucrats with the direct connivance of the head of state would directly and openly act against the economic interests of Russia" – Mikhail Khodorkovsky, in Khodorkovsky and Gevorkyan (2012)

The above discussion has tackled the question of which state actors were responsible for instigating the Yukos affair, and what events might have triggered the first coercive pressure on the company as well as the later escalation of the crisis with Khodorkovsky's arrest in October 2003. But it seems important to distinguish between triggers (which explain the timing of the attack) and underlying causes (the larger perceived transgressions that really drove the SLCT process forward). These larger transgressions cast doubt on the suggestion that the Yukos affair might never have happened if Khodorkovsky had not talked out of turn at the February 2003 meeting.

The literature on the Yukos affair provides no shortage of suggestions regarding which of the actions taken by Khodorkovsky might have angered the Kremlin or elements within it. The

⁵³ Sixsmith cites Bruce Misamore, former Yukos chief financial officer, as saying that ExxonMobil CEO Lee Raymond had bragged about this possibility in a meeting with Putin at the beginning of October 2003 (Sixsmith, 2010, pp. 124–129).

literature tends to suffer, however, from an inability to discriminate between these suggestions or describe how they might relate to one another. The following political actions of Yukos and/or Khodorkovsky have been offered as explanations for the crackdown:

- the political funding activities of Yukos, Khodorkovsky and others in the run-up to the December 2003 elections (e.g. Sakwa (2009, p. 67));
- Yukos's wider political activity, including its lobbying to block legislation on oil taxes (e.g. Sakwa (2009, p. 95));
- Khodorkovsky's advocacy of a parliamentary republic and hints that he might bid to be President or Prime Minister (e.g. Sakwa (2009, p. 120), Pappe and Galukhina (2009, pp. 217–8));
- the company's perceived intrusion into the realms of foreign policy, befriending influential American politicians and holding talks with the Chinese government on the construction of an oil pipeline (e.g. Sakwa (2009, p. 136), Pappe and Galukhina (2009, p. 207));
- the activities of Open Russia, a philanthropic organisation founded by Khodorkovsky and his colleagues that was similar to George Soros's Open Society Foundation. This was perceived by the Kremlin as a subversive organisation aimed at spreading anti-government sentiment particularly among young people (Pappe & Galukhina, 2009, p. 217). According to Sakwa (2009, p. 125), Khodorkovsky "portrayed his activities as representing an epochal transformation of Russia and played up the public relations side for all it was worth, which would have annoyed the most benign of governments".

For explanations based purely on rent-seeking, such political factors provided a mere pretext for a takeover that targeted Yukos because it was highly successful and lucrative. They are also of no causal significance to those who argue that the decision had already been taken to nationalise Yukos as the quickest step towards reasserting state control over the entire oil

industry, or reasserting state power against that of the “oligarchs”. Conceivably, all of these factors came into play: the steps taken by Khodorkovsky gave the state political reasons to instigate the SLCT, but this coincided with the rent-seeking motives of the instigators and strategic considerations regarding the desire to increase state control in the economy. However, unless some effort is made to discriminate between the many proposed causes, the overall explanation becomes unwieldy and over-reliant on coincidence.

Khodorkovsky and Lebedev continued to languish in prison and were even confronted with new criminal charges long after Yukos’s assets were safely in the hands of Rosneft’, and this fact argues against the claim that politics was only a pretext for the real aim of enabling the takeover of Yukos by greedy officials. In order to still be valid, such an explanation relies on the personal animosity felt by Putin and the *siloviki* towards the people concerned. But it would be remarkable if this were all that was driving the coercive process on, given that this involved the state continuing to commit significant financial and bureaucratic resources. A more plausible explanation is that Khodorkovsky was seen as a political threat, even after he was deprived of most of his assets. As will become clear from the discussion later in this chapter regarding the precise nature of the “carrot-and-stick” offer, acceptance of that offer entailed renouncing political activity as well as giving up ownership of one’s business. The state saw the change of ownership as an important part of neutralising the political threat from these business owners, but was not confident that this was enough.

What kind of political threat did Khodorkovsky pose? Pappe and Galukhina (2009, pp. 216–8) argue that the state felt obliged to act because Khodorkovsky posed a serious challenge to the Putin regime, given his intention to enter the political arena and the fact that he had billions of dollars in cash at his disposal. But it is in fact questionable whether Khodorkovsky’s political ambitions posed any genuine threat to the incumbency of Putin’s regime. His chances as a

presidential candidate were minimal in a country so hostile to oligarchs⁵⁴. It is also far from clear how he could have hoped to run in an election on a level playing-field: it would have been easy enough for the incumbent regime to apply “administrative resources”⁵⁵, either to eliminate him as a candidate altogether (by disqualifying him on a technicality, for example) or to discredit him through control over the media and law-enforcement. He would have been seriously hampered in his ability to use the vast financial resources at his disposal to boost his electoral chances: any media outlet or political organisation perceived to be financed or owned by Khodorkovsky and his allies could have been shut down by the state with ease. It could still be asserted that the Kremlin, despite holding most of the cards, was not prepared to take any risks and was determined to nip Khodorkovsky’s political challenge in the bud. However, if this is the case then the scale, scope and duration of the ensuing Yukos affair look like a huge over-reaction.

In the quotation at the beginning of this section, Khodorkovsky expresses his bewilderment at how the state could have acted so directly against its own economic interests by going after one of Russia’s most successful companies. Indeed, Yukos was until 2003 a major contributor to Russia’s economic growth⁵⁶. But the concept of “sovereign development” provides a possible solution to this apparent conundrum. If the state identified a threat to sovereignty from Yukos’s behaviour, and prioritised such threats above the objective of economic development (in the narrow sense of boosting GDP), then the crackdown in fact fitted

⁵⁴ In a VTsIOM opinion poll at the end of 2003, 61% of respondents declared Putin to be “person of the year”. Khodorkovsky figured only among the ‘anti-heroes’ named by respondents, behind Anatoly Chubais (29% of respondents), Boris Berezovsky (20%), Vladimir Zhirinovskiy (18%), Gennady Zyuganov (13%) (“Litsa goda,” 2003). Khodorkovsky was named by 9% of respondents. While such opinion polls are to be treated cautiously, the numbers highlight the uphill struggle a Khodorkovsky presidential bid would have faced.

⁵⁵ The term “administrative resources” will occur frequently in this thesis and a definition will be helpful. It refers to the arbitrary and improper use of state resources by the state itself or by those with privileged access, in order to confer advantage over those who do not have such access. For a study of the use of administrative resources to influence the outcome of elections in post-Soviet countries, see Wilson (2005). In SLCTs, administrative resources are used by the state and state-backed companies against the existing owners and those with rival claims to the assets (see Chapter Three).

⁵⁶ According to Kryshtanovskaya (2003), Yukos was contributing around 5% of Russia’s GDP before Khodorkovsky’s arrest.

perfectly well with the state's agenda. As well as explaining why state actors interested in development might sometimes act in ways that are economically destructive at least in the short term, "sovereign development" allows for the possibility that Yukos's political activities were a causal factor despite their posing no threat to the incumbent regime. Of the political explanations offered above, the company's undue influence on parliamentary decision-making and its negotiations with the Chinese government on a possible export pipeline, are in this light identifiable as clear threats to sovereignty and thus the most important underlying causes for the SLCT.

Granted, Yukos was not the only Russian company to have been engaging in such sovereignty-threatening activities at the time. Yukos was not the only company that was seeking to influence parliamentary decision-making in ways that the Kremlin found objectionable (Sakwa, 2009, p. 117), and another privately-owned oil major, Lukoil, was part of a consortium which planned to build a privately-financed (and possibly privately-owned) export pipeline from Western Siberia to Murmansk (Smirnov, 2003). Gustafson (2012, p. 280) argues that Yukos was doing nothing different *in kind* from the other oil majors, but that it was singled out for attack because "on every point of contention [...] Yukos was more strident, more aggressive, and more radical than the other oil companies."

Russneft'

Determining the causes of the Russneft' takeover is complicated by the fact that this case has not been subject to anything like the same scrutiny from journalists and academics as has the Yukos affair. While the Yukos insiders were keen to put their version of events across to the public in Russia and abroad, the Russneft' camp remained largely tight-lipped – presumably for fear of endangering what proved to be a relatively benign outcome.

To the extent that this specific case has been discussed in the academic literature, it has tended to be described as a case of *reiderstvo*, i.e. as an illegal takeover by predatory individuals

intent on self-enrichment. Hanson (2014), Rochlitz (2013) and Zhuravskaya (2008) all include Russneft' as a case of *reiderstvo*. As discussed in the preceding chapter, the literature on *reiderstvo* has not properly addressed the question of whether takeovers where political motivations were paramount also count as *reiderstvo*. Hanson suggests that Russneft' "may well have been a case with an admixture of politics, related in some way to Gutseriev's earlier political activities, rather than an example of 'pure' asset-grabbing". Similarly, Rochlitz includes Yukos as a case of *reiderstvo* but notes that it "is not a typical case but rather a personal reckoning between a leading businessman with political ambitions and President Putin." The present project, by contrast, considers motivations of self-enrichment to be a defining characteristic of *reiderstvo*: if the state has played the leading role in the takeover and it has been enacted for some other purpose besides self-enrichment, then it should be categorised as an SLCT but not as *reiderstvo*.

When Gutseriev sold Russneft' to Deripaska under substantial state pressure, it was typically thought (as one would expect from a case of *reiderstvo*) that the company had been singled out by corrupt officials intent on enriching themselves. Deripaska was believed to be merely acting as a middleman on behalf of those corrupt officials who had launched the attack. It was expected that Russneft' would be sold on to state-owned Rosneft' forthwith, because Rosneft's political patrons (i.e. Igor' Sechin in particular) were thought to be responsible for the attack⁵⁷.

However, the subsequent fate of Russneft' calls into question the idea that self-enrichment (rather than politics) was the primary motivation behind the attack. The sale to Deripaska was blocked by the authorities, and Sechin was at the forefront of these efforts: after this, the idea

⁵⁷ Former State Duma speaker Gennady Seleznev, a friend of Gutseriev's, claimed that "this is not a fight against Gutseriev, but for his asset [i.e. Russneft']. I would not rule out that today it ends up in the hands of Deripaska, but tomorrow – in Rosneft's" (Reznik, 2007b). Similarly, Canadian lawyer Robert Amsterdam, who worked as counsel for Khodorkovsky, claimed that the Russneft' attack differed significantly from the Yukos affair: the latter had been caused by Khodorkovsky's political threat to the regime, while Russneft' "simply controlled an asset that Rosneft' wants to own". Deripaska, he insisted, was only the middleman for this takeover by Rosneft' (Pitts, 2007).

of Deripaska as a middleman for Rosneft' was no longer credible. Furthermore, the pressure on Gutseriev was dropped entirely after he agreed to sell a 49% stake in the company to a different private owner, Vladimir Yevtushenkov. Nobody suggests that Yevtushenkov had any connection to the original attack on Gutseriev. So the SLCT had a relatively benign outcome for Gutseriev even though whoever had instigated it does not appear to have taken ownership or otherwise enriched themselves. Furthermore, in both the abortive sale to Deripaska and the subsequent sale to Yevtushenkov, Gutseriev received a price for his assets that was not far from their market value. Such an outcome is far from typical of cases of *reiderstvo*.

As usual in such cases, the ownership outcome does not on its own invalidate the notion that the takeover was primarily motivated by the desire for self-enrichment on the part of those involved in instigating it. There are ways to explain the outcome that could still fit: perhaps it was a case of *reiderstvo* that went wrong, and the instigators were for some reason foiled in their attempts to claim the company for themselves. Or perhaps Yevtushenkov was acting as a front for the people who had instigated the takeover, so that they did in the end get the material reward they were after (but at a surprisingly high price). But the outcome is certainly sufficiently puzzling to merit a closer look at what evidence is available. Putin's personal involvement in the affair may conceivably point to Russneft' as a case of state predation at the very highest level. However, it also provides grounds to take seriously an alternative explanation that puts politics (understood as something more than venal wealth-maximising by state actors) at centre-stage.

If Russneft' was singled out for attack solely on the basis of its being an attractive target for rent-seeking, then Russian media reports provide a surprising variety of suggestions as to what Gutseriev or Russneft' might have done to provoke the anger of the Kremlin⁵⁸. One of the two

⁵⁸ Some of the more exotic explanations that have been offered include the suspicion (reported by an anonymous high-ranking source in the Interior Ministry) that Gutseriev had angered state-owned Gazprom Neft' by trying to prevent it buying stakes in Slavneft'-owned assets in Belarus (Sergeev,

explanations most consistently offered by the most reputable media sources is directly political in nature. This centres on Gutseriev's connections to his home republic of Ingushetia. The Gutseriev family was a major player in the politics and economy of this North Caucasian republic, and was allied to Ruslan Aushev, who was the republic's President from February 1993 to April 2002. When Aushev was removed under Kremlin pressure, Gutseriev backed candidates who were running against Murat Zyazikov, the FSB general who ultimately won the election with Kremlin backing. Initially, Gutseriev's favoured candidate was his brother Khamzat, a former Interior Minister of the republic. Khamzat was denied registration in the elections, whereupon Mikhail Gutseriev switched his support to the registered candidate Alikhan Amirkhanov (Kiseleva, 2006; Latynina, 2007).

These events date back to 2002, however, and have been cited more credibly as a proximate cause for Gutseriev's dismissal as CEO of state-controlled Slavneft' in the same year. To cite the same events as the cause of the Russneft' takeover four years later requires further explanation. Zyazikov's presidency proved extremely unpopular locally, and he presided over a marked deterioration in the security situation. Latynina (2007) has suggested that the authorities blamed the problems on continuing opposition and obstruction from the Gutseriev and Aushev clans and their allies in the republic. Thus the authorities decided that something needed to be done to reduce Gutseriev's political and economic power locally. According to Latynina, the trigger was the kidnapping in Ingushetia of one of Zyazikov's relatives in Ingushetia: "It was necessary somehow to explain how the situation in Ingushetia, headed by an FSB General, was different from the chaos in Chechnya [...] President Zyazikov arrived at the Kremlin and said publicly to president Putin that 80 enterprises and 500,000 square metres of accommodation had been built. It's hard to say what he said in private, but the pressure on Gutseriev began after that [...] Who is guilty of the abduction of Uruskhan Zyazikov? Of course, enemies. Gutseriev possesses the undoubted advantage as an enemy that it is easier to

Grib, Rebrov, & Butrin, 2007), or that he had angered Sechin by refusing to let Russneft' sell its oil via Gunvor (then Rosneft's favoured trader) instead of Glencore (Vin'kov, 2007).

catch him than to catch the terrorists, and he has more money.” Latynina notes as a possible final straw the fact Gutseriev was lobbying in 2006 for a Free Economic Zone (FEZ) for the neighbouring republic of Chechnya, along the lines of the Ingushetian FEZ that had been the focus of his early business activities in the 1990s. This reportedly threatened the business interests of Chechen President Ramzan Kadyrov (Chabanenko, 2007). Another North Caucasus-related factor is the fact that Gutseriev was rumoured in law-enforcement circles to be involved in financing illegal paramilitary groups in the region. An unnamed high-ranking government bureaucrat told *Forbes* magazine that unproven allegations of this nature made their way up to Putin, on whom they “acted like a red rag [to a bull]” (Malkova et al., 2012).

This explanation based on Ingushetian politics derives additional credibility from the fact that the crackdown on Russneft’ was foretold in this context before there were any outward signs that the company was coming under pressure. It is widely accepted that the crackdown began in November 2006 with the opening of criminal cases against the heads of three Russneft’ subsidiaries regarding alleged overproduction. But a magazine had noted in passing as early as 25 September 2006 that the Kremlin was angered by Gutseriev’s earlier support for the “wrong” candidate in Ingushetia’s presidential elections, and that the PGO was rumoured to have received a “quiet instruction to look more attentively at how Mikhail Gutseriev conducts his business. Are there, for example, any serious violations in their oil field licences?” (Kiseleva, 2006)⁵⁹.

It should be stressed that Russneft’ had no local presence in Ingushetia, and in this sense the case differs from that of Bashneft’, whose companies were strategic enterprises for the Bashkortostan republic. As noted in the case narrative above, Gutseriev sold other Russian businesses in the wake of the Russneft’ crackdown, most notably Binbank, which was

⁵⁹ Thus, as in the Yukos affair, the PGO appears to have been engaged to ‘dig the dirt’ on the subject company once the decision to act against it was already taken. These preliminary investigations then formed the basis of the coercive pressure which the state applied when making its “carrot-and-stick” offer to Gutseriev.

formally majority-owned by his nephew Mikhail Shishkhanov (Chaikina, 2008). But this appears to have been in response to the pressure on Russneft', with Gutseriev understandably concluding that it was unwise to retain any significant business interests in Russia. The state does not appear to have forced these other sales in the same way as at Russneft'. The fact that Russneft' was the sole target lends weight to the view that Gutseriev must also have done something to make him no longer welcome in the Russian oil industry in particular.

This brings us to the second cause most widely cited for the Russneft' crackdown. This is not directly political and is linked to the Yukos affair. Gutseriev allegedly committed the transgression of buying Yukos assets that were by then effectively earmarked for sale to state-owned companies as part of the bankruptcy process. In November 2004, Russneft' bought six oil producing companies in Tomsk region that had once belonged to Tomskneftegazgeologiya, a company part-owned by Yukos-subsiary VNK. There was concern that this sale had damaged the value of VNK, which was to be sold as part of the Yukos bankruptcy process. Additionally, in spring 2005 it emerged that a Cyprus company named Broadwood Trading & Investments, which was widely thought to be affiliated with Russneft', had bought from a Yukos subsidiary a 34% stake in the small oil producer Geoilbent. In May 2005, Russneft' bought a 50% stake in Yukos's Zapadno-Malobalykskoe oil field, allegedly purchasing the stake directly from Yukos-affiliated investment funds. In February 2006 the company undertook to buy Yukos's 49% stake in Slovakian pipeline operator Transpetrol. Another relevant acquisition was Yukos's stake in Sakhaneftgaz, bought by Russneft'-affiliated Binbank in November 2005 (Reznik & Nikol'skii, 2007)).

In July 2007, Russneft' issued a press release denying that it had ever bought any assets from Yukos. It pointed out that the oil producing companies formerly owned by Tomskneftegazgeologiya were bought not from Yukos but from Cyprus-registered companies owned by State Duma deputy Maksim Korobov. As for Transpetrol, Russneft's bid came two months before the Yukos assets were frozen as part of the bankruptcy process, and had come

with the approval of the Economy Ministry. Russneft' had pulled out of the purchase after Aleksandr Ryazanov, former President of state-owned Gazprom-Neft', asked them to stand aside in favour of that company (Gorshkova, 2007). As Reznik and Osetinskaya (2007) point out, it may well be that Russneft' had done nothing wrong from a formal point of view, but this did not change the fact that it had bought assets formerly belonging to Yukos when the Kremlin had intended them to be sold to someone else⁶⁰.

The Yukos factor could perhaps be seen as sufficient on its own to explain the crackdown on Russneft', and the timing of the acquisitions fits reasonably neatly with the beginning of that crackdown. However, the Ingushetia factor seems to have been at least as important. Not only was it presented as the cause of the crackdown before it happened, it appears (as explained below) that Zyazikov's removal as leader of Ingushetia played an important part in Gutseriev's subsequent rehabilitation. Thus it appears most likely that the crackdown at Russneft' was triggered by a Kremlin meeting with Zyazikov regarding the Ingushetia situation, though the company's acquisition of Yukos assets may well have been an underlying cause adding to the Kremlin's negative view of the company.

As with the Yukos case, it appears that the Russneft' crackdown was caused by political factors despite the fact that the company's political activity posed no threat whatsoever to the incumbency of the current regime (at least, not at the national level). Gutseriev is described as having been a loyal member of the elite with no interest in challenging the political status quo (Rubanov, 2007), but he clearly objected to the way his home republic was run after Aushev's removal. Once again, the concern was that the federal government's *sovereignty* (in this case, its ability to project its authority in a troubled region) was being frustrated by Gutseriev's

⁶⁰ From a *Vedomosti* interview with Aleksandr Temerko, Yukos's former deputy CEO: "Yukos managers did discuss with Gutseriev the possibility of selling to him certain assets, and in particular of selling 50% of Tomskneft', [insists Temerko]. 'When Yukos's problems began, we began to look at what assets we could sell. But at that time everyone was very afraid of doing business with us, because they understood that they would have trouble from the state', Temerko recalls. But Gutseriev wasn't afraid, he received the nod for these talks from certain high-ranking Kremlin officials and thought no-one would touch him, Temerko explains. He appears to have found himself in a serious clash of interests among Kremlin officials" (Reznik, 2007c).

activities. The (unproven) allegation that Gutseriev might have been supporting illegal armed groups in the North Caucasus presumably exacerbated the situation, given the ruling elite's preoccupation with national security.

Explaining the rehabilitation

Two factors appear to have been crucial to Gutseriev's rehabilitation, which began in late 2009: the removal of the force that had created the pressure on him in the first place, and support from well-connected individuals who were able to plead his case within the Kremlin.

In October 2008, Zyazikov was replaced as the head of Ingushetia by Yunus-Bek Yevkurov. The latter was without doubt more positively disposed towards Gutseriev⁶¹. He is said to have asked President Dmitry Medvedev to allow Gutseriev to return to the country. Reportedly, this request won Medvedev's backing but was opposed by Putin (Nikol'skii, Mazneva, & Rakul', 2009). Although Yevkurov later denied responsibility for Gutseriev's subsequent rehabilitation, he did comment that "as an Ingush I publicly stated my view that this person should come to Russia and use his abilities, he would be of assistance to his country and his homeland, Ingushetia" (Muradov, 2010).

The *New Times* claimed that Gutseriev's return had been specifically requested by Medvedev as part of his drive for a business- and investments-focussed strategy for the Caucasus, replacing the previous strategy based on force (Alyakrinskaya & Vardul', 2010)⁶². However, Gutseriev did not play any prominent political role in Ingushetia following his return (though he was said to be in frequent contact with Yevkurov). As of January 2013 he had not yet made any new investments in the republic (Muradov, 2013). It therefore appears unlikely that his

⁶¹ Presumably to ease his transition from power, Zyazikov was given a job as aide to President Dmitry Medvedev. He was dismissed from this position in January 2012, and one news site suggested that it was because Zyazikov had lost his remaining political authority that Gutseriev was permitted to restore his full ownership of Russneft' in 2013 (Yegorov, 2013).

⁶² The most obvious symbol of this change of strategy was the appointment in January 2010 of Aleksandr Khloponin, the former head of Norilsk Nickel, as the presidential representative for the North Caucasus. Medvedev's election as President in March 2008 gave him responsibility for regional policy.

rehabilitation was conditional on his playing a role in solving Ingushetia's problems. Instead, Gutseriev managed after Zyazikov's removal to get the message across to the Kremlin (and specifically, to Putin) that he was not a threat.

Gutseriev flatly denied that Ingushetia had anything to do with his rehabilitation (Reznik, 2010), but one suspects that this was part of the general caution he exercised when discussing matters political after the takeover, the reasons for which will be explored below. By his account, the individuals who were key to his rehabilitation were Vladimir Yevtushenkov (head of AFK Sistema) and Sberbank CEO German Gref. He said that Yevtushenkov's involvement began at the end of 2009, when they met in London to talk about Sistema's purchase of Bashneft'. "The conversation turned to my return, and what would be the correct way to communicate to officials that I had been unjustly sentenced. Yevtushenkov decided to help me for unselfish reasons. He played a not insignificant role in communicating the truth to senior officials."

Bashneft'

As the outline case narrative showed, the sale of the Bashneft' companies to AFK Sistema occurred against the wider context of the Kremlin's efforts to remove Murtaza Rakhimov as President of Bashkortostan. Understanding the state's motives for the takeover entails coming to some conclusions about how these two processes related to each other.

Writing in 2004-5 about events surrounding Rakhimov's re-election in 2003, Yenikeyeff (2005) focused on the role played by "Moscow-based corporate groups" in political and economic processes in the Russian regions and the "collateral effect" on centre-periphery relations. Yenikeyeff describes the rival presidential bid from Sergei Veremeenko as having been an attempt by Moscow-based Mezhprombank (of which Veremeenko was managing director) to gain access to the republic's oil sector through regime change. He suggests that the first round of the election took place amid a "massive attack" waged by Mezhprombank

against Rakhimov, and hints that the Audit Chamber investigation into Bashneft's privatisation was an example of such pressure (i.e. was 'ordered' by Mezhprombank) (Yenikeyeff, 2005, pp. 245–6)⁶³. As noted earlier, the Kremlin switched support from Veremeenko to Rakhimov in the second round of the elections, ensuring the latter's victory. Yenikeyeff explains this variously in terms of Putin's concern regarding possible instability in the republic in the event of regime change, or in terms of "a temporary defeat of the [...] *siloviki* [...] in their political battles with the old 'family' group in the presidential administration", or by reference to Putin's concern that Veremeenko had become too popular in the republic⁶⁴. He also suggests that the Kremlin may never have taken seriously Veremeenko's bid, and was using Mezhprombank as "a battering-ram aimed at bringing the semi-independent region back under Moscow's control".

By not discriminating between these possible explanations, Yenikeyeff omits to make clear who was using whom: was the Kremlin using Mezhprombank to break down regional autonomy, or had Mezhprombank "captured" the state's coercive resources in order to attempt regime change for its own "gain-maximising" motives?⁶⁵ The present case study looks at Rakhimov's eventual ouster some years later, with the involvement of a different Moscow-based corporate group, AFK Sistema. It seeks to understand the state's motives in part by determining whether it was the state or Sistema that was calling the shots.

One clear difference from the events of 2003-4 is that AFK Sistema was not behind a rival presidential bid in Bashkortostan. Furthermore, although it clearly had designs on Bashneft', it

⁶³ The case of Veremeenko's bid for the Bashkortostan presidency is seen as an example of the following more general statement: "A federal corporate group may seek gain-maximisation through a direct attack on the political, economic and administrative resources of a paternalistic regional regime" (Yenikeyeff, 2005, p. 202).

⁶⁴ Yenikeyeff suggests that Mezhprombank, bolstered by its acquisition of Bashneft' and with the popular Veremeenko at the helm, would have been seen by Putin as a political threat (Yenikeyeff, 2005, pp. 289–290).

⁶⁵ Similarly, Speckhard (2004) finds a correlation between low levels of assertiveness in a region vis-à-vis the federal centre and the presence of national-level businesses in that region. Although he provides excellent insight into the motivations driving regional leaders to monopolise their local economies and keep them in a state of isolation from the rest of the country, he does not specify whether it is national-level companies or the Kremlin that are driving efforts to break down such autonomies.

managed to win the trust of the Rakhimov family that it could help them defend themselves against an attack that was coming not from Sistema but from the Kremlin. Selling Bashneft' to Sistema was acceptable to the Kremlin but did not prevent Rakhimov's subsequent removal from office. The political removal of Rakhimov was being sought on the Kremlin's initiative, not that of Sistema. It is helpful to consider first what was behind this political campaign to remove Rakhimov.

Rakhimov's ouster

As with Gutseriev, it is quite clear that Rakhimov presented no threat to the incumbency of the regime in Moscow. In fact, from that perspective Rakhimov was a positive asset: through his control of "administrative resources" he was able to "deliver" for the Kremlin an overwhelming vote in his republic in favour of the ruling United Russia party and the appropriate presidential candidate in nationwide elections (V. Ivanov & Voronina, 2003)⁶⁶. However, Rakhimov had been a consistent opponent of Putin's federal reforms - the system of federal super-districts, the change in composition of the Federation Council, and the new division of powers between the centre and the regions - all of which were aimed at imposing the Kremlin's authority and breaking down the power and autonomy of regional leaders. Although Rakhimov was happy to ensure that his republic voted consistently strongly in support of Kremlin-backed candidates in national elections, he expected to rule his republic without interference from Moscow. The economy was also seen as largely closed to outsiders, which served as an irritant both to the Kremlin and to the major business interests in Moscow (Badovskii, 2002).

There was real anger in Moscow at the way the Bashneft' companies were privatised in April 2003 (Bushueva, Khrennikov, et al., 2003). But rather than causing the Kremlin's moves to

⁶⁶ On the expectation that regional governors will "deliver" the vote for the Kremlin in national elections, see e.g. Sharafutdinova (2010, p. 675). Rochlitz (2013) suggests that regional leaders who deliver high pro-Kremlin votes are in exchange allowed by the Kremlin to engage in *reiderstvo*. If the Bashneft' takeover also counts as *reiderstvo*, then it seems particularly odd that Rakhimov should have been targeted, given his strong track-record in delivering pro-Kremlin votes.

replace him, the privatisation happened once those moves were already underway (Butrin, Skorobogat'ko, & Il'khamov, 2003)⁶⁷. According to some reports, when the Kremlin switched its support to Rakhimov in the second round, it made this conditional on Rakhimov agreeing to cede control of Bashneft' (Khannanova, 2005; A. Levinskii & Sokolova, 2010b)⁶⁸.

Rakhimov's election meant that he could serve out a five-year term that would end in December 2008. However, in late 2004 the system of electing regional leaders was replaced with what were effectively direct appointments by the federal President, subject only to approval by the regional parliament (which has proved to be a mere formality) (Goode, 2007). Under the new system, incumbent regional leaders could opt before the expiry of their term to "raise the question of trust" before the President, effectively forcing the latter to either replace him or grant him a new five-year term. Rakhimov took advantage of this in September 2006, and his candidacy for reappointment was duly presented by Putin to the Bashkortostan parliament, who overwhelmingly voted in favour in October 2006 (Khannanova & Gainullin, 2006b).

Several reasons were given in the media for the Kremlin's decision to reappoint Rakhimov in 2006. Firstly, it was suggested that he would be more vulnerable as a presidential appointee than as an elected republican President, and could now be removed much more easily by the Kremlin at the appropriate time. Secondly, his ability to "deliver the vote" was needed for parliamentary elections in December 2007 and presidential elections in March 2008. Thirdly, it followed the Rakhimovs' sale of blocking stakes in the Bashneft's companies to AFK

⁶⁷ When it was first announced in August 2002 that the republic would sell stakes in the Bashneft' companies, analysts assumed that the buyers would be Moscow-based companies that could lobby support for Rakhimov in the 2003 elections "despite the Kremlin's obvious dissatisfaction" with the republic's president (Khannanova & Skorobogat'ko, 2002). According to Speckhard (2004, p. 139), the Kremlin had by 2002 labelled Bashkortostan "a problem region" because of its refusal to phase out the 1994 power-sharing treaty.

⁶⁸ But see above for the alternative explanations proposed by Yenikayeff.

Sistema, and it was thought that Rakhimov had finally agreed to hand over control (Khannanova, 2006; Vinogradov, 2006)⁶⁹.

Sharafutdinova (2010) poses the question of what Putin's objectives had been in moving to the new system of gubernatorial appointments in 2004. She notes that the justifications offered by Putin and Surkov emphasized "technocratic" goals of "manageability", control and policy implementation. Putin stated that the reform was "with the aim of unifying state power," while Surkov claimed that this unity of power "is the necessary precondition for the unity of the nation". These stated justifications are strikingly similar to the definition of "domestic sovereignty" offered by Krasner (1999). However, Sharafutdinova effectively argues that this rationale conceals political goals that were left unstated by Putin and Surkov. She names "Luzhkov (Moscow), Shaimiev (Tatarstan), Rakhimov (Bashkortostan), and Yakovlev (St Petersburg)" as being the "most powerful and oppositional" regional leaders, and describes them as "the archetypal regional 'barons', with vast autonomy and discretion from the center, against which the reforms were supposedly undertaken, in the first place". Thus, she notes that if political consolidation were the key objective, all these regional leaders should have been replaced under the appointments system. At the time of her writing, only Yakovlev had been replaced. She argued instead, based on data on appointments available at the time, that only the weakest regional leaders who were unable to deliver the vote had been replaced. She concluded in part that delivering the vote, i.e. ensuring the survival of the existing regime in the Kremlin, had been Putin's primary consideration all along; but she also suggested that the particular failure to replace Rakhimov had in part been down to his having been canny enough to "pledge loyalty" and refrain from criticising Putin, as well as the fear of regional destabilization in ethnic republics such as Bashkortostan (as well as Tatarstan and Chechnya).

⁶⁹ Another suggestion was that Rakhimov had agreed to allow the sale of the local gas processing company Salavatnefteorgsintez to Gazprom, and that Dmitry Medvedev (then Gazprom's Chairman) had in exchange lobbied for his reappointment (Latukhina, 2006). However, given that the pressure continued on Rakhimov to sell the Bashneft' companies, this seems unlikely to have been the whole story.

Since Sharafutdinova's article was published, all of the named "archetypal regional barons" including Rakhimov *have* been replaced, suggesting that the sovereignty-based rationale given by Putin and Surkov for the 2004 reform was perhaps the genuine reason after all. It seems clear from the account given above that there was a desire on the part of the Kremlin to do away with Rakhimov's regime at least as early as 2003. However, in line with Sharafutdinova's argument, a countervailing concern to ensure that Rakhimov continued to "deliver the vote" in national elections does seem to have helped to keep him in power for a time.

The turning point appears to have come with the March 2008 presidential elections that were won by Dmitry Medvedev. It has been suggested that the Kremlin felt Rakhimov was no longer valuable in terms of delivering the vote: his advanced age meant that he would almost certainly retire before the next important elections (Gal'perin, 2008). This would seem to fit with the idea that Putin's primary concern in the question of whether or not to replace Rakhimov was maintaining or consolidating the political power of his regime. But Rakhimov's ouster was also part of a wider trend: as Blakkisrud (2011) notes, Medvedev's presidency saw a substantially higher turnover of incumbent governors than had been the case under Putin⁷⁰.

If delivering the vote was the key objective, the Kremlin could have made life much easier for itself by allowing Rakhimov to appoint his own post-retirement successor, someone from the existing republican elite who would be equally well-placed to deliver the pro-Kremlin vote in future national elections. Instead, in summer 2008 the Kremlin went on the offensive. Negative reports about Rakhimov appeared on federal channels including TV-Centre, REN-TV and Pervyi Kanal. The media coverage was reportedly coordinated by Surkov, who had previously been of the view that Rakhimov was a necessary evil for the Kremlin (Gal'perin,

⁷⁰ Blakkisrud interprets this higher turnover as a drive to complete Putin's project to curb regional autonomies, rather than as a *departure* from Putin's approach.

2008). Also at this time, Radei Khabirov, Rakhimov's chief of staff, was given a job in Medvedev's presidential administration, amid rumours that he was being considered as the Kremlin's preferred successor. Between October and December the Kremlin brought in people from outside the republic to head the local Interior Ministry and division of the FSB, replacing Rakhimov allies (Gal'perin, 2008). A criminal case was opened on suspicion that the Rakhimovs' security team had illegally possessed weapons and ammunition.

Reports appeared in the local media in December 2008 that Rakhimov had been persuaded to resign by the president's special representative for the Urals Federal District, Grigory Rapota; but that Rakhimov had asked to wait until after his 75th birthday in February 2009 (Kostenko, Glikin, & Shcherbakova, 2009). However, that deadline came and went, and in March 2009 Rakhimov launched a public attack on the Kremlin for undermining federalism, trying to dictate terms to the regions and encroaching on the cultural rights of ethnic groups (Shcherbakov & Gorodetskaya, 2009).

In June 2009, Rakhimov gave an interview with a major newspaper that was even more critical, claiming that Russia was a one-party state, was more centralised than in Soviet times, and that the State Duma was a disgrace (Rostovskii, 2009). Soon afterwards, Surkov arrived in the Bashkortostan capital and secured a statement from Rakhimov that was supportive of the Kremlin. Some sources in Moscow claimed that Rakhimov was to keep his post, but others argued that this was only temporary pending a decision on who should replace him (Kostenko, Glikin, & Kholmogorova, 2009). Rakhimov's resignation finally came in July 2010. During the intervening period, the Kremlin *did* consult with Rakhimov on who might be an acceptable successor, but this was not the same as allowing him to choose: his preferred choice, Prime Minister Rail' Sarbaev, was effectively vetoed by the Kremlin (Kostenko, Glikin, & Kholmogorova, 2009), and the eventual choice, Rustem Khamitov, was widely seen as having no ties to Rakhimov (Khannanova, 2010).

The coercive takeover

The above section helps to clarify how the Kremlin went about removing Rakhimov from power, and what its underlying objectives were. The next task is to understand how the SLCT involving the Bashneft' companies relates to that process. Table 1 places key events in the two processes side-by-side in a single chronology.

Date	Developments relating to Rakhimov's ouster	Developments relating to the SLCT
Early 2003	Veremeenko rival presidential bid	
Apr 2003		Bashneft' privatised in favour of Rakhimov's son, Ural
Jul 2003		Audit Chamber investigation into privatisation
Dec 2003	Kremlin supports Veremeenko in 1st round of elections	
Early 2004	Kremlin switches support to Rakhimov, who wins 2 nd round	
Feb 2005		Rakhimov accuses Ural of political "conspiracy", begins campaign to renationalise Bashneft'.
Jun 2005		Rakhimov drops legal action vs Bashneft' after reported peace deal. Legal challenge from local prosecutors.
Late 2005		With prosecutors' appeal pending, Rakhimovs sell blocking stakes in Bashneft' cos to AFK Sistema.
Mar 2006		Criminal case opened re tax evasion at Bashneft' parent company, Bashkirskii Kapital
Apr 2006		Rakhimovs split stakes in Bashneft' cos into smaller tranches and sell them onto obscure charities, LLCs
Oct 2006	Kremlin grants Rakhimov new term	
Dec 2006		Federal Tax Service moves to expropriate Bashneft' in response to April 2006 transactions
2007		Putin reportedly tells Rakhimov to cede control of Bashneft' or face expropriation
Summer 2008	Kremlin media campaign vs Rakhimov; his allies removed	
Nov 2008		Sistema subsidiary becomes temporary manager of Bashneft' cos for 3-year period
Mar 2009	Rakhimov public criticism of Kremlin	Rakhimov agrees to cede control of Bashneft' to Sistema
Jun 2009	Surkov intervenes to stop Rakhimov's attack on Kremlin	
May 2010		Audit Chamber closes investigation into privatisation
Jun 2010		Audit Chamber investigation re-opened
Jul 2010	Rakhimov resigns	
Sep 2010		Audit Chamber head promises to establish "who bought what and for how much" in 2003.

Table 1. Rakhimov's ouster and the Bashneft' takeover⁷¹

⁷¹ The table is compiled from sources cited elsewhere in this chapter. Some of the events mentioned in the table are described in more detail later in this report.

The table underlines the fact that Rakhimov's removal was more than simply a part of the main objective of bringing about the Bashneft' takeover. At the end of 2003 and in October 2006 there was speculation that the Kremlin's decision at the time to support Rakhimov's continued reign had been part of an agreement whereby Rakhimov would agree to cede control of Bashneft' to a more appropriate owner. However, it was not until 2009 that he finally did so. Rakhimov resigned *after* handing over control of Bashneft' to AFK Sistema. The fact that that sale met no serious obstruction from the authorities indicates that this was an outcome that was acceptable to the government⁷². But it did not mean that Rakhimov was permitted to remain in office.

A more robust argument is that the SLCT was part of the main objective of removing Rakhimov from power. In the words of one Kremlin source, removing Rakhimov's control over Bashneft' was a first step towards a change of leadership in the republic (Kostenko, Glikin, & Shcherbakova, 2009)⁷³. But the chronology does not neatly support that argument. The two processes were not always co-ordinated as a single campaign of attack by the Kremlin. For example, the Kremlin reappointed Rakhimov in October 2006 despite the fact that the Rakhimovs had recently carried out dubious transactions involving Bashneft' shares that threatened to put them beyond the reach of the state (and these transactions had been public knowledge since April). Rakhimov continued his public criticism of the Kremlin after he had agreed to sell controlling stakes in Bashneft' to Sistema.

⁷² The Audit Chamber investigation into the 2003 privatisation was closed down in May 2010, after AFK Sistema had gained control of Bashneft'. But it was re-opened just a month later, some time before Rakhimov's resignation. And after that resignation, in September 2010, Audit Chamber head Sergei Stepashin arrived in Bashkortostan promising to establish "who bought what and for how much" (Amladov, Granik, & Gorodetskaya, 2010). However, it seems reasonable to propose that the Audit Chamber's investigation had something of a life of its own, independent from the political campaigns to remove Rakhimov and force the Bashneft' takeover. It stemmed from real concerns regarding the legality of the privatisation. The attempt to close it down in May 2010 suggests an unsuccessful political intervention, perhaps as part of the state's deal with Rakhimov.

⁷³ cf. Barnes (2006a), who argues that rival forces (including the state) compete for commercial assets not only as sources of profit, but also as sources of institutional power.

The most plausible explanation is that the Kremlin was pursuing both the ouster and the SLCT, and did not intend to sacrifice one on behalf of the other. The political motivations behind the SLCT were not limited to Rakhimov's ouster. They also involved developmental concerns and economic sovereignty. Rakhimov had a strong hold over much of the republic's economy, maintaining it in a high degree of isolation from the rest of the country. Peregudov, Lapina and Semenenko (1999, p. 196) described Bashkortostan under Rakhimov as being similar to neighbouring Tatarstan, where companies that did not succeed in establishing ties with the republican administration were obliged to quit the republic altogether. This posed a challenge to Putin's efforts to create a single, nationwide economic space⁷⁴. But the main implications were for the oil industry specifically: the Bashneft' group's oil refining capacities had an important role to play in Putin's drive to boost oil product exports as a way of moving up the value chain in the world economy⁷⁵. This would not happen as long as Bashneft' was being run under Rakhimov's ownership in such a way as to create "an independent market with its own internal price for oil and oil products" (Mordyushenko et al., 2009). Importantly for the second research question, nationalisation was not a requirement for solving this problem: it could instead be done by transferring Bashneft's ownership to a *private* business that had a federal, rather than a parochial, reach.

Research question 2: explaining the ownership outcomes

Factions and rent-seeking

Much journalistic and expert commentary regarding these takeovers has sought to predict and/or explain their outcome by reference to rivalry between self-interested bureaucrats. These bureaucrats act as patrons of the various companies who might emerge as the new

⁷⁴ "Widespread assertive regionalism would erode the state's ability to [...] ensure a uniform legal framework and infrastructure for the national market" (Speckhard, 2004, p. 58).

⁷⁵ See the discussion in Gustafson (2012, pp. 369–370) of tax changes introduced in 2005 to favour the export of refined oil products.

owners. In each case, the expected owners were Rosneft' or Gazprom. At Yukos, state-owned Rosneft's political patrons are described as having instigated the takeover (and seen off a challenge from their rivals at state-owned Gazprom) for their own power- or wealth-maximising motives. Rosneft' and Gazprom are also seen as having competed to take over Russneft' and Bashneft'. When private companies became involved, they were seen as acting on behalf of the *real* buyers (Rosneft' or Gazprom) or of their political patrons.

As noted above, however, the instigators in all three takeovers were the same, and there is considerable evidence of Putin's personal involvement. In this light, the fact that the ownership outcomes differed can only be explained in factional terms if Putin is acting as an arbiter between rival factions, maintaining a balance between them in order to preserve his own power. On this reasoning, the *siloviki* must not be allowed to become so dominant that they pose a potential challenge to Putin himself, therefore the "liberals" are permitted the occasional victory (Holmberg, 2008; Mehdi & Yenikeeff, 2013; Rochlitz, 2010). It could be claimed that the *siloviki* were not permitted to build on their victory at Yukos by taking over the (much smaller) Russneft' and Bashneft' as well.

There are methodological problems with this type of explanation: there is little hard evidence against which to test it (how would we know whether or not Putin is actually "balancing" the interests of rival factions?), there are problems defining and delimiting factions (how do we know who is "in" and who is "out" of a particular faction?), and the explanation is worryingly flexible (it can be used to explain the fact that Rosneft' was the main buyer of Yukos's assets, but with a few tweaks could equally well have been used to explain an entirely different outcome). However, it still needs to be considered for the possibility that it best explains the outcomes of the three cases.

Limitations of state ownership

The literature provides some theoretical grounding for an explanation of the dependent variable that is instead based on the strengths and weaknesses of state ownership versus private ownership. As noted in Chapter 1, Hanson (2009, 2011) has explored the possibility that Russian state actors use “trusted” (*doverennye*) private businessmen as an alternative to state ownership. Without coming to any firm conclusions about what motivates state actors to carry out SLCTs, he suggests (2009, pp. 22–23) that the Yukos affair might have been prompted by a decision to establish state control over the oil sector. He argues that to do this it was only necessary to explicitly *nationalise* Yukos itself: this was enough to signal to the remaining private actors in the sector that they had to submit to the Kremlin’s instructions on how to behave. In this atmosphere of greater subordination to the Kremlin, it became a viable option to let “trusted” businessmen become the new owners in subsequent SLCTs such as Russneft’. Hanson states that in the unlikely event state actors were pursuing economic development rather than narrow interest-maximisation, they should have learned that state-controlled companies underperform their private counterparts. If power is instead the main motivation, then in the post-Yukos climate “trusted” businessmen are sufficiently subordinate to the Kremlin to be used to undermine the power-base of political adversaries. And if it is material self-interest that dominates, state actors should have realised that it is just as easy to extract rents from private business (e.g. through hidden ownership or kickbacks) as from state-owned companies. Therefore, by any of the possible motivations, control through “trusted businessmen” is an attractive alternative to state ownership from the point of view of state actors.

This would only provide a causal explanation for the varying ownership outcomes in this chapter’s three cases if it were indeed the case that state actors *learned* since the Yukos affair that nationalisation was a bad idea, and accordingly preferred subsequently to allow companies to be sold to “trusted” private businesspeople instead. This would fit with the

sequencing of the Yukos, Russneft' and Bashneft' takeovers. But there are weaknesses in the argument: firstly, it does not fully explain why nationalisation was a necessary outcome for the expropriation of Yukos. Would the warning to other oligarchs not have been just as clear if Yukos had instead been expropriated in favour of a politically loyal private businessman? Secondly, the demonstration effect of the Yukos case has been questionable given that the state has felt the need to intervene in subsequent cases (including Russneft' and Bashneft'). And the Russneft' intervention, which has not resulted in nationalisation, took place when the Kremlin's fondness for state ownership was apparently at its peak⁷⁶. Thirdly, it would seem that state actors have not learned the requisite lesson either, because SLCTs after Yukos *have* had nationalising outcomes, for example the takeover of Bank Moskvyy by state-owned VTB in April 2011 ("Chei Bank Moskvyy?," 2011).

Contingent nature of the outcomes

The strongest argument against explanations based on Putin's acting as arbiter between factions, and those based on state actors learning about the weaknesses of state ownership, comes from evidence that the outcomes of the three cases were in fact highly contingent in nature.

With respect to the Yukos affair, this point is expressed well by Gustafson (2012, p. 314): "The simplest version—that Yukos was expropriated because the leading siloviki saw an opportunity to take it over for themselves—is demonstrably false [...] the transfer of Yukos's resources to Rosneft came about as the result of a fluke, which was not foreseen by the ultimate beneficiaries themselves." As will be discussed below, the nature of this "fluke" was that Gazprom, the state-owned company which at some point did become the Kremlin's intended buyer, was prevented at the last minute from taking ownership of Yukos's main asset

⁷⁶ Two major new state-owned joint-stock companies, the United Aviation Company (OAK) and the United Shipbuilding Company (OSK), were created in November 2006 and March 2007 respectively. Vneshekonombank (VEB) became a state corporation in July 2007. The state corporation Rostekhnologii was created at the end of 2007.

by international legal action from Khodorkovsky's allies. Rosneft' stepped in because, unlike Gazprom, its international exposure was at the time close to nil. But it is also argued below that before the Kremlin settled on Gazprom as its intended buyer, it had been prepared to accept a *private* buyer for Yukos (in the form of a revised version of the Yukos-Sibneft' merger which would have given the latter management control).

It will also be shown below that at Russneft' and Bashneft', the new private owners are unlikely to have been those the Kremlin had in mind specifically when the takeovers were instigated. Deripaska approached Gutseriev with the offer to buy Russneft' after receiving the nod from the Kremlin, only to have his acquisition blocked by the Kremlin. When this deal was unwound, the idea to sell instead to Yevtushenkov arose at a meeting in London with Gutseriev, and was apparently in exchange for Yevtushenkov's lobbying senior Kremlin officials to get the criminal charges against him dropped. Rakhimov approached Yevtushenkov as a *defensive* move against Kremlin pressure, rather than being instructed by the Kremlin to sell to him. Furthermore, in both cases these private ownership outcomes followed failed attempts by state actors to expropriate controlling stakes in the companies through the courts.

The takeover as bargaining game

The contingent nature of the outcomes lends weight to the view that the primary concern of the state was to deprive the existing owners of their assets: whether those assets were transferred to state or private hands was a matter of secondary importance. In the absence of a strong preference for a particular new owner, the differing outcomes instead depended to a large degree on the way the takeover played out as a bargaining game between the state and the existing owner.

The previous chapter introduced the notion of the SLCT as bargaining game, and began to explore how the outcome of this game affects the ownership outcome. Simply put, each

takeover begins with state coercion, on the basis of which the state makes a “carrot-and-stick” offer to the existing owner. The reason why this offer is made at all (why the state does not in every case opt for the full-scale asset seizure and mass arrests it eventually pursued against Yukos) is that such actions are a substantial drain on state resources as well as having reputational costs.

Just how great an administrative burden is entailed by full-scale asset seizure depends on the type and nature of the business that is being expropriated. Does its value consist largely of physical assets that can be easily seized, or cash that can easily escape seizure, or other intangible assets that would not survive seizure (such as dependence on key clients who will take their business elsewhere)? Is it a solely domestic company in its ownership, financial flows and physical assets, or will the asset seizure have to be waged internationally, including through foreign courts which take a dim view of the Russian justice system? As these questions show, there are defensive tactics available to business owners to increase the costs of asset seizure by the state. For example, owners can build offshore affiliates and financial networks to save a greater portion of the business’s value from seizure and increase the administrative costs to the state if it chooses to pursue asset seizure. However, as the Rakhimov family demonstrated with its sleight-of-hand involving shares in the Bashneft’ companies, this can also be done using purely domestic techniques.

If the owner rejects the “carrot-and-stick” offer and the state follows through on its threat to pursue full-scale coercive seizure, then the ownership outcome is almost certain to be nationalisation. After the state’s coercive resources have been used on such a scale to force the takeover, a “private” outcome would be controversial. The state would be accused of having been “captured” by this new owner, of having allowed its coercive resources to be used for his mercenary ends. It would face a loss of credibility at home, criticism abroad and (if the target business has an international dimension) international legal action from the victims. It would be unable to argue that the company had been expropriated in the national interest. Only a

highly authoritarian regime living in a state of international isolation would be willing to go down this road. It would also require the consent of the private company that was set to be the new owner, which might be less than keen to be associated with the expropriation because of the damage to its reputation and (if it has one) its share price, and the likelihood that it would be entangled in the ensuing international litigation brought by the victims. It might find the doors of Western financial institutions and foreign markets closed to it as a result⁷⁷.

Such is the state's reluctance to pursue full-scale asset seizure that, if the owner instead agrees to sell and accepts certain other conditions (i.e. to refrain from activities deemed to threaten state sovereignty), he can expect to receive material compensation that goes at least some way towards the market value of the asset. The ownership outcome can, in this case, be either the sale to a state-owned company or to a new private owner. As noted in Chapter 1, the outcome at this point depends on a variety of political and commercial factors which determine who might be genuinely interested buyers (Pappe & Galukhina, 2009, pp. 161–5; Radygin & Mal'ginov, 2006). However, the case evidence to which we now turn suggests that the state's reluctance to pursue full-scale asset seizure favours the private ownership outcome, because private buyers can help to bring about the negotiated outcome that the state prefers.

Relating the cases to the theory

Yukos

The “carrot-and-stick” offer and the possibility of an alternative outcome

As the quotation from Gustafson noted above, there was in fact nothing predetermined about the ownership outcome of the Yukos affair. There is credible evidence that an offer was on the table from the Kremlin that could have enabled Yukos to survive under private ownership.

⁷⁷ Russia's annexation of Crimea in 2014 suggested that Putin was now prepared for such international isolation. But at the time of the Yukos affair, he was not. As will be shown below, the government both cited the national interest as justification and went to considerable lengths to maintain the facade that Yukos was bankrupted in a legal and “market-based” way.

Furthermore, even after that offer was withdrawn and the Kremlin resolved to pursue nationalisation, it was only a highly contingent and extraneous factor that led to Rosneft's being chosen over Gazprom as the preferred new owner for Yukos's assets.

After the merger between Yukos and Sibneft' was announced in April 2003, the government continued for several months to express its support. In its original form, the merger would have amounted to the takeover of Sibneft' by Yukos⁷⁸. The result would have been the largest player in the oil sector, with no state ownership (Pappe & Galukhina, 2009, p. 213). Putin reportedly gave the nod to the Yukos-Sibneft' merger the day after it was announced⁷⁹, and it received approval from the FAS as late as August 2003 (Sapozhnikov, 2003). If the state was intending to destroy Yukos from the outset, then the government's apparently benign attitude to the Yukos-Sibneft' merger must have been some kind of trap laid for Khodorkovsky, as indeed some in the Yukos camp have claimed (Sixsmith, 2010, p. 76). A less conspiratorial and more likely explanation is that at this time, the government was genuinely in favour of the deal. But how to square this with the mounting pressure on Yukos in the months following April 2003? Pappe and Galukhina (2009, p. 215) suggest that at this time the Kremlin was already set on neutralising Khodorkovsky as a political threat, including by cutting him off from ownership of Yukos and the financial flows he derived from it – *but* that the intention was to do so without harming Yukos itself. The Kremlin's attitude to Yukos-Sibneft' was surely one of support for the creation of a national champion for the oil sector (even under private ownership), but on the condition that Khodorkovsky and his allies agreed to exit the company. In other words, it assumed their acceptance of a “carrot-and-stick” offer from the Kremlin.

⁷⁸ Sibneft's shareholders would sell 20% of the company to Yukos for \$3bn, and exchange a further stake of just over 70% for new shares issued by Yukos. Yukos would thus own over 90% of Sibneft'. 55% of the merged company would be owned by Yukos's core shareholders, and 26% by those of Sibneft'. The merged company was to be headed by Khodorkovsky (Pappe & Galukhina, 2009, p. 213).

⁷⁹ Putin's demonstration of approval came in the form of his meeting the following day with Khodorkovsky and Sibneft' president Yevgeny Shvidler (Pappe & Galukhina, 2009, p. 213).

That such an offer was made is indicated by these words from an unnamed oil executive quoted in Sixsmith (2010, p. 244): “I think Putin, or the Kremlin, would have been prepared to pay for the company. So if Khodorkovsky had not taken such an aggressive stance against Putin, he might have received a good deal of money and been able to leave the country. I am sure a deal like that could have been concluded, but Khodorkovsky’s attitude made it impossible”.

The Kremlin may not have approached Khodorkovsky and spelled out the terms of its ultimatum prior to his arrest, but it seems that he and his allies were aware implicitly of what was expected of them. Sakwa (2009, p. 156) writes that, before his arrest, Khodorkovsky made clear that he refused to “take the Berezovsky or Gusinsky path and go into exile,” despite being strongly urged by Nevzlin and others to do so. “Among other things, Nevzlin considered that this would be a way of saving the company.” Viktor Gerashchenko, the former Central Bank governor who became Chairman of Yukos in July 2004, later claimed that “with Mikhail Khodorkovsky they waited almost to the end of the year [i.e. 2003], they were sure that he would ‘understand everything’ and leave the country, and then it would be possible to redistribute Yukos without any fuss” (Yaroshevskii, 2008).

Khodorkovsky’s arrest in October 2003 naturally upped the stakes, but it did not mean that the “carrot-and-stick” offer was yet off the table⁸⁰. In fact, an anonymous, “knowledgeable” source cited by Hanson (2007a, p. 880 fn. 24) claimed that Khodorkovsky, when in pre-trial detention, “was offered a dropping of all charges if he surrendered his assets”.

The Yukos-Sibneft’ merger also lived on as a possibility after Khodorkovsky’s arrest, albeit in a changed form. In November, Sibneft’ heads Roman Abramovich and Yevgeny Shvidler met

⁸⁰ cf. Sixsmith (2010, p. 148): “In retrospect there may well have been a window of opportunity for a deal to be done in the first days after Khodorkovsky’s arrest. The price of his freedom, though, may have been higher than the Yukos executives expected or were willing to pay at that stage. It would almost certainly have meant exile; the loss of all his wealth in Russia; the end of his political ambitions both through the Duma and through the social engineering of Open Russia. It also would probably have meant Khodorkovsky’s remaining in gaol until December’s parliamentary elections – or even the following March’s presidential elections – were safely out of the way.”

with Khodorkovsky's Menatep colleagues in Tel Aviv, and proposed that Sibneft' rather than Yukos take management control of the merged company, which would be chaired by Putin's former chief of staff Aleksandr Voloshin⁸¹. Abramovich presented this as being the only way that the Kremlin would approve the merger ("Yukos rejects Sibneft demand," 2003). The later accounts of various Menatep insiders indicate that Leonid Nevzlin, to whom Khodorkovsky had delegated decision-making authority, effectively vetoed the Abramovich proposal. He was convinced that the merger had even in its original form been a trap set by Abramovich in collusion with Putin (Sixsmith, 2010, pp. 159–160). Khodorkovsky, former Yukos Vice-President Aleksandr Temerko and former Yukos CFO Bruce Misamore all disagreed with Nevzlin on this point, believing that Abramovich was acting in good faith (Sixsmith, 2010, pp. 159–163, 290).

Once this Sibneft' offer had been rejected by Menatep, the Kremlin removed its offer from the table and resolved to pursue full-scale asset seizure at Yukos. The following months saw Yukos making counter-proposals in an effort to resolve the conflict. Gerashchenko claims that, soon after he became Yukos Chairman in July 2004, Khodorkovsky offered to place his stake in Yukos (and those of his Menatep allies) in trust, to be sold by the Yukos management to pay the company's tax debts. This could have left the state with a controlling stake in the company, but the offer was declined by Putin's aide Igor' Shuvalov, who said that the Kremlin had no faith that Khodorkovsky would honour such an agreement (Yaroshevskii, 2008).

There is some agreement in the literature that Khodorkovsky bears personal responsibility for the fact that no deal was reached with the Kremlin. Although Yukos and its owners employed various defensive tactics, these were aimed at persuading the state to yield altogether or, failing that, at raising the costs to the state of full-scale asset seizure. They were not aimed at improving the terms of a negotiated outcome, because Yukos's owners were (at least until the

⁸¹ Voloshin resigned as chief of staff on 30 October 2003.

beginning of 2004) unprepared to accept such an outcome. Khodorkovsky's decision to stand his ground and fight for justice came at considerable cost not only to himself, but to a great many of Yukos's other shareholders and employees and their families. As the game-tree presented in the preceding chapter suggests, the decision to take a stand against the state and refuse the negotiated outcome makes little sense in terms of rational, interest-maximising actors. It was driven not least by a sense of injustice at the arbitrary state coercion that was used against him, his colleagues and the company itself; it became an altruistic (if somewhat quixotic) campaign for justice (Khodorkovsky & Gevorkyan, 2012).

Defensive tactics of the existing owners

As noted in Chapter 1, Markus (2008) has singled out the enlisting of foreign minority shareholders as one of the most important defensive strategies businesses can adopt against "expropriation" by the state. Yukos too had foreign minority shareholders, and it is true that the holders of its depositary receipts launched legal action in the United States against the Russian state, Rosneft' and other defendants (LaCroix, 2007). Furthermore, had Yukos succeeded in taking on Exxon or Chevron as a strategic investor, then such a shareholder might have been able to use its influence with the US government to help protect Yukos from expropriation, as Markus envisages. But other aspects of Yukos's internationalisation proved more important in raising the costs to the state of pursuing full-scale asset seizure.

In financial terms, the destruction of Yukos was in fact highly profitable for the state and for state-owned Rosneft'. As Sakwa (2009, p. 245) notes, "the Putin regime won hands down in its struggle with Yukos [...] Not only had it managed to squeeze at least \$32 billion out of the company in back taxes, it had then been able to buy its assets for roughly half their market valuation." Rosneft' had a market capitalisation of \$4bn in 2003, spent \$21bn buying up Yukos assets, and saw its market capitalisation rise to \$90bn in 2007. However, the Yukos affair came at considerable cost in terms of the drain it placed on the state's limited and flawed bureaucratic resources. It required the deployment of large numbers of police,

prosecutors, lawyers, accountants and tax officials, and the coordination of their activities. The complexity of the task was undoubtedly compounded by the fact that Yukos had not only foreign minority shareholders, but also foreign assets, directors, and creditors, as well as international cash-flows and commodity-flows, and an ownership structure spanning numerous offshore jurisdictions⁸². This provided the basis for further international legal action. Furthermore, Sixsmith's interviews with Khodorkovsky's associates reveal how they scrambled to get as much of their money safely offshore before the Russian government was able to seize it (Sixsmith, 2010, pp. 255–257)⁸³. Even the company's share register was smuggled offshore and beyond the reach of the Russian authorities (Gurova, Rubchenko, & Tsunskii, 2004). Because it was intent on seizing as much as possible of Yukos's value (albeit under the façade of market-based legitimacy), the Russian state was forced to respond internationally as well, and this meant putting its prosecutorial case to foreign judges who did not hold any bias in its favour.

In order to test the proposition that expropriation requires nationalisation, it is possible to consider the plausibility of a counterfactual scenario whereby Yukos's assets, having been seized by the state, were then acquired by private company Sibneft'. This seems unlikely for the reasons already stated: the Kremlin would have been widely accused of having been "captured" by Sibneft', and it would not have been able to cite the national interest in its justification for the expropriation⁸⁴. The presence of foreign minority shareholders at Sibneft', that company's international ownership structure⁸⁵ and its exposure to international markets would certainly have made Abramovich think twice about such a deal. If Sibneft' were buying

⁸² Including Cyprus, the Isle of Man and Gibraltar (Sakwa, 2009, p. 169; Sixsmith, 2010 ch. "The British Troika").

⁸³ Kevin Bromley, one of three British men who became directors of Menatep (GML) in 2004, spoke openly to Sixsmith about their role in "selling off assets without bringing the full wrath of the Russian authorities down on our heads [...] It was a big programme to salvage as much as possible" (Sixsmith, 2010, p. 256).

⁸⁴ For an attempt by the government to portray the Yukos affair as having been for the public good, see Medetsky (2007), cited in Sakwa (2009, p. 246).

⁸⁵ Sibneft's then-parent company, Millhouse Capital, was registered in the UK.

Yukos as a favour to the Kremlin, it may well have considered asking for a substantial financial consideration to make the risks more palatable, as Pappé has argued (Gurova et al., 2004).

The international dimension of the Yukos affair explains why considerable lengths were gone to in order to create the façade of a legal and even market-based process to what was essentially seizure of assets with negligible compensation. This façade was sufficient to allow Rosneft' to conduct a successful IPO in July 2006, raising \$10.4bn for a 13% stake, and enabled it to work successfully with the international financial community after the IPO. But it was not enough to prevent a compensation lawsuit brought by Menatep in The Hague that threatened to lead to the seizure of Russian government assets abroad, and those of Russia's state-owned companies (Sixsmith, 2010, pp. 267–270), though it was uncertain whether Menatep could convert a favourable ruling into meaningful enforcement. The Russian government also expended a great deal of effort, largely without success, to persuade foreign courts to extradite former Yukos or Menatep employees for trial in Russia, or prevent Yukos assets abroad being sold outside the framework of the Russian bankruptcy process. If the authorities had been more blatantly arbitrary in their treatment of Yukos, then these problems would have been still more acute.

Why this new owner?

Rosneft's management is seen as having been involved in the pressure on Yukos in the crucial months leading up to Khodorkovsky's arrest and afterwards⁸⁶. However, even if nationalisation was the Kremlin's determined end goal for Yukos from the end of 2003, there was no guarantee at the time that Rosneft' would be the state-owned company to benefit. In September 2004 it emerged that the government was preparing a merger deal that would effectively have seen Rosneft' taken over by Gazprom. According to Gustafson (2012, pp.

⁸⁶ e.g. Gustafson (2012, p. 336) claims that Rosneft' CEO Sergei Bogdanchikov, "more and more plainly backed by the Kremlin, became one of the principal leaders of the campaign against Mikhail Khodorkovsky and Yukos."

338–341), this deal was presented to Putin by Gazprom CEO Aleksei Miller and Prime Minister Mikhail Fradkov, effectively sidelining Igor' Sechin (Rosneft's Chairman since July 2004) and Rosneft' CEO Sergei Bogdanchikov.

At the time of the Yuganskneftegaz auction in December 2004, Gazprom's takeover of Rosneft' was still on the cards. It was Gazprom, not Rosneft', that was originally intended to be the buyer of this key Yukos asset. Legal action from Yukos in a court in Houston, Texas led to the judge issuing a temporary injunction suspending the auction, whereupon the international banks that planned to lend money to Gazprom to finance its acquisition got cold feet. The auction went ahead nonetheless, and was won by the sole bidder, an obscure company named Baikalfinance Group (Skorobogat'ko, Butrin, & Kovalev, 2004). It was then bought by Rosneft' a few days later (Reznik et al., 2004). Putin made clear that Baikalfinance Group was a transitional purchaser whose role was to shield the ultimate buyer from legal action⁸⁷. Significantly, no Western banks were involved in providing the finance for the acquisition⁸⁸.

The outcome of the Yuganskneftegaz auction strengthened the hand of Rosneft's leadership, who were not keen to have their company absorbed into its larger state-owned sister company. But it did not yet mean that a decision had already been made to let Rosneft' acquire the majority of Yukos's assets, though many observers promptly predicted that this would happen (Reznik et al., 2004). In fact, Gazprom still intended to buy Yuganskneftegaz as part of its takeover of Rosneft'. Resistance from the latter meant that it briefly looked as though Rosneft' CEO Sergei Bogdanchikov would be permitted to head a standalone

⁸⁷ Putin's words, in an interview with Spanish media on 7 February 2006, were as follows: "The future owners had to think about how they would work; how it may be that they would have to defend lawsuits which might be issued against them. And when BaikalfinanceGroup bought the corresponding stake, it became the owner. Everything that happened later took place on the secondary market. In this way the claims against those who then bought this asset were effectively reduced to nothing" (Putin, 2006).

⁸⁸ Gustafson (2012, p. 348) writes that "the bulk of the cash came from the Chinese oil company CNPC, in the form of a prepayment against future oil exports by Rosneft' to China [...] The prepayment went through Russia's state-owned bank for foreign trade, Vneshekonombank (VEB). In addition, Rosneft' received a sizable loan from the other major Russian state-owned bank, Sberbank."

Yuganskneftegaz, with the rest of Rosneft' being taken over by Gazprom ("Rosneft' sol'etsya s Gazpromom bez Yuganskneftegaza," 2005). The Gazprom-Rosneft' merger was abandoned at the last minute in May 2005, apparently thanks to lobbying by Sechin and Bogdanchikov (Goldman, 2008, pp. 190–191; Sakwa, 2009, pp. 326–9). But it would be wrong to see Rosneft's superior lobbying power as having determined its ultimate victory: the turning-point had been Yukos's legal action, which put paid to Gazprom's bid for Yukos's main asset. It was Rosneft's largely domestic focus at this time, and its corresponding lack of exposure to international legal action, that proved decisive.

Subsequently a political decision must have been taken to ensure that Rosneft' emerged as the preferred buyer for all the Yukos assets⁸⁹. As the problems later faced by Russneft' illustrate, no private company was permitted to bid for any of the assets of bankrupted Yukos, despite speculation that cash-rich Surgutneftegaz would be a contender (Sakwa, 2009, p. 187).

Thus it seems clear that the state's intervention at Yukos was not undertaken with a nationalising outcome in mind, let alone with the specific outcome of transfer to state-owned Rosneft'. Therefore it is possible to reject the notion that the Yukos affair was from the outset aimed at restoring state control of the oil industry by increasing the role of state-owned oil companies. Since the company which ultimately benefited most from the Yukos affair could not have known from the outset that that would be the case, it also seems unlikely that the SLCT was undertaken with rent-seeking as the central motive.

It may be that when the decision was taken (probably towards the end of 2003) to pursue the nationalisation of Yukos through full-scale asset seizure, the Kremlin resolved also that it was time to bring the bulk of the oil industry, or even of the wider economy, into state control. Certainly, the expansion of state ownership in Putin's Russia is typically traced back to the Yukos affair, and the fact that Gazprom went on to acquire Sibneft' in September 2005 could

⁸⁹ One of the few exceptions was a 50% stake in Tomskneft', which Gazprom subsequently bought from Rosneft' (Sakwa, 2009, p. 244).

be seen as a continuation of the nationalising drive that began with Yukos. But it remains unclear whether the acquisition of Sibneft' was part of what Pappé and Galukhina (2009, pp. 161–5) call a “sectoral” decision in favour of nationalisation, or was more narrowly driven by the political leadership’s desire to see Gazprom become a diversified energy company along the lines of the Western majors. This had been the rationale behind the Gazprom-Rosneft’ merger, the failure of which left Gazprom still lacking any significant oil production⁹⁰.

If there was indeed a sectoral logic behind the government’s ultimate decision to nationalise Yukos, and behind Sibneft’s subsequent sale to state-owned Gazprom, then conceivably the later “private” outcomes of the Rosneft’ and Bashneft’ takeovers could be explained in terms of the Kremlin being satisfied that sufficient state control of the industry had by that time already been achieved. However, as will be shown below, those outcomes were also highly contingent in nature.

Rosneft’ and Bashneft’

Before beginning to explain the ownership outcome of the Rosneft’ and Bashneft’ takeovers, it is worth recapping just what that these outcomes were. When Rosneft’s owner Gutseriev agreed in July 2007 to sell to a new private owner (Deripaska), both buyer and seller expected that this would satisfy the government and bring the case to a resolution. However, although considerable steps were taken towards implementing the deal (including the payment of \$3bn to Gutseriev), governmental and regulatory approval was repeatedly delayed until apparently extraneous factors (a liquidity crunch due to the global financial crisis) prompted Deripaska to back out. In January 2010 the company was returned to its original owner, Gutseriev, who had by this time been “rehabilitated” and had returned to live in freedom in Russia. In April 2010 Gutseriev sold a 49% stake in the company to a different private owner, AFK Sistema, whose

⁹⁰ As Gustafson (2012, p. 336) notes, “From the moment he became President, Putin had encouraged Rosneft and Gazprom to work together. That was the trend worldwide. In contrast to oil, gas had long remained a regional industry; but that was rapidly changing, as technological advances, chiefly the growth of liquefied natural gas (LNG), made gas increasingly global. All the major international companies did both oil and gas.”

Chairman Vladimir Yevtushenkov had helped bring about the rehabilitation. This latter sale proceeded without any objections from the government.

In March 2009, i.e. prior to its purchase of a stake in Russneft', AFK Sistema reached agreement to become the new controlling shareholder of the Bashneft' companies. This sale met no serious resistance from the Kremlin.

The possibility of a nationalising outcome

Since the current study primarily seeks to explain outcomes in terms of a state vs. private dichotomy, it is most helpful to develop a causal explanation for the Russneft' and Bashneft' outcomes in terms of a “contrast space” (Garfinkel, 1981) of nationalisation. Were the interventions undertaken with a state ownership outcome in mind, and if so, what went wrong?

The Russneft' intervention, which began at the end of 2006, coincided with the creation of Russia's major new state-owned companies and state corporations⁹¹. Its “private” ownership outcome (through the sale to Deripaska in 2007) therefore happened at the very time when the state ownership expansion drive was at its peak. Thus it cannot be argued that the government's appetite for nationalisation across the economy was waning by this point. However, an explanation specific to the oil industry remains possible for the private outcome at Russneft'. As mentioned earlier, it was responsible for only 3% of Russia's total oil production, and thus a private ownership outcome may have been acceptable to the Kremlin because the sector was by this time already dominated by state-owned players. Only TNK-BP, Lukoil and Surgutneftegaz remained as big private players, and only the first of these was considered relatively independent of government influence.

⁹¹ Of the new state-owned joint-stock companies, the United Aviation Company (OAK) was created in November 2006; the United Shipbuilding Company (OSK) was created in March 2007. VEB became a state corporation in July 2007. Rostekhnologii was created at the end of 2007.

Applying the same logic to the Bashneft' outcome is more problematic: the Bashneft' group of companies included significant refining capabilities that the state-owned companies, Rosneft' and Gazprom-Neft', particularly lacked. This gave the government a "sectoral" reason for wanting a state ownership outcome for Bashneft', and provided the state-owned companies themselves with a commercial reason to be interested in acquiring it (Derbilova, 2005; Tutushkin, 2006).

While Bashneft's refining capacities made it a commercially interesting acquisition for both private and state-owned Russian companies, not all analysts agreed that Russneft' was an attractive target: one investment bank analyst pointed out that production at its oil fields was a technologically complex task, and claimed that the company's profitability was low. For this reason, he suggested that the prospect of expropriating Russneft' was no more than a "pleasant accompanying bonus" to the main task of settling scores with Gutseriev (Rebrov & Pleshanova, 2007). The company itself was claiming before the attack that it expected to post a profit for 2006 of \$1bn ("Oil and gas company RussNeft plans \$1bln net profit for 2006 - Company's President," 2006), but it managed only RUB 9.9bn (\$380m) (Grib, Akhundov, Rebrov, & Pleshanova, 2007). Rebrov (2007) pointed out that if it was not an attractive target for state-owned companies, Russneft' might still be of interest as a private investment for rent-seeking officials (possibly the same officials who acted as patrons to the state-owned oil companies). He suggested that such officials might be behind Deripaska's purchase. At the time of his writing, it had not yet become clear that that purchase was encountering serious resistance.

Of course, even a relatively unprofitable company might still be an attractive acquisition target (for asset-strippers if nobody else) if it is possible to force down the sale price. It has been suggested that a state-owned company (most likely Rosneft') made an approach to buy Russneft' in 2006 for \$1bn, and that this approach was swiftly rebuffed by Gutseriev because

it was far below the company's market value (Nikol'skii et al., 2007)⁹². If this did indeed happen, it is unlikely that declining this offer was the root cause of Gutseriev's problems: the more compelling reasons for the attack on Russneft' have been detailed above. The alleged offer to buy the company for \$1bn is more likely to have been the first "carrot-and-stick" offer that was put to Gutseriev after the takeover had been triggered for those other reasons.

Gutseriev has claimed that Deripaska was merely one of six potential buyers he considered after the problems began. The six included Gazprom, but he rejected this possibility because it would have taken the state-owned company too long to arrange the deal, and he needed to get it done quickly (Reznik, 2010)⁹³. If his words can be taken at face value, he did not feel under pressure to sell to a particular buyer, state-owned or otherwise.

As noted in the earlier section discussing the causes of the crackdown, even after Deripaska emerged as Russneft's buyer, the assumption remained that he would swiftly sell it on to the state-owned company (either Rosneft' or Gazprom) that was the real intended buyer. This assumption was fuelled by the fact that Deripaska had negligible previous involvement in the oil industry. But it was confounded by subsequent events: the expected onward sale to a state-owned company never happened. Either something went wrong with the planned onward sale, or it was never the plan. As noted earlier, the idea of Deripaska as transitional buyer on behalf of Rosneft' can be ruled out, because there is sufficient evidence to indicate that Rosneft's Chairman Igor Sechin was behind the campaign to stop the Deripaska acquisition⁹⁴. That leaves the possibility that Deripaska was acting instead for Gazprom, and that the plan was sabotaged by Sechin. But there is little evidence that Gazprom was seriously interested in

⁹² The article cited above stated that an unnamed senior oil company manager was its source for the \$1bn bid from an unnamed state-owned company; separately it cited a source close to Gutseriev as saying the latter had been in talks with officials on selling to Rosneft' specifically.

⁹³ For more on the difficulties faced by Gazprom when attempting to move quickly in time-sensitive situations, see the following chapter.

⁹⁴ Furthermore, there is little evidence that Rosneft' had any significant appetite to buy Russneft'. It was widely noted in July-August 2007 that Rosneft's debt burden did not allow it to consider further purchases at that time (Polukhin, 2007; Rubanov & Vin'kov, 2007), and that Russneft' did not provide an appropriate fit with Rosneft's assets (Tsymbalov, 2007).

acquiring Russneft'. Granted, it was confirmed in 2009, when Deripaska was attempting to restructure Basic Element's debts, that talks had taken place on the possible onward sale of Russneft' to Gazprom. However, the latter's senior management was reportedly unconvinced, as it had its eyes on more prestigious international projects and was unwilling to pay the price demanded by Deripaska (Mazneva, 2009a).

In his first public comment on the matter in November 2007, Deripaska insisted that his interest in Russneft' was strategic (Tutushkin, 2007b). He had in 2005 formed a company named United Oil Group⁹⁵, whose main asset was an oil refinery in Krasnodar region but which also included a chain of petrol stations in southern Russia. The continuing obstruction by the government and Basic Element's troubled financial position after the global financial crisis provide sufficient explanation for his later decision to unwind the deal, and it seems credible that he did indeed intend to use the Russneft' acquisition to gain a proper foothold in the oil industry. In other words, contrary to the assumption at the time, it was never the plan to sell the company on to the state. Either his plans were indeed strategic, or he hoped to profit from re-selling the company a few years down the line.

The latter approach is what AFK Sistema consistently said it was taking with Bashneft'. Sistema's Vice-President Levan Vasadze said in 2005 that the plan was to create a vertically-integrated holding for resale within eighteen months to two years (Yartsev & Vadimova, 2005). This timetable was of course delayed by the fact that Sistema did not gain control of Bashneft' until 2009. The planned restructuring was completed in 2012, with the previously disparate group of companies becoming a vertically-integrated holding with a "single share" under the oil producing company Bashneft' ("Bashneft'" zavershila perekhod na edinuyu aktsiyu," 2012). Clearly this was no mere speculative purchase, and at the time of writing in March 2014, Sistema is still the controlling shareholder. It might therefore be a stretch to

⁹⁵ OOO Ob''edinennaya Neft'yanaya Gruppya.

describe it as a transitional buyer, but the long-term plan was always to sell the company on after adding value through the restructuring.

The speculation that this onward sale would be to a state-owned company began as early as 2005 (e.g. Yartsev & Vadimova, 2005), and was understandable given the increasing dominance of the sector by state-owned players. In June 2013 it was reported that Rosneft' was considering buying Bashneft' (Dzyadko, Derbilova, Kezik, & Voronova, 2013). But before concluding from this recent news that Yevtushenkov was working all along as transitional buyer on behalf of Rosneft', it should be remembered that all the bets had previously been on him working on behalf of Gazprom⁹⁶. This was denied by Sistema sources who insisted that the ultimate buyer had not yet been determined (Fokina, 2005). But the rumours persisted, fuelled by the fact that Yevtushenkov accompanied Dmitry Medvedev (then First Deputy Prime Minister and Gazprom's Chairman) on a trip to Bashkortostan's capital Ufa in August 2006 (Gavshina, 2006; Khannanova & Gainullin, 2006a; A. Levinskii & Sokolova, 2010a).

In summary, there is a lack of compelling evidence that either of the state-owned companies, Gazprom or Rosneft', was designated as the intended new owner when the SLCTs of Russneft' and Bashneft' were instigated. Neither is there strong evidence that either company was determined to buy Russneft' or Bashneft' in the event that they were put up for sale. But in considering the possibility of a nationalising outcome for either case, there is one more important factor to be taken into account. In both cases, the Federal Tax Service (FTS) attempted to nationalise both companies through the courts, through a direct act of expropriation rather than the sale to a state-owned company. Both of these legal challenges were based on Article 169 of the Civil Code, a law which dated back to the 1920s and envisaged the confiscation of property in favour of the state as punishment for transactions

⁹⁶ Source close to Sistema management cited in Yartsev and Vadimova (2005). Source close to Rakhimov cited in Fokina (2005), predicting the group would end up in Gazprom hands within two years. Source close to Bashkortostan leadership cited in Gainullin & Skornyakova (2005).

“carried out for a purpose that is contrary to the fundamentals of public order and morality” (White, 2008). Beginning around 2003, tax officials had begun using this article for tax cases: a perfect example of state actors finding innovative applications for existing laws in contexts that were clearly unforeseen and unintended by their original authors (Woodruff, 2013)⁹⁷.

The FTS first adopted this approach in December 2006, launching legal action based on Article 169 in response to transactions in April 2006 which had seen Bashkirskii Kapital (then the main parent company of the Bashneft’ group of companies, beneficially owned by Murtaza Rakhimov’s son Ural) break up its stakes in the Bashneft’ companies into smaller tranches and transfer them to obscure charities (Tutushkin, 2007a). Then in April 2007, the FTS attacked Russneft’ in the same way: it brought a series of criminal cases against eleven of Russneft’s past and present first-level shareholders, challenging deals involving Russneft’ shares that had been carried out in a way that had allegedly allowed the company to evade RUB 6bn (\$230m) in taxes. As with the Bashneft’ case, Russneft’ stakes had been broken down into smaller tranches “through a long chain of transactions” (Rebrov & Zanina, 2008; Reznik et al., 2007).

In the event, neither attempt was successful: the use of Article 169 in civil cases was brought to an end in 2008, after an April ruling from the Supreme *Arbitrazh* Court that it was only to be used in certain categories of non-economic criminal cases (Pleshanova, 2008a, 2008b; White, 2008)⁹⁸. This was explained in the media by reference to the fact that the head of the court, Anton Ivanov, was an ally of Dmitry Medvedev, who was on the verge of assuming the presidency and was promising to introduce changes to the law and judiciary to ease the pressure on business.

⁹⁷ Article 169 was additionally used in an effort to confiscate from accounting firm PwC the money it had received from Yukos for its auditing services prior to the crackdown (Pleshanova, Kiseleva, & Grib, 2007).

⁹⁸ The FTS challenged the Supreme *Arbitrazh* Court’s ruling at the Constitutional Court, but the latter ruled against the FTS in January 2009 (Pleshanova & Zanina, 2009).

Advocates of an explanation based on rent-seeking factions can see this as a victory for the ‘liberal’ faction, which sought to block the further expansion of the *siloviki* into the oil business. However, there are some problems with this interpretation. Firstly, it appears that, in the event that the expropriation had been successful, the government would have promptly put the confiscated shares up for auction⁹⁹. Granted, it is possible that such an auction would have been rigged in favour of a favoured state-owned buyer, but this can only be speculation. Secondly, there is no evidence in the public domain that Rosneft’ used the campaign to make an approach to either company to sell at a lower price.

Furthermore, the expropriation campaign followed (and was at least formally triggered by) moves by the existing owners which look very much like defensive tactics aimed at raising the costs to the state of full-scale asset seizure, as will be discussed below. It therefore seems quite possible that the expropriation effort was aimed at ‘blocking’ such moves rather than nationalising the companies concerned.

Overall, it appears that the state and state-owned companies were not maximising their efforts to bring either company into state ownership, either by acquisition or by expropriation. Therefore it is unlikely that the state had nationalisation in mind when it began to apply pressure on Gutseriev and Rakhimov to give up control of their companies. As a former employee in Rakhimov’s administration has claimed with respect to Bashneft’, “they just wanted to take it from the wrong kind of people [*u neponyatnykh lyudei*] and give it to decent guys [*normal’nym patsanam*] for a decent price” (A. Levinskii & Sokolova, 2010b).

The private ownership outcomes therefore should not be seen as successfully thwarted attempts to nationalise the two companies. In the Bashneft’ case, transfer to Sistema’s control

⁹⁹ In an interview with Yevtushenkov regarding his company’s acquisition of Bashneft’, the journalists asked: “It is said that back in 2007 Rakhimov senior met with President Putin face to face, and there were two options: either by force, returning [Bashneft’] to federal property through the courts, *and then auctioning it*, or simply finding a new owner and giving it to him. Why did they choose you?” (A. Levinskii & Sokolova, 2010b).

was an acceptable ownership outcome from the state's point of view; and, as will be further elaborated below, the state's objections regarding Deripaska's acquisition of Russneft' were not based on its preference for that company's nationalisation.

Defensive tactics of the existing owners

As in the Yukos case, the coercive takeovers in the Russneft' and Bashneft' cases were far from being a one-sided game where the state held all the cards. In both cases, a new buyer was brought in by the existing owner in the hope that they were capable of calling off the state's attack on the company. In his open letter announcing his departure from the company, Gutseriev had written that "I am handing over control of the holding to a new owner whose appearance, I am sure, will mean that the problems Russneft' has encountered will be resolved" (Gutseriev, 2007).

In the Bashneft' case, discussion of the defensive tactics of the existing "owners" is complicated by an apparent rift that developed between Rakhimov senior (President of the republic) and his son Ural (beneficial owner of Bashneft') in late 2004. This came to a head in February 2005, when Rakhimov senior accused his son of being behind a "conspiracy" to unseat the republican parliament speaker, and began a legal campaign to return Bashneft' to state (i.e. republican) property (Khannanova & Gainullin, 2005). But on 9 June 2005, this legal campaign was abruptly dropped, following a "peace deal" between father and son (Gainullin, 2005). Contemporary reporting of the rift tended towards the naive assumption that Ural Rakhimov was the true beneficial owner of Bashneft', rather than merely the nominal owner on behalf of his father (who was prevented by law from owning the companies himself). Some opposition politicians argued instead that the rift, the allegations regarding Ural's political "conspiracy", and Rakhimov senior's efforts to renationalise Bashneft' were all exaggerated or invented as defensive moves against Kremlin pressure (Khannanova & Gainullin, 2005; "Ot redaktsii: Bash na bash," 2005).

According to a former Bashkortostan official, it was Rakhimov senior who first approached AFK Sistema later in 2005 with the proposal to sell stakes in Bashneft'. This is significant for its indication of who was the real owner at Bashneft', but also because it shows Sistema was not imposed on Rakhimov by the Kremlin. The official claimed that the sale of the blocking stakes was (like the subsequent shenanigans involving the remaining shares) a response to the Kremlin's coercion: beset by criminal investigations relating to his son's activities, Rakhimov had decided to bring in as a strategic investor a Moscow-based company who he hoped could protect Bashneft' from whoever was behind the investigations (A. Levinskii & Sokolova, 2010b)¹⁰⁰. This tactic is similar to the one described by Markus (2008), with the important difference that the new minority shareholders are Russian rather than foreign, and it is hoped that they can lobby the Kremlin directly through their own contacts, rather than through diplomatic representation.

The defensive tactics of the existing owners did not stop at bringing in a new owner who might be acceptable to the Kremlin. The other tactics suggested in the literature, i.e. relying on support from business associations (Markus, 2007) or the provision of public goods to increase the reputational cost of expropriation (Frye, 2006), do not appear to have played a significant role. Instead, the owners focused on increasing the costs to the state if it decided on a path of full-scale asset seizure, and putting as much as possible of the companies' value beyond the state's reach. Some of the transactions involving Russneft' shares that were challenged by the FTS under Article 169 pre-dated the beginning of the state's crackdown and may have been aimed solely at avoiding tax. However, others occurred after the crackdown and may have been a response to it (Reznik et al., 2007). The sale of Russneft' to Basic Element was also a highly complex transaction. It took place exclusively at the level of the offshore beneficiary companies behind Russneft's first-level shareholders on one hand, and

¹⁰⁰ In 2010, Yevtushenkov was asked why Rakhimov had chosen to work with him specifically: [interviewers] "Maybe people in Bashkortostan believed that you have some kind of..." [Yevtushenkov] "Resource? Yes, probably they did believe that, given that it all worked out as it did" (A. Levinskii & Sokolova, 2010a).

offshore entities controlled by Jersey-registered Basic Element on the other¹⁰¹. While the offshore nature of the transaction was no doubt aimed in part at minimising tax liabilities and ensuring that the agreement was governed by a more reliable non-Russian legal system, it was also intended to protect the sale and the money involved from intervention by the Russian state. Specifically, it thwarted efforts on the part of the Interior Ministry Investigative Committee to freeze shares in Russneft' (Skorlygina & Rebrov, 2007).

In March 2006 a criminal case was opened on suspicion of tax evasion that could have led to the bankruptcy of Bashkirskii Kapital, which held the controlling stakes in the Bashneft' companies. In response, the Rakhimovs moved in April 2006 to break up their shares in those companies into smaller stakes of 13-16.5% each. These smaller stakes were then donated free of charge to four charities which had been newly founded by obscure individuals. Bashkirskii Kapital itself was placed into liquidation. The charities each promptly founded a limited-liability company, to which the stakes in the Bashneft' companies were transferred (Pleshanova & Gainullin, 2006).

In response, a large team of federal law-enforcement officers arrived in Bashkortostan's capital in May 2006 (Khannanova, 2006), and the FTS campaign to expropriate a controlling stake in the Bashneft' companies was undertaken in December. In February 2007 the Moscow *Arbitrazh* Court placed a freezing order on the shares. In November 2008 the Rakhimovs settled on a way to bypass the court-imposed share freeze, by reaching agreement with a Sistema subsidiary to take over management of the Bashneft' companies for a three-year period (Khannanova, 2008).

There is an offshore dimension also to the Rakhimovs' defensive tactics: there is reason to believe the infrastructure was put in place for the rapid exit of the Rakhimovs' money in the event of expropriation. Ural had been living in Vienna for many years, and while his father

¹⁰¹ This provided formal grounds on which the FAS and the government commission later refused to approve the sale, as explained below.

was still President, his Prime Minister Rail' Sarbaev is known to have made several trips to the Austrian capital, returning with money (for social projects and to pay teachers and doctors) in cash that was drawn from Ural's charities (Allenova, 2012). Although the \$2bn proceeds from the sale of Bashneft' were said to be residing in accounts in banks in Bashkortostan, the previous arrangement suggested that it would be relatively easy to facilitate this money's rapid exit offshore in the event that the state made renewed claims on it.

Why these new owners?

Besides the question of why these two companies were not nationalised, there is the supplementary question of why the assets were transferred to these *particular* new private owners. The private buyers must have felt confident that they could persuade the Kremlin to halt its pressure on the companies: otherwise they would not have risked their investment and their own political standing by getting involved in a sector that was so politically charged after the Yukos affair. Presumably their confidence was based on their status as what Hanson (2009) calls "trusted businessmen", i.e. their immaculate personal connections in the Kremlin had heretofore ensured a peaceful political environment for their other business activities. But personal ties and trust played an important role also in the existing owners' selection of (or agreement to work with) new buyers: to some extent, the owners were putting their fates in the buyers' hands. Gutseriev and Deripaska had jointly held in trust shares in Slavneft', the state-controlled company Gutseriev headed from 2000 to 2002. They also both had the commodities trader Glencore as a major business partner: it was a co-owner of Deripaska's company Russian Aluminium and was Russneft's largest creditor (Reznik & Osetinskaya, 2007). Russneft' had bought oil industry assets from AFK Sistema in 2003 (Nicol'skii et al., 2007). No such long-standing ties existed between Sistema and the Rakhimovs, and Yevtushenkov has said that it took time to build up the latter's trust, before they were prepared to contemplate giving up control of Bashneft': "The sellers of this asset are complex

people from the point of their mentality and experience. Probably it was important for them to realise that they were not dealing with raiders, with people for whom nothing is sacred” (A. Levinskii & Sokolova, 2010a).

There are some indications that Deripaska received approval from Putin personally before making his original bid approach¹⁰². Additional evidence of early support from the highest level comes from the fact that Deripaska borrowed \$3bn from state-owned Sberbank to finance the deal (using a controlling stake in his automobile manufacturer GAZ as collateral): the expert commentary at the time was that approval would have been needed from the Presidential Administration for Sberbank to grant such a substantial loan at short notice (Grib, 2007).

Clearly Deripaska was mistaken in thinking that the Kremlin would wave through his acquisition. Technical reasons were given for the failure to approve the deal, but the evidence suggests that these concealed what was really a politically-motivated decision. The FAS initially explained its delay by claiming that the required documents had not been received from the applicant outlining the full details of the transaction. Later it claimed that the details of the transaction were not only highly complex but also frequently changing. In February 2008, the FAS announced that it would not consider the deal until the outcome of the Article 169 cases was known (Rebrov & Zanina, 2008).

The prospects for Basic Element’s purchase appeared to brighten in the course of 2008 as Article 169 court cases were dropped by the Federal Tax Service. However, a new obstacle then appeared. The law was changed in April 2008 requiring an additional level of approval for acquisitions by foreign companies of assets included on the government’s list of strategic assets, which included one of Russneft’s oil fields (Rebrov, 2008). The FAS was obliged to refer such matters to a government commission which was headed by Prime Minister

¹⁰² Information from a source close to Basic Element cited in Grib (2007). See also Rebrov and Zanina (2008), citing “major Russian businessmen and investment bankers who were familiar with the deal”.

Vladimir Putin and included Deputy Prime Minister Igor' Sechin. The fact that Basic Element was registered in Jersey qualified it as a foreign buyer. There is no suggestion that this policy decision was aimed specifically at frustrating Basic Element's acquisition. But what happened next left no doubt that there was high-level opposition to the deal. Over the course of 2009, the Putin-led commission three times omitted to examine the case at its sessions. Incomplete documentation was the reason initially given (Malkova, Reznik, & Fedorinova, 2009), but then Sechin claimed that the problem was the offshore nature of what was an essentially Russian-Russian transaction (Rebrov, 2009). A source in the government claimed that Putin himself was against the deal's offshore structure ("Kto zhe protiv?," 2009). But this had not stopped Cyprus-registered Nafta-Moskva (representing the Russian businessman Suleiman Kerimov) gaining approval to buy the Russian gold mining company Polyus Zoloto at the commission's June session (Mazneva & Chechel', 2009).

Precisely what the real political objection was to the deal is not clear, but Sechin is rumoured to have been particularly opposed as well as having a personal grudge against Deripaska¹⁰³. It has been suggested that Deripaska was not welcome in a sector "where Kremlin bureaucrats of the highest rank, particularly Igor' Sechin, are used to ruling unchallenged" (Kharat'ian, 2007). It was later claimed that Sechin was angry that Deripaska had effectively gone over his head by approaching Putin directly for approval, despite Sechin's formal responsibility for the oil sector (A. Levinskii & Sokolova, 2010b).

But before concluding that Deripaska's acquisition failed to gain approval because of hostility from rival factional/bureaucratic interests, it should be remembered that Putin did not remain above the fray here: he was personally involved in holding up the deal at the government commission level. It therefore appears that Putin, having initially been in favour of Deripaska

¹⁰³ Confirmed in author's interviews with two leading Moscow-based financial journalists, one English and one Russian. Cf. also Belkovsky's claim in 2007 that the continuing pressure on Gutseriev was down to a fight between Sechin and Deripaska over who would take over Russneft' ("Pochemu prodolzhaetsya pressing Gutserieva?," 2007).

buying Russneft', was subsequently persuaded against the idea by Sechin. It is possible (as an alternative or supplementary explanation) that what turned Putin against the Deripaska acquisition was the open letter that Gutseriev wrote and published in the Russneft' corporate journal soon after the agreement with Deripaska had been reached. Subsequently reprinted by *Vedomosti*, the letter explained Gutseriev's decision to sell in terms of the "unprecedented pressure" placed on him and his company by the authorities (Gutseriev, 2007). Conceivably, Putin's objection was not to Deripaska becoming a player in the oil industry, but to Gutseriev being able to leave the country with his freedom and his cash, if at the same time he was going to complain in public about his treatment by the authorities¹⁰⁴.

Significantly, Gutseriev swiftly backpedalled after the letter's publication: it promptly disappeared from the Russneft' website, and two days later he told Interfax that the decision to sell the company had been taken by the shareholders "without any pressure [...] the political aspect which journalists are writing about does not exist" (Tsymbalov, 2007)¹⁰⁵. Gutseriev was careful in his choice of words in subsequent interviews, as illustrated by the way he parried a question in 2010 regarding whether Sechin had been responsible for what had happened to him: "I have heard this theory many times, but I have no evidence that the command came from him. I cannot say that it's true [*ya ne mogu etogo utverzhdat*']. I don't think that he was behind Russneft's problems or will do this in the future" (Reznik, 2010).

As noted above, it was Rakhimov who first approached AFK Sistema in 2005, rather than Sistema being imposed on Rakhimov by the Kremlin. Furthermore, Sistema helped the Rakhimovs to bypass the court-imposed freeze on Bashneft's shares. This reinforces the notion that Sistema and the Rakhimov family were allies, now united against a common enemy in the shape of the FTS.

¹⁰⁴ Latynina suggested in August 2007 that this might be the explanation for the arrest order that had just been issued against Gutseriev ("Yuliya Latynina: 'Gutseriev otdal "Russneft"' ne tem, kto za nim okhotilsya,'" 2007).

¹⁰⁵ Cf. Kakha Bendukidze's insistence (Chapter Four) that he sold his stakes in Atomstroiekспорт and OMZ entirely of his own volition and without government pressure.

AFK Sistema's head Yevtushenkov can be assumed to have had better relations with the Kremlin as a whole, given that the company encountered no serious resistance to its acquisition of Bashneft' and was able to help secure Gutseriev's rehabilitation. But Deripaska (and Abramovich in the Yukos case) had planned to play the same role, offering to solve the existing owners' problems by taking the asset off their hands and solving problems with the authorities. Although for Deripaska it did not work out, both Deripaska and Yevtushenkov expected to be *both* a defensive tactic by the existing owners against state coercion, *and* buyers who were acceptable to the Kremlin. How one might explain this paradox is discussed further in the concluding section of this chapter.

Contrasting fates of the existing owners

One of the arguments against considering Russneft' and Bashneft' to be cases of *reiderstvo* is the fact that both existing owners survived the situation relatively unscathed. Firestone (2008) distinguishes *reiderstvo* from racketeering by stating that the *reider* is more ambitious, seeking to take over an entire company rather than just a share of the profits. But the ideal-typical *reider* surely seeks to take over a business without handing over much money (if any) to the existing owner. When the existing owner walks away with an amount of cash that comes close to the market value of his business, this goes against the spirit of *reiderstvo*. Gutseriev received \$3bn in cash from Deripaska in a deal which valued Russneft' at \$6.5bn overall (the remainder of the total went on the assumption of Russneft's debt). This must have softened the blow of being forced to leave the country and being subject to a Russian arrest warrant while living in the UK. Thanks to the later intervention of Yevtushenkov and others, he subsequently returned to Russia with all charges against him dropped and bought back full ownership of Russneft'.

The Rakhimov family received \$2bn from Sistema in exchange for ceding control of the Bashneft' companies. This appears to have been part of a deal that was attractive even by the standards of the Russneft' case. Rather than being cast into exile, Rakhimov was permitted to

continue to operate at least for a time as a parallel centre of power in the republic, undermining his successor Rustem Khamitov's efforts to establish his own authority. He benefited from a law passed by the republican parliament granting immunity from prosecution (Kamyshev, 2010), worked for a time as an official adviser to Khamitov (Allenova, 2012) and was given a seat on the board of Bashneft' (Derbilova, Kostenko, & Simakov, 2010)¹⁰⁶.

The amount of money received was particularly remarkable given the Audit Chamber's claims that the family had originally taken ownership of Bashneft' by illegal means. Back in July 2003, one of its auditors had described the privatisation as "the most unprecedented case of theft of assets from state property" (Amladov, Granik, & Gorodetskaya, 2010). Restrictions were put in place to prevent the Rakhimovs using this money at their own discretion. It was paid to the charities which owned Bashneft' and whose beneficiary was widely held to have been Murtaza Rakhimov's son, Ural. In November 2010 these charities were merged into a single body named the Ural Foundation (with Murtaza Rakhimov as Chairman). An unusual compromise was reached, with the Ural Foundation committing to invest the annual interest in social projects in the region supposedly under the supervision of the republican authorities ("Rustem Khamitov: v Bashkortostane preodolen krizis upravleniya den'gami ot prodazhi TEK," 2010)¹⁰⁷.

Rakhimov's political influence in Bashkortostan, his ability to "deliver" pro-Kremlin votes, and the Kremlin's concerns about stability and separatist sentiments in the republic, no doubt

¹⁰⁶ In May 2012 Bashneft' announced that by mutual agreement, Rakhimov would not be reappointed to the board of directors. This followed Khamitov's criticism of Bashneft' for a wave of redundancies that he said threatened social stability in the republic ("Glava Bashkirii Rustem Khamitov predupredil ob ugroze sotsial'nogo vzryva," 2012). A source close to the republican government claimed that Khamitov was angered by Bashneft's close ties to Rakhimov (Dzyadko, 2012).

¹⁰⁷ It is clear from subsequent events that the republican authorities did not secure any meaningful control over the charity. In October 2011, Khamitov gave an interview in which he criticised the Ural fund for failing to invest the principal amount by "building factories, supporting agriculture, strengthening infrastructure" rather than leaving it in bank accounts (Stepovoi, 2011). He made it clear that the fund was under Rakhimov's control. Rakhimov responded with sharp criticism of Khamitov and a threat to end the fund's cooperation with the republican government ("Murtaza Rakhimov: 'I ne takie trudnosti preodolevali,'" n.d., "Zayavlenie Soveta Blagotvoritel'nogo fonda 'Ural' po materialam interv'yu R.Z. Khamitova gazeta 'Novye Izvestiya' ot 5 oktyabrya 2011 g.," 2011).

played a significant role in strengthening his bargaining position. But the Kremlin may also have been concerned that full-scale asset seizure would not have captured a large proportion of Bashneft's value, because of the defensive tactics used by the Rakhimovs.

In any case, the fates of both Gutseriev and Rakhimov were in stark contrast to that of Khodorkovsky and Lebedev, who spent ten years in Russian prisons, and of the many other Yukos-affiliated individuals who were caught up in the state's massive campaign of coercion. These contrasting fates serve to underline that the state's preference for a negotiated solution is so great that it is prepared to "buy" this solution with a relatively attractive offer to the existing owner.

Conclusion

The above comparative case study provides a great deal of information that helps to confirm and illustrate the arguments made in Chapter 1. But it also suggests the need to make additional refinements to the theoretical framework outlined in that chapter. The task now is to summarise the theoretical lessons from the case studies.

Explaining the causes of the takeovers

All three takeovers were ordered from the very top of the Russian political system, either by Putin personally or at least with his knowledge and participation in how they subsequently progressed. This fact lends weight to the possibility that the takeovers were driven by political considerations rather than rent-seeking. It does not on its own negate the rent-seeking hypothesis, but raises the stakes considerably. Either Putin was personally engaging in the rent-seeking, or he was helping a group of his associates to do so.

Another key finding from the case studies is that the outcomes were contingent rather than pre-determined. There was a credible prospect in each case that the outcome would have been quite different: Yukos could possibly have been resolved through handing ownership to a new

private owner (i.e. Sibneft'). It was also a "fluke" that Rosneft' ended up as the state-owned company which acquired most of Yukos's assets. Both Russneft' and Bashneft' were the subject of legal campaigns aimed at bringing them into state ownership.

The contingent nature of the outcomes provides a further argument against rent-seeking: if Putin was acting as an arbiter between rival rent-seeking factions, then why was it a matter of chance who ended up as the new owners of the assets? There are additional points from the cases that cast doubt on the rent-seeking explanation. Why were Khodorkovsky and Lebedev still in jail many years after the Yukos assets were largely safely in the hands of the alleged rent-seekers? Why did Gutseriev and Rakhimov receive so much money in exchange for handing over their assets, if these were cases of predatory *reiderstvo*?

For all these reasons, political motivations should be taken seriously when explaining the takeovers. The contingent nature of the outcomes suggests that the goal was to deprive the existing owners of their assets for political reasons; precisely who would be the new owners was of secondary importance. But at the same time, the political threat to the regime posed by Khodorkovsky has been substantially exaggerated, Gutseriev posed no threat whatsoever to the Kremlin, and Rakhimov was a positive asset in terms of his ability to deliver pro-Kremlin votes at federal elections. Hence the conclusion that the political threat posed by the existing owners related specifically to sovereignty rather than regime incumbency. The undue influence Yukos had gained over the parliamentary decision-making process and its direct negotiations with foreign powers (bypassing the Kremlin) on matters affecting Russia's international relations were seen as clear challenges to sovereignty. The Kremlin saw Gutseriev's involvement in Ingushetian politics, and the political and economic autonomy from the Kremlin that Rakhimov enjoyed, as threats to its ability to project its authority throughout the country.

As noted in the previous chapter, “sovereign development” entails two separate vectors that sometimes can be pulling in opposite directions. It would appear that these were cases in which the objective of tackling perceived threats to sovereignty trumped developmental considerations. There was a possible developmental motive behind forcing the change of ownership at Bashneft’, and opening up its petrochemicals complex so that it played a role in the economy beyond Bashkortostan (perhaps in order to help realise Putin’s objective of boosting exports of refined products). But the economic impact of all three takeovers was bound to be negative in the short term (through the impact on operations at the companies, and on investor sentiment nationally), with little prospect of long-term upside for economic output in the long-term.

Explaining the ownership outcomes

Even if rent-seeking is rejected as an explanation for the takeovers, it may still in principle play a causal role in determining their outcome. If the question of who would be the new owner of these assets was of secondary importance to the Kremlin, then perhaps the outcome depended on struggles between rival rent-seeking factions who were keen to get their hands on the spoils. Putin’s involvement in all three cases makes such explanations problematic: rather than remaining aloof, he was without question involved in obstructing the acquisition of Russneft’ by Deripaska, and he is rumoured to have been involved in encouraging Rakhimov to sell to Yevtushenkov. He was almost certainly party to the struggle between Rosneft’ and Gazprom over their merger and the related issue of who would emerge as the main buyer of Yukos’s assets. On the face of it, this undermines the argument that the outcome was of secondary importance to the Kremlin. Putin did show a preference for one new owner over another, and this preference apparently changed over time in the case of Russneft’ (anti-Gutseriev and pro-Deripaska at first, then anti-Deripaska, then pro-Gutseriev and pro-Yevtushenkov). At times he reacted to events to shape the ownership outcomes of the

takeovers, but the key point is that those outcomes cannot have reflected an initial intention when the SLCTs were instigated.

The other suggestion that can be found in the existing literature to explain the private outcomes of the Russneft' and Bashneft' cases is that the factors that had heretofore been driving state ownership no longer applied. The sale of Russneft' to Deripaska happened at a time when the trend of expanding state ownership was at its peak. It could still be the case that sufficient control had been achieved over the oil industry specifically so that the Kremlin saw no particular imperative to nationalise a company contributing only 3% of overall oil production. But the contingent nature of the outcomes makes this explanation also problematic: why, if there was not much Kremlin interest in bringing Russneft' and Bashneft' into state ownership, was there an (albeit unsuccessful) effort to nationalise both companies through the courts?

The takeover as bargaining game

In Chapter 1, the theory was introduced that the outcomes of SLCTs might be influenced by how they proceed as bargaining games. If, as argued above, the SLCTs in the present chapter were undertaken without a specific ownership outcome in mind, then one would expect to see the bargaining game play a particularly strong causal role in determining their outcomes, assuming the proposed theory has any validity.

A key building block in that theory is the argument that the state prefers to see a negotiated outcome to the takeovers rather than having to pursue the kind of full-scale asset seizure seen in the Yukos case. The existing owners in this chapter met sharply contrasting fates: Khodorkovsky imprisoned for 10 years and receiving no compensation for his assets (the money raised from their sale instead went to pay off Yukos's deliberately inflated tax debts); Gutseriev receiving \$3bn in cash for his assets and able to live in peace in London, before being rehabilitated, returning to Russia and reclaiming his company; Rakhimov receiving

\$2bn and being permitted to live on in Bashkortostan, even continuing to play a political role to the exasperation of his successor. These contrasting fates provide a strong argument in favour of the state's preference for a negotiated solution: this preference is so strong that it is prepared to let existing owners who opt for that solution walk away with a level of compensation very different to what we would expect in cases of *reiderstvo*.

The cases also provide clues as to precisely what the state's "carrot-and-stick" offer entails. It is clear that the existing owner is asked to do more than simply part with his asset. He must also refrain from the kinds of sovereignty-undermining political activities he was suspected of engaging in. In the case of Khodorkovsky and Gutseriev, it seems clear that emigration was also part of the deal¹⁰⁸. The bitterness of this pill is, however, sweetened by the prospect of receiving an amount of money that approximately reflects the value of the asset.

To say that Khodorkovsky refused his offer while the other two owners accepted would be an over-simplification: Gutseriev apparently refused unceremoniously an earlier offer from a state-owned company to sell his business for a heavily discounted price, while it took many years of coercion and careful bargaining before the Kremlin was able to persuade the Rakhimovs to cede control of Bashneft'. But there is a significant distinction to be made between Khodorkovsky's refusal on principle to play the game—his willingness to take a very public stand against state coercion—and the way the other two owners responded to the situation.

Defensive tactics and constraints on coercion

The Yukos case drives home the point made by Markus (2012, p. 254) that "business is likely to lose in a head-to-head confrontation with the central executive." But the Yukos affair provides clues to explain why the Kremlin prefers a negotiated outcome, rather than effecting

¹⁰⁸ That Rakhimov was not required to leave the country may be thanks to the extra bargaining power available to him through his local electoral support and ties to the local political and business elite, as well as Kremlin fears over potential instability in the republic. His cooperation was required in ensuring a (relatively) smooth transition for his successor.

every SLCT through full-scale asset seizure. The crackdown on Yukos meant recruiting the state's coercive resources on a massive scale, and coordinating this effort across state agencies. The Russian state probably lacks the administrative resources to wage such a campaign against several companies at once. This fact by itself amounts to a (limited) constraint on the state's appetite for coercive takeover. Furthermore, the existing owners of companies targeted by the state have tactics at their disposal that make full-scale asset seizure a less attractive option. The internationalisation of the business is one such defensive tactic: it means that the pursuit of assets by the state must also be international in nature, and it must press its case in foreign courts that cannot be so easily leant on to provide a favourable ruling. The use of offshores can also facilitate moving assets abroad and getting them to a place where they cannot be found or seized by the Russian state. In the Yukos case, there is little evidence that any *domestic* institutions offered any significant constraints on the state's behaviour. Although considerable effort was expended to give the bankruptcy auctions a semblance of market-based legitimacy, this was probably determined by the international factor (in terms of reputation, investor sentiment, and legal claims) rather than by domestic institutions. International legal risk also proved decisive in the decision to allow Rosneft', rather than Gazprom, to buy Yukos's main asset, Yuganskneftegaz.

But as the Bashneft' case shows in particular, there are also some *domestic* constraints which qualify as "coercion-constraining institutions" (Frye, 2004) inside Russia's jurisdiction. The transactions that were aimed at protecting against expropriation, by breaking up shares in the individual companies and moving them on to Russian charities and limited-liability companies, would have been meaningless if the state were not constrained by domestic institutions from simply seizing the assets. In the chapters that follow, more evidence will be provided that domestic institutions play a significant (albeit still an inadequate) role in constraining coercion in Russia.

Relating “bargaining outcomes” to “ownership outcomes”

In the introductory section of this chapter, a simple explanation was provided for how the “bargaining outcomes” of the takeovers affected their “ownership outcomes”: the negotiated outcome can lead to either state or private ownership, but full-scale asset seizure will ordinarily lead to nationalisation. Why full-scale asset seizure leads to nationalisation (except perhaps in countries that are particularly “kleptocratic” and already isolated internationally) is explained above in the context of Yukos: transfer to a new private owner would be highly controversial after full-scale asset seizure involving the state’s coercive resources; it would be difficult to find a private buyer who was prepared to play this role, because of the associated legal and reputational risks; there would be no “national interest” justification for the takeover; it would have negative consequences in terms of the legitimacy of the ruling group, and internationally in terms of legal risks stemming from the seizure.

In its present form, the theory says the following about the ownership outcome that results from the “negotiated” bargaining outcome. The company may still be nationalised in pursuit of a political strategy for the sector, or as a one-off intervention to address a market failure. If there is no such political factor, then the ownership outcome will be determined by the apolitical issue of which private or public companies happen to have the greatest commercial appetite to acquire the company. However, as the following section explains, the evidence from the cases suggests a further refinement to this element of the theory.

Private buyers as intermediaries

How can AFK Sistema have been simultaneously a defensive play by Rakhimov against Kremlin coercion, *and* the Kremlin’s preferred buyer? The answer to this apparent puzzle lies in viewing private buyers as *intermediaries* who facilitate the negotiated outcome that the state prefers. An obstacle to this outcome is the level of animosity created when the state applies coercion and makes clear that – either through agreement or force – the existing owner must part with their business. The animosity makes it psychologically more difficult for the

existing owner to accept that he must sell to the same people who are applying the coercion. A third-party buyer, who has no affiliations to the state but is acceptable to the Kremlin, is therefore a mutually preferred solution. In the case studies, we saw some indication that Gutseriev may have rejected an approach from Rosneft' to take the company off his hands for \$1bn. Although he later denied that Rosneft's Chairman Igor' Sechin was involved in the Russneft' takeover, we can speculate that this was privately what he believed, and that his flat refusal of Rosneft's offer was prompted not only by the price but also by the offer having come from the same people responsible for the coercion. Similarly, there is little doubt that Khodorkovsky's refusal to accept any kind of offer was driven by his sense of injustice at the coercion being used against him (Khodorkovsky & Gevorkyan, 2012). This almost certainly ruled out a voluntary sale to Rosneft', and the alternative of a sale to Sibneft' might have been possible if Yukos's owners had been more convinced that Sibneft's owner Roman Abramovich was really acting independently of the state officials responsible for the coercion. Both Deripaska and Yevtushenkov were favoured by the existing owners precisely because they were seen as third parties who could nevertheless help persuade the Kremlin to call off the attack.

Thus it remains the case that the "negotiated" bargaining outcome can lead to either a private or state ownership outcome. But the state's preference for a negotiated outcome makes a private ownership more likely. The following chapter provides additional evidence for this process, and in a surprising context. In all of the takeovers in the next chapter, the state has in mind a specific ownership outcome (state ownership through acquisition by *de facto* state-controlled Gazprom). Yet once again, it makes use of an "intermediary" buyer who can facilitate the negotiated outcome.

Finally, there is one small piece of evidence from the Russneft' case that anticipates an issue which looms large in the next chapter. Gutseriev mentioned in passing that, when the state began to apply coercion on him, he considered Gazprom as one of six possible buyers for

Russneft'. However, he felt that Gazprom would not be able to move fast enough – and time was of the essence, presumably because the “carrot-and-stick” offer was conditional on him parting with Russneft' within a certain time-frame. The precise obstacles which prevented Gazprom from moving fast, and how it sought to bypass those obstacles, will become clear in the following chapter.

Chapter 3. Gazprom's campaign to re-take "lost" assets

Introduction

This chapter examines developments at Gazprom, arguably Russia's most strategically-important state-owned company, in the first years of Vladimir Putin's presidency. Putin assumed the presidency in May 2000, and from the outset paid close attention to what was happening at Gazprom¹⁰⁹. A substantial change in the company's management soon followed. In June 2000, Viktor Chernomyrdin, the former USSR Gas Minister who created Gazprom, stood down as Chairman of its board of directors. His replacement was Dmitry Medvedev, then deputy head of Putin's administration (Panyushkin & Zygar', 2008, p. 104). On 30 May 2001, Rem Vyakhirev, who had been Gazprom's chief executive since 1992, was dismissed on Putin's orders (Butrin, 2001)¹¹⁰. His replacement, Aleksei Miller, had very little experience of the gas industry, but shared with Putin a professional background in St Petersburg¹¹¹. Miller moved to replace the majority of the Vyakhirev-era management team, primarily with people with similar backgrounds to his own (Panyushkin & Zygar', 2008, pp. 113–115).

One of the salient features of the new management team's first years at Gazprom was a campaign to recover assets over which the company had lost control under the previous management, either through sales based on a suspiciously low valuation or through other means such as share dilutions. According to one assessment, these lost assets included gas

¹⁰⁹ Panyushkin and Zygar' (2008, p. 107) cite unconfirmed rumours that as early as the end of 1999, when Putin was Prime Minister, he ordered his close associates to study the company with a view to replacing its management and consolidating the state's control. It was even suggested by some analysts that the new Gazprom CEO, Aleksei Miller, took few strategic decisions without first consulting Putin (Kozyrev, 2011).

¹¹⁰ Vyakhirev was made Chairman of Gazprom and stayed on in that role for approximately one more year. The decline in his political power is said to have begun soon after Viktor Chernomyrdin was fired as Prime Minister in 1998 ("Rem Vyakhirev," 2013).

¹¹¹ Between 1991 and 1996, Miller worked under Putin at the Committee for External Ties of the St Petersburg mayor's office. His only professional experience of the gas industry prior to heading Gazprom was his time as Deputy Energy Minister between 2000 and 2001 ("Aleksei Borisovich Miller," n.d.).

fields which amounted to nearly 10% of Gazprom's hydrocarbon reserves, and were equivalent to the total reserves of US oil major ExxonMobil (Kleiner, 2008, p. 89). This campaign to recover lost assets is the focus of this chapter. Three companies, which were the subject of takeover by Gazprom in 2002, are examined as case studies. These are the construction contractor Stroitransgaz, petrochemicals firm Sibur, and the company Zapsibgazprom, which held the licence for a substantial gas field named South Russkoe. In each case, Gazprom had lost control of the company itself or of its most important assets, or was at imminent risk of doing so. The cases have been selected firstly because they were undertaken at approximately the same time, meaning that the circumstances surrounding the takeovers (including the composition of the Gazprom management) were similar across cases. Secondly, all three cases involved Gazprom's use of state coercion in the takeover process (while in other cases Gazprom was able to take over assets without resorting to such methods).

As in the previous chapter, the case studies aim to answer two research questions: firstly, what were the motives behind these SLCTs, and secondly, what explains their ownership outcome. For the present chapter, answering the first question entails understanding the motivations of the Gazprom management and its government patrons in undertaking to bring the 'lost' assets back under Gazprom's control.

Gazprom's privatisation in the 1990s left the majority of its shares under the control of its own management, and thus when Putin became President in 2000, it was not a formally state-controlled company. The state's direct stake stood at just 38.4%, there was no 'golden share' arrangement granting it additional voting privileges besides this stake, and it had no majority on the board of directors. An important motivation behind these SLCTs was the political leadership's desire to turn its precarious *ad hoc* control over this strategic company into formal control on the basis of majority ownership. This desire was in turn driven by the importance of Gazprom to the state as a tool of domestic economic policy and of foreign

policy. However, establishing majority ownership over Gazprom cannot explain the decision to take back all the lost assets in question, some of which had no involvement in Gazprom's ownership. Gazprom's management at times sought to explain the re-gathering of its lost assets by reference to the exclusively commercial goal of boosting market capitalisation (Reznik, 2002a), but some of the assets involved were both outside of Gazprom's core business¹¹² of gas production, distribution and sales, and there was apparently no other commercial imperative for Gazprom to return them to its control. The principal objectives behind the campaign were instead political, and included wider developmental considerations.

Turning to the second research question, because the SLCTs in this chapter were aimed at bringing assets back into the ownership of *de facto* state-controlled Gazprom, their ownership outcome was pre-determined as "state ownership" (but not formal state control until the state subsequently formalised its majority control over Gazprom itself, as will be discussed below). In each case, the takeover involved the existing owner's acceptance of the state's "carrot-and-stick" offer, though in the Sibur case this happened only after the owner was placed under a high degree of coercion (his agreement to sell the company was signed while he was in pre-trial detention). The cases therefore provide confirmation that SLCTs can result in state ownership not only through full-scale asset seizure (as with the Yukos case), but also when the existing owner accepts the state's "carrot-and-stick" offer.

However, Gazprom used a wholly-owned subsidiary named Gazprominvestholding in all three SLCTs, as buyer of some or all of the shares and/or as negotiator on behalf of Gazprom. Gazprominvestholding's chief executive, Alisher Usmanov, was a major private businessman in his own right, as well as someone who had worked with the former management of Gazprom, with which the existing owners of the targeted assets had close ties. Usmanov

¹¹² A company's "non-core" assets and business lines are those deemed by the management not to be central to the main "value proposition" of the business. Precisely what constitutes "core" and "non-core", and a company's appetite for diversifying into non-core business areas, shifts as strategy changes and as the profitability of certain business lines changes over time.

actively played on this dual status to help persuade the existing owners to accept the carrot-and-stick offer. Thus, while a private buyer was ruled out in these cases because of the need to restore Gazprom's control, Gazprom still found a way to capture some of the advantages (seen in the Russneft' and Bashneft' cases in the previous chapter) of using a private buyer as intermediary who could facilitate a negotiated outcome to the takeover.

The use of Gazprominvestholding as a buyer did not change the overall "state ownership" outcome of the cases. However, in explaining the causal factors that determined the specific ownership outcomes, the case studies will highlight the extent to which Gazprom was forced to work within legal and other constraints. Some of these constraints were common to all Russian joint-stock companies. However, as Gutseriev's comment at the end of the previous chapter suggested, Gazprom's status as a state-owned company and one that dominated its market placed significant additional restrictions on its freedom of manoeuvre. The political motivations behind Gazprom's takeovers highlighted its privileged position as a channel of government policy. But despite this privileged position and its superior access to 'administrative resources', Gazprom was forced to find innovative solutions to bypass legal obstacles that stemmed in part from its own 'state-ness'. These legal obstacles were largely domestic in nature, providing further evidence that (contrary to what one would expect in an ideal-type kleptocracy) *some* domestic institutions in Russia are working as constraints on coercion even by the most privileged of companies.

Research question 1: causes of the state-led coercive takeovers

Examining the motivations behind Gazprom's campaign to recover lost assets highlights a contradiction that is common to commercialised state-owned companies in market economies, particularly when (as was the case at Gazprom) those companies include private minority shareholders. As noted above, Gazprom's management at times attempted to present the campaign as being motivated by exclusively commercial considerations, namely boosting the

company's market capitalisation. But there was a clear political dimension to the campaign which was sometimes at odds with Gazprom's internal commercial logic.

It has been suggested that Aleksei Miller, the Putin appointee who took Gazprom's helm at the end of May 2001, was tasked from the outset with regaining Gazprom's lost assets¹¹³. In reality, however, the months that followed his appointment were characterised by indecision and internal debate among the company's directors, including the state's representatives on the board (Denisov, 2001b). This indecision centred on how to proceed with taking back the lost gas producer Purgaz, and whether and how to prevent the threatened loss of petrochemicals company Sibur. While media reports tended to blame this indecision on the incompetence and inexperience of the new management team, in both cases there were real reasons to question whether re-taking the assets in the proposed way, or even re-taking them at all, was commercially desirable.

Purgaz is not treated as a case in this chapter because it was taken over by Gazprom without recourse to coercion. However, the debates within Gazprom's management regarding how to proceed at Purgaz highlight the doubts over the commercial rationale for the campaign to re-take lost assets. As will be shown below, these doubts persisted until a clear political signal was given to proceed with a large-scale campaign of takeovers. Purgaz was a producing company with the licence to develop the Gubkinskoe gas field, with substantial proven reserves of 400bcm. This was the first case in which Gazprom had handed control of one of its own gas fields to a third party. It had been founded in 1998 as a joint venture between Gazprom (51%) and the independent producer Itera (49%)¹¹⁴. In the following year, Gazprom sold Itera a further 32% stake, leaving it with just 19%. The sale price had been just \$1200 (sic), equivalent to the nominal value of the shares. Gubkinskoe swiftly became Itera's main producing asset: it was already producing 3.8bcm of gas in 1999 and 14bcm in 2000. This

¹¹³ e.g. Drankina & Tatevosova (2002); Henderson (2010, p. 59).

¹¹⁴ Gazprom's stake was via its subsidiary Noyabr'skgazdobycha and Itera's via ZAO Itera-Rus'.

looked like an extremely generous gift to a competitor: the hedge fund Hermitage Capital Management, which was an activist minority shareholder in Gazprom, claimed that the market value of the 32% stake was \$566m (Kleiner, 2002).

At the beginning of 2001 (i.e. before Miller's arrival at Gazprom), two separate investigations had been launched into Gazprom's dealings with Itera, whose business was at the time primarily based on re-selling gas produced either in Turkmenistan or by Gazprom in Russia. One investigation was commissioned by the government and was conducted by the Audit Chamber (whose role is to monitor the use of federal budget money); the other was commissioned by Gazprom's board of directors and was conducted by the accounting and auditing firm PwC. One of the findings of the PwC investigation, which reported to Gazprom's board at the end of July 2001, was that Gazprom still had an option available to buy back its 32% stake in Purgaz at the same nominal price for which it had been sold, provided that it did so before 1 January 2002 (Bushueva, 2001f; Reznik, 2001b). It ought to have been clear how Gazprom should proceed: it had handed over an asset apparently worth \$566m for next to nothing, and now had the option of buying it back for the same token amount. Nevertheless, Gazprom's board was riven by debate for some six months before it finally resolved in December 2001 to exercise the option (Reznik & Khrennikov, 2001).

What gave the Gazprom board pause were the following considerations. At a board meeting in August 2001, the State Property Minister (one of the state's five representatives on the board) voiced the concern that, if Gazprom went ahead and deprived Itera of its main producing asset, Itera might have trouble paying debts for which Gazprom was acting as guarantor (Bushueva, 2001f). Furthermore, by regaining its controlling stake in Purgaz, Gazprom would be taking on responsibility for the latter's debts to Itera: the latter had provided between \$250m and \$300m in short-term loans to Purgaz between 1998 and 2000, in order to get production up and running. It emerged that the terms of the option agreement meant Gazprom would have to pay Itera \$194m in compensation for these investments (Reznik & Bushueva,

2001). Furthermore, the Gubkinskoe field's location meant that its gas could only be sold domestically. While under Itera's control, Purgaz could sell its gas at a price set by the market, though it was dependent on Gazprom's pipeline network to find a market outside the immediate vicinity¹¹⁵. If Gazprom regained control, the gas could only be sold at the tariff set by the government. It was therefore uncertain whether Gazprom could profitably exploit the asset. If it opted instead to retain the status quo, Gazprom could continue to collect transit revenues from Itera in exchange for taking the gas to market. These were substantial, amounting to \$215m in 2001 (Bushueva, 2001b; Davydova & Reznik, 2001). Thus the reality was distinctly more complex than Hermitage had claimed: if their valuation was correct and the 32% stake in Purgaz was indeed worth \$566m, then it is doubtful whether it was worth this amount to Gazprom, subject as it was to regulated prices.

The case of petrochemicals company Sibur provides further evidence that Gazprom and its political masters did not yet have a coherent strategy for its lost assets until some time after Miller became chief executive. In July 2001, Gazprom found that it had failed to convert a newly-gained majority stake in Sibur into a board majority. It was also being asked to buy into a new Sibur share issue which Gazprom First Deputy CEO Petr Rodionov believed was based on an exaggerated share price (its stake would be drastically diluted if it did not subscribe). At the end of September, Rodionov demanded the resignation of Sibur's CEO Yakov Goldovsky. But he found himself reprimanded by Gazprom's then Deputy Chairman Dmitry Medvedev, on the grounds that he had exceeded his authority. Rodionov submitted his resignation soon afterwards (Bushueva & Reznik, 2001b). But only a few months later, in January 2002, Goldovsky was arrested and effectively accused of trying to steal the company from Gazprom.

By the time of Goldovsky's arrest the Gazprom management had finally arrived at a strategy for its lost assets that was straightforward in its approach even if unclear in its motivations. In

¹¹⁵ Non-Gazprom producers had since 1998 been released from any obligation to sell their gas at regulated prices (Ahrend & Tompson, 2005, p. 804).

the same month, Gazprom Deputy CEO Aleksandr Ananenkov said that “everything which by rights belongs to Gazprom must be returned”, as part of a new company strategy “aimed at increasing the capitalisation of the company” (Reznik, 2002a). While the reference to increasing capitalisation implied that this was a commercially-motivated strategy, the assertion that the campaign extended to all assets “which by rights belong to Gazprom” suggested otherwise. The commercial rationale was doubtful not just with respect to Purgaz, but also regarding some of the assets that are the subject of the case studies below.

It appears that an intervention by President Vladimir Putin was the prompt for Gazprom’s new strategy. On 20 November 2001, he publicly reprimanded Miller for deficiencies in his work to date, and passed judgement on Sibur using wording that implied the same lesson was to be applied to other lost or threatened Gazprom assets: “You must pay close attention to the ownership issue. If you sit with your mouth open, you will lose not only Sibur, but other companies too before you have time to look around” (Gorelov, 2001; Isachenkov, 2002; “Tsitata nedeli,” 2001).

Barnes (2006a, 2006b) provides a good starting-point for understanding the political objectives behind the decision to recover the lost assets that “by rights belong to Gazprom”. He states that commercial property is prized by competing interests (including the state) not just for its financial value but as a source of power in an economic environment characterised by a high degree of uncertainty. Additionally, he suggests that Putin’s views on economic development include a Gerschenkronian stress on the need for the state to play an active role, particularly in “late developing” countries, and an adoption of Baldwin’s notion that control over natural resources can be used to gain international influence (Baldwin, 1985; Gerschenkron, 1962). Gustafson (2012, pp. 247–250) notes that once Putin had moved from St Petersburg to the national stage in 1999, “he increasingly [stressed] the importance of state power and control. State power is the precondition for stability and economic growth, and control of natural resources is the precondition for state power”. This is the reason for the

close personal interest that Putin took in Gazprom, and explains why it became a major priority to transform the state's somewhat precarious *de facto* control over Gazprom into solid *de jure* control by achieving a direct majority stake.

Gazprom had begun its existence as the direct successor to the USSR Gas Industry Ministry. In August 1989, Viktor Chernomyrdin, who headed the Ministry, persuaded the USSR Cabinet of Ministers to transform it into a Union-wide state-owned *kontsern* (Panyushkin & Zygar', 2008, pp. 16–19)¹¹⁶. Gazprom's managers tried unsuccessfully to exclude the company from the wider privatisation programme led by Anatoly Chubais. However, they did succeed in winning concessions that allowed them to control the privatisation process. They emerged with control over a substantial Gazprom stake and considerable autonomy of action¹¹⁷.

Pappe and Galukhina (2009, p. 170) question whether the state ever lost its *de facto* control over Gazprom: they argue that the management always obeyed clearly expressed directions from officials at the level of deputy prime minister and above. Furthermore, they claim that from the formal point of view, the state in the early 2000s enjoyed a majority vote at Gazprom because it could rely on the management and other shareholders whose loyalty was guaranteed. By contrast, journalistic accounts give the impression that this situation was more precarious: the state was able to cobble together a majority vote at shareholder meetings by reaching *ad hoc* agreements with other shareholders (Petrovsky, 2002; Reznik, 2001a). In any case, it is clear that the political leadership did not find the situation satisfactory, and felt that it could not rely on being able to exploit Gazprom's resources effectively until state control was formalised. There was also a perceived risk, possibly exaggerated in the minds of political

¹¹⁶ Gazprom was the first *kontsern* and entirely replaced the USSR Gas Ministry. Although entirely state-owned, this and subsequent *kontserny* gave enterprise managers some autonomy from government for the first time (Gustafson, 2012, p. 72; Sim, 2008, p. 18)

¹¹⁷ For details of the privatisation process and subsequent developments affecting the state's control over Gazprom in the 1990s, see Ivanova (2001).

actors who were arguably unusually preoccupied with national security, that the lack of formal control might mean Gazprom falling into the hands of Russia's 'enemies'.

As will be discussed below, formal state control over Gazprom was achieved in summer 2005, when a state-owned company named Rosneftegaz bought a 10.7% stake in Gazprom from its subsidiaries. But this final transaction was made possible by Gazprom's earlier work to buy back Gazprom shares that had been sold to third parties under the previous management. Most notably, this included a 4.83% Gazprom stake that had been sold to Stroitransgaz in 1994-1995. In Gazprom's SLCT of Stroitransgaz, which is examined below, it was the Gazprom stake that was the main prize and not Stroitransgaz itself.

Restoring state control over Gazprom cannot, however, have been the sole objective behind the campaign to recover its lost assets. Otherwise, the campaign could have been restricted to pressuring Stroitransgaz and other companies to hand over their Gazprom shares. The fact that it extended to many other lost Gazprom assets can largely be explained by the wish to boost Gazprom's asset base as far as possible. Doubts over the commercial rationale of taking back some of these assets were ultimately rejected in favour of an apparently indiscriminate campaign, proving that this was not, as Ananenkov claimed, essentially a policy aimed at boosting Gazprom's market capitalisation¹¹⁸. The more important motivation appears to have been to maximise Gazprom's effectiveness as a tool of the state.

Heinrich (2008) has examined Gazprom's use by the Putin administration as a means to boost Russia's influence abroad, while pointing out that it has also been used to bolster state power within Russia's borders. Gazprom also serves as an example to support the claim made by Chaudhry (1993) that in developing countries state ownership is often "a response to the administrative weakness of a state" and to "the difficulties encountered by late developers in

¹¹⁸ Pappe and Galukhina (2009, p. 171) express doubts also regarding the wisdom of this 'bloating' (*razbukhanie*) of Gazprom, which included the acquisition of vast new assets as well as re-taking ones that had previously been lost. They argue that the scale and diversification of the Gazprom business would inevitably lead to problems of manageability.

constructing effective national legal and regulatory institutions”¹¹⁹. Gazprom fulfils official regulatory functions on behalf of the government as well as being a supposedly commercially-motivated joint-stock company. Ahrend and Tompson (2005, pp. 813–4) argue that Gazprom needs to transfer its regulatory functions to state bodies, but the fact that this has not been done to date most likely points to the government’s awareness that it is unable to provide effective regulation. It has also been argued (though not uncontroversially) that by fixing Gazprom’s domestic prices at below-market rates, the government has used it to provide a subsidy to the wider economy (Henderson, 2011, p. 8)¹²⁰.

The evidence from the three cases, to which we now turn, shows that the state went on to try to use Gazprom’s restored ownership of some of these assets to solve certain micro-economic problems, despite indications that these efforts made no commercial sense for Gazprom itself. Therefore the political objectives for the campaign included (or came to include through a form of ‘mission creep’) wider considerations of state-led economic development.

Sibur

Sibur was created in 1995 through a government decree which transferred to it numerous gas processing plants which had previously been the property of state-owned Rosneft’. The plants took as inputs the associated gas which is a by-product of oil production; they separated it into pipeline-quality natural gas on the one hand, and natural gas liquids which could be used in petrochemicals production on the other. By 2001, Sibur had expanded to become Russia’s largest petrochemicals company, with a 47% share of the country’s production of rubber, 43% of its tires, 25% of its liquid gases and 23% of its synthetic fibres (Bushueva, Reznik, Novolodskaya, & Chertkov, 2002). As will be discussed below, this was an asset that had not

¹¹⁹ “In cases where the government becomes the primary employer and producer and assumes the role of setting prices, its task is simplified to monitoring the activities of corporations and agencies that it owns and manages” (Chaudhry, 1993, p. 252). By contrast, Evans (1995, pp. 69–71) suggests that excessive expansion of state ownership can undermine developmental goals by placing “an intense strain on state capacity.”

¹²⁰ Woodruff (1999) challenges this notion by problematizing the concept of “below-market”.

yet been strictly ‘lost’ by Gazprom, but was in imminent danger: Gazprom had secured majority ownership for the first time in summer 2001, only to find soon afterwards that its stake risked being diluted to the point where it had no influence over the company.

The petrochemicals industry was beyond Gazprom’s core business of gas production and supply. But by controlling Sibur, Gazprom (which already had some gas processing plants) could establish itself as a monopsony buyer of the associated gas produced by oil companies. Heinrich (2008) describes this as one of the ‘administrative resources’ which Gazprom (after retaking Sibur) used against oil producers with ambitions to become significant gas producers, in order to stop them competing with Gazprom on a level playing field. In addition to Gazprom’s monopsony position, the oil producers had since 1998 been forced to sell their associated gas at a price fixed by the regulator in order to preserve Sibur’s commercial viability. They had responded by increasingly electing to simply ‘flare’ this gas on-site.

When Putin made his remarks in November 2001 about the danger of losing control of Sibur, he commented at the same time on the need to preserve and revive Russia’s petrochemicals industry. Sibur’s creation had helped to bring about a partial revival of the industry, but it was feared that without its affiliations with Gazprom, and the stable demand this brought for the pipeline-quality natural gas produced at the gas processing plants, Sibur would be an unviable business (Drankina & Tatevosova, 2002)¹²¹.

In an April 2002 interview, Gazprom Deputy CEO Aleksandr Krasnenkov conceded that Sibur was strictly speaking a non-core asset for Gazprom, but noted that “the Sibur production cycle lengthens the chain of gas processing and allows [us] to export not just raw materials but processed products”. This can be seen as an exclusively commercial explanation for

¹²¹ For the sake of clarity, two monopsonies were involved in Gazprom’s relationship with Sibur: 1) with Sibur under its ownership, Gazprom stood to own all of the country’s gas processing plants, giving it monopsony status as buyer of associated gas from oil companies; 2) Gazprom was also the only company in a position to buy the pipeline-quality natural gas produced at Sibur’s plants. This dependence on a single buyer would have imperilled the profitability of this side of Sibur’s business, if Sibur were no longer under Gazprom’s ownership.

Gazprom's interest in Sibur, but it is also notably similar to the developmental interest taken by Putin in moving oil exports up the 'value chain' by boosting the exports of refined products (Gustafson, 2012, pp. 369–370)¹²². It also recalls Wengle's (2012, p. 101) description of the Russian government's interest in promoting electricity exports from Russia's Far East as part of a strategy "aimed at moving away from exporting raw materials, toward value-added production."

Stroitransgaz

Stroitransgaz was another company that could hardly be described as a core asset for Gazprom: it built pipelines and provided other construction services relating to the development of oil and gas fields. Like Sibur, the company itself was not 'lost' by Gazprom under Vyakhirev – it had never been controlled by Gazprom. But what *was* deemed to have been lost to Stroitransgaz was a 6.2% stake in Gazprom itself. Gazprom had transferred the bulk of these shares (4.83%) to Stroitransgaz in 1994-5 as payment for construction services. The exchange was based on a substantially under-valued price for Gazprom's shares¹²³. Stroitransgaz had bought the remaining Gazprom shares on the open market in subsequent years.

If the state could gain control of the Gazprom stake that was held by Stroitransgaz, it would be well on the way to its ultimate goal of securing a direct majority stake in Gazprom. The government considered this a pre-condition for eliminating the 'ring-fence' bar on foreign shareholders owning Gazprom's domestically-issued shares (Grivach, 2003). Removing the

¹²² Putin aimed to achieve this increase in refined oil products exports through a reduction in export tax; as noted in Chapter Two, such motivations may have contributed to the decision to force Bashkortostan's petrochemicals industry to open itself up to the national economy.

¹²³ STG's CEO Arngold Bekker claimed in a 2000 interview that Gazprom had the option of taking back the 4.83% stake by repaying its debt in cash within three years, but had not elected to do so (Bushueva, 2000c). An investigation by the Russian Federal Securities Commission in 2001 found that the Gazprom shares had been priced at just their nominal value for this 1994-5 transaction, i.e. the 4.83% stake was in payment for a debt of \$2.5m. The market value of the stake at the time was said to be at least \$70m. However, this had been legal and in line with other deals that year involving Gazprom shares (Prezhentsev & Reznik, 2001; Yakubova, 2001).

ring-fence would boost Gazprom's capitalisation, a strategic aim of Gazprom's management which would also delight the company's existing minority shareholders. No doubt a large number of Gazprom insiders and Russian officials who were also Gazprom shareholders also stood to benefit from the removal of the ring-fence¹²⁴. But as noted earlier, these commercial motivations were less important than the government's wish to establish full control of Gazprom because of its power as a political and economic tool both domestically and internationally. At the same time this meant removing the risk that the company might instead fall under the control of domestic or foreign 'enemies'.

Stroitransgaz presented an additional hindrance to the state's efforts to exert *de facto* control over Gazprom. Its CEO Aleksandr Bekker had been voted onto the Gazprom board of directors in 1999 (Davydov, 1999). While Vyakhirev's management had been in control of Gazprom, Bekker's loyalty had not been in question. But after Vyakhirev's removal as Gazprom CEO in May 2001 there was concern that Bekker would vote independently or against the new management's initiatives.

It will become clear later in this chapter that Gazprom could have confined its efforts vis-à-vis Stroitransgaz to taking control of the Gazprom shares on its balance sheet and pressuring Bekker to withdraw from the Gazprom board. But it elected additionally to purchase a blocking stake in Stroitransgaz itself. The rationale for this latter decision was commercial. The intention was to optimise Gazprom's dealings with an important counterparty by bringing it under Gazprom's ownership. Stroitransgaz had historically been its main general contractor for pipeline construction work¹²⁵. In the absence of a meaningfully competitive market for these services, Stroitransgaz was close to being a monopolist provider, and there was

¹²⁴ For reasons that cannot be dwelt on here, there were also many companies and individuals who benefited financially from the distortions created by the ring-fence.

¹²⁵ In 2000 Stroitransgaz had received RUB 31bn out of the total RUB 97bn which Gazprom invested in construction (Rybal'chenko, 2001).

particular concern regarding its inflated costs¹²⁶. Furthermore, as general contractor Stroitransgaz only supervised projects and sub-contracted the work out to other companies, and these included many of Gazprom's own construction subsidiaries; yet most of the profit from the work was retained by Stroitransgaz (Reznik, 2002d). Consequently, Gazprom considered the alternative strategy of replacing Stroitransgaz with a Gazprom subsidiary offering the same services. In fact, as will be seen below, Gazprom tried for a time to do both at once, with the project to create a new rival subsidiary acting as a useful bargaining tool when negotiating with Stroitransgaz's existing owners.

Zapsibgazprom and South Russkoe

While it is debatable whether Sibur's petrochemicals business or Stroitransgaz's gas field construction business rightly belonged within the Gazprom group of companies, there was a clear case for Gazprom to recover control of the South Russkoe gas field. Located in central Yamal, this field had proven reserves of 600bcm (Reznik, 2001c). Given Gazprom's total proven reserves of 28tcm at the end of 2001 (OAO "Gazprom," 2002a, p. 14), this was of sufficient size to be significant if not momentous for Gazprom's future. Production began in 2007, by which time German firm BASF had become a minority shareholder in the field's operating company. It was scheduled to increase from 10bcm in 2008 to 25bcm (equivalent to 4.5% of Gazprom's overall production) in 2009. But the field was to have additional strategic significance for Gazprom and the Russian state: it became the main resource base for the Nord Stream gas pipeline, which runs under the Baltic Sea from Russia to Germany and came onstream in 2011-12 (Mazneva, 2007; Paszyc, 2012). This pipeline is of considerable

¹²⁶ As Usmanov explained in December 2002, "Gazprom needs a blocking stake [in Stroitransgaz] in order to have strategic influence over a company connected with [its] business. The blocking stake will allow Stroitransgaz to take part in tenders on equal terms with other bidders, and Gazprom will be able to exercise real control over the cost of work done by this company" (Reznik, 2002h). A government bureaucrat close to the Gazprom board of directors said in 2004 that he and others had been against the purchase of a blocking stake, believing that Gazprom should be using competitive tenders to buy its equipment. "But Gazprom persuaded us that it was important for it to be able to monitor [*kontrolirovat*] the finances of its contractor" (Reznik, 2004a).

geopolitical value to Russia, as it allows Gazprom to deliver stable supplies of gas to western Europe without risk of disruption from transit countries (Helén, 2010).

As will be explained below, the licence to develop South Russkoe was until 1998 held by Gazprom's subsidiary Zapsibgazprom, one of the largest industrial enterprises in Tyumen' region, which owned various companies involved in laying new gas infrastructure for Russian regions (Bushueva, 2001a). The gas field licence was then transferred to a subsidiary of Zapsibgazprom named Severneftegazprom, though this fact was not confirmed in public until 2001. No-one within Gazprom's management disputed the need to regain control of the gas field, but there was some debate as to whether the company needed the infrastructure business of Zapsibgazprom itself¹²⁷. There were concerns about the commercial viability of the latter, and these concerns would later prove to be well-founded. Nevertheless, the decision was made to recover Zapsibgazprom in its entirety. It may be that this decision simply reflected an indiscriminate, essentially political strategy to take back everything that 'by rights belonged to Gazprom'¹²⁸. But if that were the case, one would expect the company's ailing infrastructure business to have been quietly forgotten after the takeover¹²⁹. Instead, the intention was that Gazprom would revive the business by sending new orders its way, especially by making it general contractor for development of the South Russkoe field (Mokrousova, 2003b; Morgun, 2002a). Vladimir Zav'yalov, a former deputy of Tyumen' region's parliament, was made head of a new managing company created on 20 April 2002 that was tasked with reviving Zapsibgazprom's fortunes. It appears that the region's governor Sergei Sobyenin had a hand

¹²⁷ In July 2001, when it was becoming clear that Zapsibgazprom no longer had the licence to the gas field, an unnamed Gazprom senior manager was cited as saying "I don't understand at all why we need this acquisition. Zapsibgazprom is on its own a non-core enterprise, and its only value was in the licence" (Bushueva, 2001e). Gazprom Deputy CEO Aleksandr Krasnenkov was more positive about the remaining Zapsibgazprom business in April 2002, saying that the company was "without exaggeration a second Gazprom within Gazprom, and is involved in literally everything. There are many non-core and core assets there" (Butrin, 2002b).

¹²⁸ A Gazprom representative said in February 2002 that the attempt to take back Zapsibgazprom was part of company policy to take back illegally stolen assets, "and in this we are prepared to go to the end, be that with Sibur or with Zapsibgazprom" (Reznik & Lysova, 2002).

¹²⁹ There was talk of using the Zapsibgazprom stake as part-payment for Gazprom's contribution to a new share issue at Sibur (Bushueva, 2001g), but this did not come to pass.

in this appointment¹³⁰. Zav'yalov said in an interview that he reported to Gazprom Deputy CEO Aleksandr Ryazanov, who was responsible for Zapsibgazprom within Gazprom's senior management. Zav'yalov made clear his determination not to let Zapsibgazprom go the way of the region's other oil and gas enterprises, which had "been liquidated before my very eyes" (Morgun, 2002b)¹³¹.

Summary

It is clear from the case studies that Gazprom's decision to take back these assets was not motivated by exclusively commercial considerations. The stated objective of boosting market capitalisation fits perfectly with the acquisition of the South Russkoe gas field (which previously belonged to Zapsibgazprom). Re-taking Stroitransgaz's Gazprom stake also promised to boost Gazprom's capitalisation through the removal of the ring-fence, but the political objective of consolidating state control over Gazprom was more important. The objective of boosting Gazprom's power as a political and economic resource applies to the South Russkoe acquisition given its later strategic importance as source of gas for the Nord Stream pipeline. But the decision to keep Zapsibgazprom's ailing gas infrastructure business alive with new orders, and some of the justifications given for including Sibur in the campaign, indicate that both the government and Gazprom's managers felt that Gazprom had a responsibility to act as a tool of industrial policy. Gazprom was seen as having a responsibility to play an 'altruistic' role in solving problems associated with Zapsibgazprom and Sibur, even if this worked against Gazprom's institutional self-interest¹³².

¹³⁰ Sobyenin was governor of Tyumen's from January 2001 to November 2005, when he was made Putin's chief of staff. In October 2010 he became mayor of Moscow.

¹³¹ Despite the good intentions, Gazprom failed to turn Zapsibgazprom around. It took another three years for work to begin to develop South Russkoe, during which time Zapsibgazprom's financial condition had worsened. Gazprom decided instead to bring in German investors to help develop the field. In December 2012, the now heavily-indebted company was sold to financial firm IFK Metropol ("Metropol" 'pokupaet' Zapsibgazprom," 2012).

¹³² The fear of the social impact on Tyumen' region in the event of Zapsibgazprom's collapse appears to have prompted Gazprom's efforts to keep it alive through new orders. Stable orders from Gazprom

The decision to buy at least a blocking stake in Stroitransgaz can be seen as motivated by Gazprom's commercial self-interest, but not in the sense of directly boosting Gazprom's market capitalisation. Instead, the aim was to use ownership to control the costs involved in Gazprom's relationship with a key supplier. Ownership was also key to helping Sibur and Zapsibgazprom through the provision of a steady stream of orders. What stood in the way of achieving the same objectives *without* the use of ownership were the costs associated with transacting with the same companies across the market. As well as the uncertainty this would bring to prices, it would severely complicate the task of ensuring that contracts were honoured reliably. The work of Williamson (1981) on the use of vertical integration in response to high transaction costs provides valuable theoretical insight into these problems and their attempted solution. The prevalence of monopsony and monopoly relationships relates to his discussion of asset-specificity, which complicates the task of finding alternative buyers and sellers and thus raises the spectre of 'hold-up problems'. Williamson sees 'uncertainty' as another critical dimension for describing transactions and determining whether they are better carried out across the market or within a vertically-integrated company. Adachi (2010, pp. 37–38) employs Williamson's theory as part of her explanation for what prompted Russian business to 'reconstruct the production chain' through vertical integration. She argues that the lack of market-supporting institutions in Russia, the high costs of contract enforcement due to its weak legal system, and undeveloped markets for products, labour and finance all added to uncertainty and made vertical integration a more attractive option. However, as dissenting voices within the company told the media at the time, many of the assets being brought into the Gazprom fold were in fact *unrelated* to the chain of production in Gazprom's core activity of gas production and transportation. This fact serves to underline that the objectives behind the campaign were essentially political and developmental, rather than being based on Gazprom's internal commercial logic.

were important to Sibur's viability, which in turn had been identified by Putin as being of importance to the petrochemicals sector as a whole.

Research question 2: explaining the ownership outcomes

The remainder of this chapter seeks to explain what determined the *outcomes* of these takeovers. Although state ownership was the outcome in each case, the aim is to understand the specific ways in which Gazprom structured its ownership. The outcomes are once again explained by reference to how the SLCTs progressed as bargaining games between state and existing owner. In order to understand the nature of the bargaining games, we first examine the nature of Gazprom's predicament on the eve of the takeover. This means understanding whether it had already lost control over the target company or was merely at imminent risk of doing so. However, Gazprom's predicament was compounded by the fact that, thanks to defensive tactics employed by the existing owners, the target companies and the assets which Gazprom prized were not always one and the same.

Ownership status on the eve of takeover

Sibur

From its creation in 1995 until 1998, Sibur was state-owned and had no affiliation with Gazprom. It was then privatised, and the obscure companies that emerged as the buyers also had no formal connection to Gazprom. But they were linked to Yakov Goldovsky, an oil trader whom Gazprom had hired to be head of its subsidiary Gazsibkontrakt¹³³. Goldovsky maintained later that he and certain unspecified private business partners had been the real buyers in the Sibur privatisation (despite the fact that it was financed by a loan from Gazprom's then-subsiidiary Gazprombank, with Gazprom acting as guarantor), but that he had always encouraged Gazprom to buy in to the business at a later stage (Novolodskaya, 2003). This claim runs counter to the account provided by journalists from Russian *Forbes*, who

¹³³ The two main stages of the privatisation involved the sale of a 20.22% stake to a company named OOO Bonus-Invest, which was owned by four obscure individuals, and the sale of a second tranche of 50% minus 1 share to a company named Gazoneftekhimicheskaya Kompaniya (GNK). The latter was owned by companies which were based in Liechtenstein but had Goldovsky as their Chairman (Makarkin, 2002).

stated that Gazprom had hired Goldovsky with the specific aim of buying Sibur in circumvention of restrictions preventing it from participating in the privatisation auction directly (Lysova & Nogina, 1999). The fact that Sibur's board was dominated by Gazprom representatives as early as 1999 lends some additional weight to the *Forbes* account (Lysova & Nogina, 1999; Makarkin, 2002).

The *Forbes* journalists did not elaborate on why they believed Gazprom did not have the right to take part in the privatisation directly. The Law on Privatisation at the time only prevented companies in which the state had a *direct* stake of above 25% from participating in privatisation auctions (Neimysheva & Reznik, 2003). Therefore, to get around this legal obstacle, Gazprom could simply have used one of its own subsidiaries to buy Sibur. Admittedly, to have done so would have been politically controversial: at the time, the notion of state-owned companies acting as buyers in privatisation auctions still struck many as defeating the object of privatisation¹³⁴. But the specific obstacle to Gazprom's participation in the Sibur privatisation process may well have come instead from the antitrust regulator¹³⁵. As mentioned above, Gazprom stood to become a monopsony buyer of associated gas as a result of the Sibur purchase. It would therefore have needed to gain prior approval from this regulator before it or any affiliated company (as defined by the extant antitrust legislation)

¹³⁴ A few years later, state-owned Rosneft' did attempt to participate in the privatisation of Slavneft, using two affiliates including a subsidiary of a Rosneft' subsidiary. This was blocked by the State Property Fund, which was apparently aware that it was on shaky ground legally but insisted that allowing these indirectly state-owned companies to participate would have defeated the object of the privatisation (Neimysheva & Reznik, 2003). The State Property Fund's head was subsequently fined by a Dagestan court for having incorrectly applied the Privatisation Law. In recent years, the involvement of state-owned companies as buyers in Russian privatisation has become almost the norm, as evidenced by the emergence of state-owned Gazprom and Inter RAO as major owners of electricity generating companies.

¹³⁵ The regulator was named the State Antimonopoly Committee from March 1997 until September 1998, when it was renamed the Ministry for Antimonopoly Policy and Support for Entrepreneurship. Today it is named the Federal Antimonopoly Service. As shown in Tazhetdinov (1996), antitrust legislation, including the legal concepts of "affiliated entity" and "group of entities", was already well developed by the time of the Sibur privatisation.

could bid in the privatisation auction. This may have made it impossible in practice for Gazprom to have made a timely privatisation bid¹³⁶.

Using various companies to which he was linked, Goldovsky bought stakes not only in Sibur itself but in various associated petrochemicals enterprises. He placed Sibur's assets 'at one remove' from the company itself by making it managing company of the petrochemicals enterprises but not their parent company: the ownership ties between them were either highly complex or non-existent¹³⁷. According to Goldovsky, he and Gazprom had planned all along that this relationship would be restructured and simplified when Gazprom bought into the company: the enterprises Sibur managed would become its formal subsidiaries, and Gazprom would acquire a controlling stake in the main Sibur entity by subscribing to a new share issue (Novolodskaya, 2003).

Goldovsky had worked with members of Gazprom's management in devising the plan for Sibur (Lysova & Nogina, 1999), but as early as August 1999 the Kremlin was putting pressure on Gazprom to think again. On the day before a Gazprom extraordinary general shareholders' meeting (EGM), the offices of Sibur and Gabsibkontrakt were searched by police and documents were confiscated relating to their dealings with Gazprom (N. Ivanov, 1999). At the beginning of June 2000, Vyakhirev said he was not yet sure whether Gazprom would increase its stake in Sibur from the current 18% to controlling. However, in December the Antimonopoly Ministry approved Gazprom's application to do just that through subscribing to a new share issue (Bushueva, 2000d; Novolodskaya, 2000). Before this acquisition was implemented, Sibur's board in May 2001 approved *another* share issue, which would oblige Gazprom to subscribe again (at a cost of \$700m) in order to retain control (Novolodskaya,

¹³⁶ Approval from antitrust body was later required when Gazprom formalised its controlling stake in Sibur in summer 2001 (see below). The role of the antitrust regulator in constraining the behaviour of large companies including Gazprom is a major theme of the following chapter.

¹³⁷ In spring 2001, Russia's oil companies were to discover that Sibur *owned* very little in the way of assets. This fact came to light when the companies conducted due diligence on Sibur after they were invited to buy a blocking stake. The invitation arose from a condition imposed by the antitrust regulator when it approved Gazprom's purchase of a controlling stake in Sibur (Novolodskaya, 2001b).

2001a). Little attention was paid at the time to the fact that Sibur was planning to issue both ordinary voting shares (to which Gazprom was encouraged to subscribe) and preference shares to which it was not eligible to subscribe. Gazprom's senior management realised only later that these preference shares posed a serious threat to their investment in Sibur.

Perhaps because Gazprom's new management was still getting to grips with company business following the change of command with Miller's appointment as CEO at the end of May 2001, the company failed to convert its majority stake into a board majority at the Sibur AGM in July 2001¹³⁸. Only five out of sixteen Sibur board seats were occupied by Gazprom representatives. Other seats were filled by representatives from foreign companies who were helping Sibur expand into Eastern Europe, but also by a representative of a foreign company which was thought to be planning to subscribe to one of the new share issues. Somehow this company had made its way onto the board before the share issue had taken place ("Transnatsional'nyi 'Sibur,'" 2001).

As noted above, one member of Gazprom's senior management took it upon himself to act against Goldovsky in September 2001. Angered by the loss of Gazprom's board majority at Sibur and believing its assets to be substantially over-valued for the purposes of the new share issue, Gazprom First Deputy CEO Petr Rodionov demanded Goldovsky's resignation. Goldovsky refused and instead wrote to Miller, explaining that "I do not consider it possible to agree with the proposal to dismiss me, as I believe that this would lead to serious consequences for Sibur and to the winding up of the programme to create on its basis a powerful vertically-integrated company". Reportedly the letter also contained an offer from certain Sibur shareholders to finance the repayment of Sibur's debts to Gazprom, and to halt the controversial new share issue, on the condition that Goldovsky remain as CEO (Lysova & Novolodskaya, 2001).

¹³⁸ Similarly, management disarray at Gazprom is likely to explain why Gazprom suffered two serious setbacks in May 2001 that put control of the South Russkoe gas field beyond its reach; this will be explained below.

A few days prior to this board meeting it had come to light that the preference shares which Sibur was planning to issue, and to which Gazprom was not eligible to subscribe, would be convertible into ordinary shares within three years. This meant that, even if it paid the required \$700m investment to buy enough voting shares to retain control, Gazprom might still find itself a mere minority shareholder in Sibur (Fedorin & Denisov, 2001)¹³⁹.

On 5 November 2001, Aleksei Miller announced the appointment of Aleksandr Ryazanov as Gazprom Deputy CEO. Ryazanov was made responsible for Gazprom's relations with Sibur and Itera¹⁴⁰. This was an ill omen for Goldovsky given Ryazanov's past: he had in 1998 been director of the state-owned Surgut gas processing plant when Goldovsky, as head of the Gazprom subsidiary Gabsibkontrakt, was working to bring such plants under Gazprom's control. Ryazanov had refused to accept a share-swap proposed by Goldovsky, and had been arrested at Surgut's airport, accused of attempting to leave town with stolen money. He claims that Goldovsky visited him in person in his detention cell and made clear he would be released if he agreed to the share-swap (Bushueva, Osetinskaya, & Shcherbakova, 2001; Drankina & Tatevosova, 2002; Malkova, 2011)¹⁴¹.

Gazprom would go on to use very similar tactics against Goldovsky. But despite Ryazanov's appointment and Putin's warning to Miller in the same month to stop further assets being lost, the decision to recruit the state's coercive resources to establish secure control over Sibur had not yet been taken. This was apparently due in part to a concern that, if it went on the offensive against Goldovsky, this would trigger a bankruptcy process at Sibur, which was in debt to numerous creditors including Gazprom itself. It was feared that the bankruptcy process

¹³⁹ Reportedly, it had been clear throughout to anyone who read the Sibur company charter that its preference shares were convertible in this way into voting shares, suggesting that Gazprom's lawyers had been somewhat negligent in not realising this earlier (Bushueva & Reznik, 2001a).

¹⁴⁰ At the time the Gazprom press office stated merely that Ryazanov would be responsible for "the whole range of production issues" (Bushueva, Osetinskaya, & Shcherbakova, 2001), but his more specific responsibilities soon became clear.

¹⁴¹ Reportedly Ryazanov held out and was in any case released. He resigned from his post soon afterwards, however.

would lead to Sibur being broken off, with some of the assets going to Gazprom's rival creditors. In order to prevent this scenario developing, Gazprom stepped in at the beginning of December 2001 to lend Sibur RUB 2.2bn (then worth around \$73m) so that it could avoid defaulting on bonds it had issued in the summer (Epshtein & Reznik, 2001).

In December 2001, Gazprom reached a 'gentleman's agreement' with Sibur's managers that the new share issue would be delayed. In the meantime, certain gas processing plants that were to be transferred to Sibur's ownership through that share issue would instead be sold to oil companies, and the money used to help repay Sibur's debt to Gazprom (Drankina & Tatevosova, 2002; Novolodskaya, 2001b)¹⁴². One sale went ahead as planned: the Surgut gas processing plant was bought by the privately-owned oil major Surgutneftegaz in late December (Novolodskaya & Tutushkin, 2001).

On 29 December 2001 Gazprom received an extract from Sibur's share register which showed that Goldovsky's company Gazoneftekhimicheskaya Kompaniya had bought newly-issued shares and left Gazprom's stake reduced to 32%. The money from the sale of the Surgut gas processing plant had reportedly financed this acquisition, rather than going to Gazprom (Drankina & Tatevosova, 2002). Reportedly, Gazprom went straight to the Prosecutor General's Office when it received this information, and from this point on Gazprom's campaign to re-take Sibur became explicitly coercive (Reznik, 2009).

Figure 4 shows the ownership situation at Sibur at the point when Gazprom launched its coercive takeover. The assets of value and interest to Gazprom - the gas processing plants - were controlled not by Sibur but by its management, which had also just won back control of Sibur itself through the latest share issue. Gazprom had only a non-controlling stake in Sibur.

¹⁴² As noted above, Goldovsky had reportedly offered in his September letter to Miller to have Sibur shareholders help repay Sibur's debts to Gazprom. Since the same management-linked offshore companies which owned Sibur also owned the gas processing plants (see Figure 4), this enabled the money raised from selling the plants to be used to repay Sibur's debt to Gazprom.

As a major creditor, it also had a claim over the company and its assets, but other creditors also had rival claims.

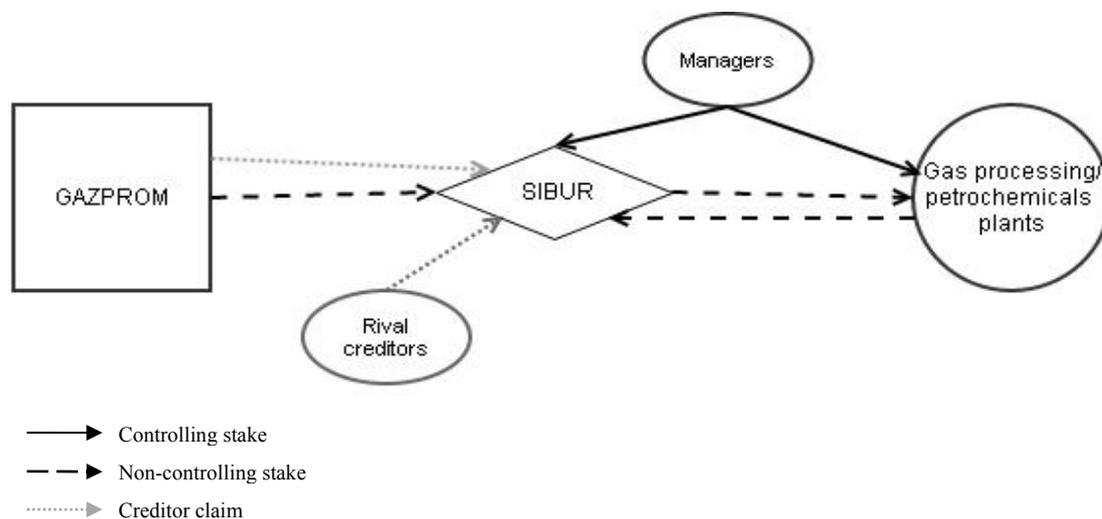


Figure 4. Sibur ownership before takeover

Stroitransgaz

Stroitransgaz was founded as a joint-stock company in 1990 and brought together enterprises that previously belonged to the Soviet Oil and Gas Construction Ministry. Its founder and president, Arngold Bekker, had worked in the Ministry for the previous twenty years and was closely acquainted with Viktor Chernomyrdin, then general director of Gazprom¹⁴³. Details of the company's initial ownership structure are scarce, but reportedly there was cross-ownership from the outset, with its construction enterprise subsidiaries acting also as its shareholders. As the company grew in the mid-1990s, its share structure changed: its managers bought shares and Bekker and his family achieved control. Also appearing among its shareholders were the children of Chernomyrdin and of his successor as head of Gazprom, Vyakhirev¹⁴⁴. In the

¹⁴³ As noted above, Gazprom was founded as a *kontsern* in 1989.

¹⁴⁴ Reportedly Chernomyrdin's sons Andrei and Vitaly each gained 14%, while Vyakhirev's daughter Tatyana Dedikova gained 6%.

meantime, Gazprom-affiliated companies reportedly only held shares equivalent to a few percentage points (Govorun, 2008).

In November 2001, i.e. a few months after Miller's arrival at Gazprom, Stroitransgaz disclosed some details of its ownership as part of an apparent strategy to deflect criticism regarding its non-transparent nature. Bekker, who was both President and Chairman, was the largest single shareholder with 19.6%. The management collectively controlled 51%. Bekker admitted that his children held shares in the company, as did Vyakhirev's daughter. Gazprom's stake was less than 1% (Chelnok, 2001).

Of the three cases, this was the most straightforward from Gazprom's perspective, as illustrated in Figure 5 below. The primary objective was retaking control of the Gazprom shares on the Stroitransgaz balance sheet. Through purchases on the secondary market, the company had increased its stake in Gazprom from the original 4.83% to 6.2% (Chelnok, 2001; Sapozhnikov, 2002). While Stroitransgaz remained under the control of its managers, there was a risk that the company's Gazprom shares might be sold on to third parties; but the managers' preference was instead to hold on to them as valuable collateral enabling the company to borrow on financial markets (Bushueva, 2000c).

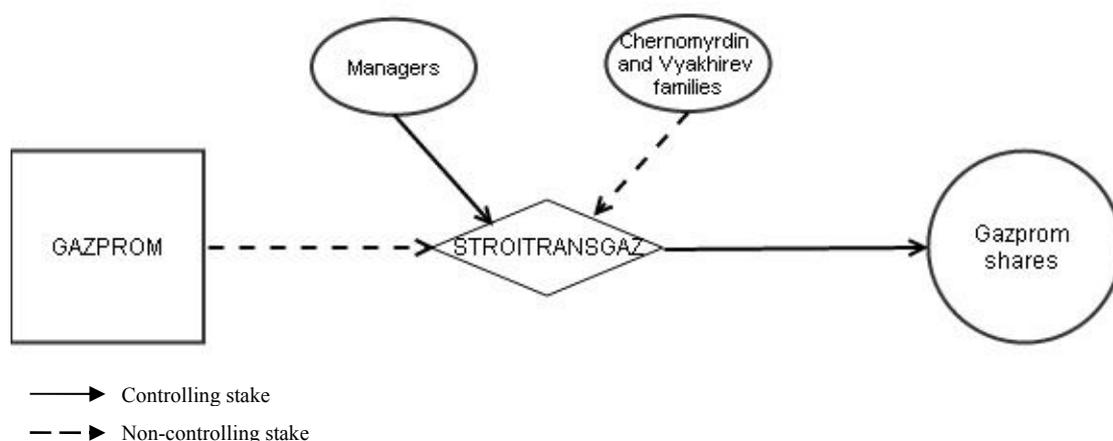


Figure 5. Stroitransgaz ownership before takeover

Zapsibgazprom and South Russkoe

The licence to develop South Russkoe was awarded to Zapsibgazprom as far back as 1993. Zapsibgazprom was at the time a newly-created company, having previously been a Soviet-era production unit named Zapsibgazpromstroi (Rybal'chenko & Mokrousova, 2002; "Zapsibgazprom," n.d.). It was made a subsidiary of Gazprom but was also privatised in 1993-4 (Analiticheskii otdel RIA "Rosbizneskonsalting," n.d.). This explains why, by the late 1990s, Gazprom only owned 51%; the other shareholders were linked to the company's management (Yambaeva, 2002).

The key moment when Gazprom lost control of the company came in summer 2000, when it failed to subscribe to a new share issue and was left with only 37% (Bushueva, 2000b). It would have cost Gazprom just RUB 51.3m (then worth \$1.85m) to subscribe to the share issue and retain its 51% controlling stake. It is not clear whether Gazprom's management made a conscious decision to cede control, or simply let slip the opportunity to subscribe to the share issue. Either way, the management came under severe criticism from the state's representatives on the Gazprom board of directors (Bushueva, 2001a).

Once Zapsibgazprom's managers had achieved majority ownership over the company, they completed their project to move the South Russkoe licence beyond Gazprom's reach. This had begun as far back as 1998, when Zapsibgazprom created a wholly-owned subsidiary named Severneftegazprom and transferred the licence to it (Bushueva, 2001e)¹⁴⁵. In February 1999, Severneftegazprom issued new shares and thereby reduced Zapsibgazprom's stake to 51%.

¹⁴⁵ At the time, such licence transfers were perfectly legal, with the only restriction being that a company could transfer a licence only to another company in which it has a controlling stake. Nothing was said in the legislation regarding what happened subsequently to the ownership of that receiving company. Information from an employee of the Natural Resources Ministry licensing department cited in Reznik (2001c).

The buyers of the new shares were companies linked to Itera, though Itera did not rush to acknowledge this fact¹⁴⁶.

Gazprom's first efforts to regain control of Zapsibgazprom began while Vyakhirev was still at the helm: in October 2000 he announced that Gazprom would increase its stake to 86.8% by buying an additional 49.8% through another new share issue (Bushueva, 2001a). This initiative was blocked by Zapsibgazprom's other shareholders at an EGM in May 2001 (Bushueva, 2001c). In the same month, Gazprom's control over the South Russkoe licence was truly severed: Severneftegazprom conducted a new share issue which left Zapsibgazprom (now only 37%-owned by Gazprom) with just an 11% stake.

It emerged only later that companies linked to Itera had by this time gained a controlling stake (51%) in Severneftegazprom, and hence controlled the South Russkoe licence ("Kak prodavalsya 'Severneftegazprom,'" 2001). In the meantime, if Gazprom's management was aware of Zapsibgazprom's loss of control of the licence, it was not telling even some of its own board members. After a Gazprom board meeting on 31 July 2001, independent board member and minority shareholder Boris Fyodorov told the press that he had repeatedly asked Gazprom's managers whether Zapsibgazprom still owned the licence; he had not received an answer. The board had nevertheless approved the proposal to buy a 49.8% stake in Zapsibgazprom (this time in a direct purchase from its management-linked shareholders, rather than through the new share issue earlier proposed by Vyakhirev). Two of the state's representatives had abstained from the vote, as had Fyodorov and one other minority shareholder representative (Bushueva, 2001f; Reznik, 2001b). On 7 August 2001, Zapsibgazprom's CEO admitted that the company no longer held the licence. He said that Gazprom must have known about the licence transfer that took place in 1998, "and there

¹⁴⁶ A year later, Itera's CEO Igor Makarov said in an interview "we do not plan to buy Zapsibgazprom, but we have created a joint venture, OOO Severneftegazprom, which is 10% owned by Itera-Rus' and 90% by Zapsibgazprom. As we invest in the South Russkoe field, Itera's stake in the joint venture will increase" (Bushueva, 2000a).

should be no sensation made of this” (Denisov, 2001a). At the end of August, it was confirmed that Zapsibgazprom only held an 11% stake in the licence-holding company, Severneftegazprom (Bushueva, 2001g).

Figure 6 summarises the ownership situation on the eve of Gazprom’s takeover. As at Sibur, Gazprom’s claim to the main asset which it prized (in this case, the South Russkoe licence) had become decidedly tenuous.

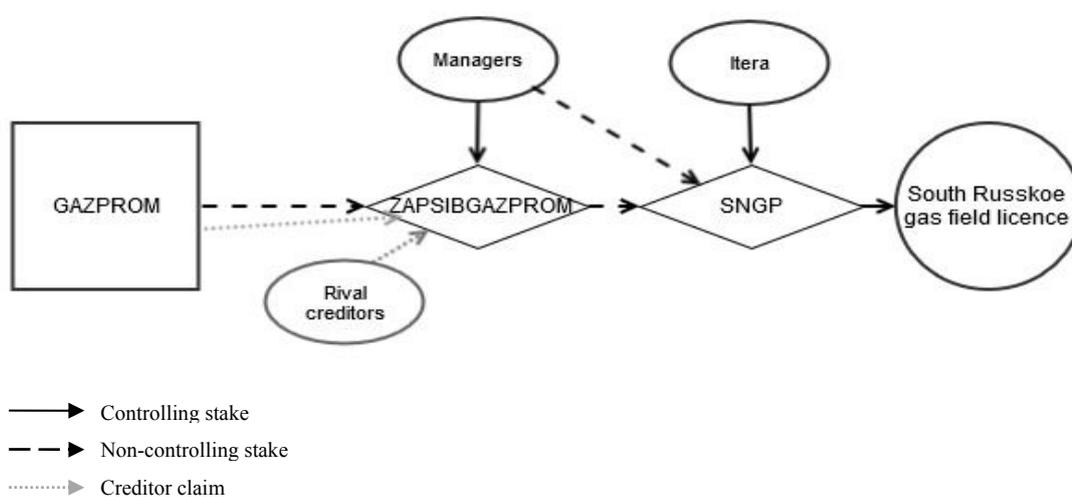


Figure 6. Zapsibgazprom and South Russkoe ownership before takeover

Summary

The above discussion highlights the fact that each case differed in terms of the nature and scale of the challenge Gazprom faced in trying to secure control of its assets. Gazprom’s control at each of the targeted companies was either precarious or already lost when the company began its SLCT. But this problem was compounded by the fact that the existing owners had managed to place many of Gazprom’s prized assets at one remove from the companies themselves.

In the previous chapter, we saw how the state was concerned that full-scale asset seizure might not capture all of the value of the assets, because of various defensive tactics available

to their existing owners. Further examples of such defensive tactics are the share dilutions and other methods used by the existing owners to separate Gazprom from its prized assets. The situation was relatively straightforward at Stroitransgaz, where the Gazprom shares (the main asset of interest to Gazprom) were held on the company's balance sheet. But at Sibur the management had taken direct control of the prized assets (the petrochemicals companies), while at Zapsibgazprom it had gone further by selling the South Russkoe gas field on to a third party¹⁴⁷.

This made the SLCTs fraught with risk: if the existing owners were to sever the remaining ties between the target company and the prized assets, Gazprom might find itself the new controlling owner of a company that no longer possessed the assets it actually wanted, and might lose those assets permanently. As will be discussed in detail below, this played a substantial role in strengthening the bargaining position of the existing owners, because it increased the state's incentives to seek a negotiated solution to the takeovers.

The coercive takeovers

The three cases studied in this chapter have been chosen from the wider sample of Gazprom takeovers partly because of their timing, but also on the basis that they involved state coercion while others did not. This choice needs to be justified by explaining precisely what is meant by 'state coercion'.

Table 2 below shows the various tactics used by Gazprom in the three core cases examined here (shaded cells), and in its takeovers of other lost assets that have not been selected for detailed case study. The columns show the tactics used by Gazprom, and are arranged left to right in ascending order in terms of their coercive nature.

¹⁴⁷ Sibur's management had done the same with the sale of one of the gas processing plants to Surgutneftegaz.

SLCT	Date of completion	Negotiate and/or purchase controlling stake	Economic embargo	<i>Non-law enforcement investigation (tax, regulatory)</i>	<i>Civil court cases e.g. bankruptcy, revoking licence</i>	<i>Searches by law enforcement</i>	<i>Criminal cases, arrests</i>
Purgaz	Dec 2001	✓	X	X	X	X	X
Sibur	Feb & July 2002	✓	X	X	✓	✓	✓
Stroitransgaz	May-Sep 2002	✓	✓	✓	✓	X	X
South Russkoe	May 2002	✓	X	X	✓	✓	✓
Nortgaz	Sep 2005	✓	✓	X	✓	X	X
Tambeineftegaz & Yamal SPG	Nov 2006	✓	X	X	✓	X	✓
Sibneftegaz	Dec 2006	✓	✓	X	X	X	X

Table 2. Gazprom takeover tactics¹⁴⁸

The tactics shown in italics are those that are taken to involve state coercion for the purposes of this project. Least problematic is the inclusion of tactics involving the state's coercive apparatus (e.g. searches by prosecutors, arrests). But two other columns are also accepted as forms of state coercion, namely civil court cases and investigations by organisations that are not part of the state's coercive apparatus (e.g. the tax authorities and regulatory bodies).

¹⁴⁸ For the first four cases, the table is compiled from the evidence presented elsewhere in this chapter. For Nortgaz, see: Heinrich & Kuszniir (2005, pp. 25–6); Stern (2005, p. 27); Levinskii (2005); Reznik & Mazneva (2005); Grib & Butrin (2005). For Tambeineftegaz and Yamal SPG, see: Batishchev & Voronin (2006); Tutushkin & Reznik (2006); Grib (2006). For Sibneftegaz, see: Grib (2005); Medvedeva (2007a); Heinrich (2008, pp. 1549–50).

In his examination of the tactics used by companies to protect against expropriation, Gans-Morse (2011, p. 7) notes that all reliance on law is backed up by the implicit threat of coercion “legitimized by formal rules and regulated by the state”. But for the purposes of the present project, a takeover is deemed to involve state coercion only if state institutions appear to have been used in a selective and arbitrary way to apply pressure on the existing owner. The case of Purgaz, which was mentioned earlier, clearly involved no state coercion: Gazprom regained control merely by exercising an option that was available to it contractually. Elsewhere Gazprom’s use of the law bore the hallmarks of what Gans-Morse labels “corrupt force”: rather than playing by formal rules, it was recruiting the help of state bodies which are assumed to have held some bias in its favour¹⁴⁹.

Such acts are also examples of what Heinrich terms Gazprom’s use of ‘administrative resources’ (2008, pp. 1549–1553). But Heinrich breaks down ‘administrative resources’ into Gazprom’s *innate* resources and its recruitment of the *state’s* resources. The present project would only include the latter as state coercion. The case of Sibneftegaz is accordingly included by Heinrich (2008, pp. 1549–1550) as a case of Gazprom’s use of ‘administrative resources’, but it does not meet the present project’s definition of ‘state coercion’. Sibneftegaz was the licence-holder to the Beregovoe gas field, located next to South Russkoe. After losing control of the field to Itera, Gazprom refused the project access to its pipeline network, thereby rendering it commercially unviable (Grib, 2005). There is a case for arguing that this was in breach of Gazprom’s legal obligation to provide such access, and that it could not have happened without at least tacit support from the government. Granted, it was the state that had given Gazprom the power to accept or deny gas from third parties into its pipeline

¹⁴⁹ It should be acknowledged that the definition of “coercion” used here (and indeed the definition of “corrupt force” used by Gans-Morse and “administrative resources” by Heinrich) is fraught with the same difficulty noted in the previous chapter with respect to *reiderstvo*. In a country whose legal system is characterised to a significant extent by “telephone justice” and corruption, there is no clear way to discern whether institutions including the law have been used in an inappropriate way in a particular case. But there are some telltale signs: for example, if an investigation is launched into a company and then promptly dropped once the desired takeover has been achieved.

infrastructure (subject to controls that oblige it, at least in theory, to grant access fairly). But essentially this was an example of Gazprom making use of its own resources and inherent advantages to bring about a takeover, and no state bodies were actively involved.

In Heinrich's depiction of Gazprom's relationship to independent producers, including some of the targets for its campaign to re-gather assets, Gazprom would appear to hold all the cards because of its access to 'administrative resources'. Yet the takeovers in the three cases below reveal that Gazprom was acting under significant constraints that limited its ability and willingness to launch a full-scale seizure of the assets concerned. These included, but were not restricted to, the aforementioned fear that it might lose forever its claim to the assets it actually wanted, which had been placed at some distance from the companies it had to first target for takeover.

Sibur

On 8 January 2002, Sibur's President Yakov Goldovsky was arrested while waiting in the reception of Aleksei Miller's office at Gazprom's headquarters. He had a meeting scheduled with Miller to discuss a Sibur shareholder meeting that was scheduled for the following day. His deputy Yevgeny Koshits was also arrested, as was Vyacheslav Sheremet, a Gazprom Deputy CEO who was also Sibur's Chairman. The three individuals were the subject of a criminal case that was based on a civil compensation claim from Gazprom stemming from Sibur's most recent share issue. Prosecutors accused the three individuals of stealing Sibur assets that rightfully belonged to Gazprom (Novolodskaya & Chertkov, 2002). Sheremet was released three days later, having signed a pledge to remain in the country. Vyakhirev (who was at the time still Gazprom Chairman) was rumoured to have intervened on his behalf ("Chelovek nedeli: odin za vseh," 2002)¹⁵⁰. On 18 January 2002, Goldovsky and Koshits were charged with abuse of office, and on 31 January they were additionally charged with

¹⁵⁰ Sheremet had been Gazprom Deputy CEO under Vyakhirev and had, until this point, survived the change of management at the company. Although he avoided prosecution, he was dismissed in July 2002.

theft of assets worth RUB 2.6bn (\$83m) and forgery of documents (Berres, 2002; Bushueva & Osetinskaya, 2002).

The Sibur takeover was to resemble an earlier case in which Gazprom had taken ownership of the media business of Vladimir Gusinsky. In June 2000, Gusinsky was arrested on charges of embezzlement during the acquisition of a St Petersburg television company. He was subsequently released after agreeing to sell to Gazprom a controlling stake in his company Media-Most. Gusinsky then left the country and reneged on the agreement, claiming it had been signed “under the barrel of a gun”. The state then set about seizing control of Media-Most through bankruptcy proceedings, based on its substantial debts to Gazprom (Belin, 2002). Goldovsky was similarly ‘persuaded’ to sign away his rights to Sibur in exchange for his release from pre-trial detention. As noted in the previous chapter, there are indications that the same choice was later offered to, but declined by, Mikhail Khodorkovsky. Such heavy-handed tactics could easily be mistaken for the full-scale seizure of Sibur’s assets, and this perception is reinforced by the paltry sum of \$96m which Goldovsky received from Gazprom in exchange for his interest in Sibur and the assets it managed (Terent’eva, 2011). This amount was clearly well below market value¹⁵¹ and in stark contrast to the amounts received by Gutseriev and Rakhimov in the previous chapter. However, unlike the coercive asset seizures that took place in the Yukos case, Gazprom obtained Sibur and its petrochemicals enterprises through an agreement with Goldovsky. Both Goldovsky and Khodorkovsky were given the stark choice of signing over their assets or remaining in detention to face criminal charges, but only Goldovsky opted for liberty.

Goldovsky had had considerable defensive measures in place to protect his business from asset seizure: he reportedly felt that he was in a strong bargaining position vis-à-vis Gazprom

¹⁵¹ In 2008, Gazprombank valued the Sibur business at \$5.5bn, and this was considered an underestimate by analysts (Malkova, 2011). See below for an explanation of the apparent discrepancy between the \$96m and the much larger amount that Gazprom claimed in an official disclosure to have paid for Sibur and its petrochemicals assets.

because only he understood the network of offshore companies through which he controlled Sibur and its major assets (Drankina & Tatevosova, 2002). A senior Gazprom manager told one newspaper that the company preferred to reach an agreement with Goldovsky so it did not have to go to court to return the assets (Chertkov, Osetinskaya, & Bushueva, 2002). The main deterrent was that, because of the offshore nature of the ownership ties, some of this legal action would be outside Russia, where a favourable ruling was far from guaranteed. Goldovsky's other main advantage was that, as mentioned above, he had arranged for Sibur only to *manage*, rather than own, many of its key assets, in which he himself owned significant stakes. Without Goldovsky's co-operation, Gazprom's task of restoring control over both Sibur *and* these key assets would have entailed much more complexity and risk.

If Goldovsky had evaded arrest through a timely departure from Russia, the bargaining would almost certainly have gone very differently. But as it was, he agreed while in pre-trial detention that in exchange for his liberty he would transfer to Gazprom the right to vote his 14.6% Sibur stake at a Sibur extraordinary shareholder meeting (EGM) that had been called by Gazprom for 25 March 2002¹⁵². This enabled Gazprom to win Sibur shareholder approval to cancel the share issue that had deprived it of its controlling stake, to gain a majority on the board, and to appoint its Deputy CEO Aleksandr Ryazanov as Sibur's new President (Bushueva & Novolodskaya, 2002; Butrin, 2002a). On 1 July 2002 it emerged that Goldovsky (who was still in pre-trial detention) had additionally agreed to sell to Gazprom his stakes in Sibur-managed assets, including at least 10 petrochemicals companies (Chertkov et al., 2002).

Gazprom disclosed in 2003 that it had in exchange agreed to pay Goldovsky RUB 19.49bn (then worth \$615m), using promissory notes that would mature in 2005¹⁵³. But in the event, Goldovsky only received \$96m (Terent'eva, 2011). His undoing was the fact that he had been compelled to hand over control of the petrochemicals assets (thereby losing his main

¹⁵² This stake was held by the Goldovsky-controlled company Gazoneftekhimicheskaya Kompaniya.

¹⁵³ The disclosure came in Gazprom's consolidated financial report for 2002 (Gazprom, 2003, p. 63).

bargaining chip) *before* he was released from detention¹⁵⁴. In exchange, he was meant to receive the promissory notes by November 2002, but this did not happen. Gazprom claimed that the promissory notes were ready to be handed over as soon as Goldovsky's company GNK sent a representative to receive them (Reznik, Lemeshko, & Golubovich, 2003), but it appears to have taken advantage of the fact that Goldovsky had no way of compelling it to hold up its side of the deal. GNK's CEO hinted in August 2003 that the company might take legal action, though it had been warned against this by people who pointed out that "there is a state interest in this matter and administrative resources will be activated in order to protect [that interest]" (Lemeshko, 2003a). In January 2004, it emerged that Goldovsky had decided against legal action (although he had left Russia, he reportedly "had not forgotten his time in a Russian prison", and this had persuaded him against another confrontation with Gazprom). He had, however, finally received payment: he had agreed on the much lower amount of \$96m, but had at least received the money in cash (Bushueva, Reznik, & Lemeshko, 2004).

However, all did not go entirely smoothly for Gazprom either. Because it could not be sure from the outset of Goldovsky's cooperation, it had put in place a 'plan B'. Accordingly, it had initiated bankruptcy proceedings against Sibur on 11 February, based on the fact that Sibur owed Gazprom \$1bn (out of a total Sibur debt of \$1.6bn) (Reznik, Osetinskaya, & Novolodskaya, 2002). In the event that it failed to restore majority control, it hoped to use its status as Sibur's main creditor to force the takeover. The bankruptcy proceedings would allow Gazprom to challenge deals done in the previous year by the former Sibur management¹⁵⁵. No doubt they served also as an additional argument to persuade Goldovsky that resistance was futile.

¹⁵⁴ As discussed in the section below dedicated to the ownership outcome, Gazprom was in a hurry to gain control of these assets before it dropped its civil case against Goldovsky (the first step in dropping the related criminal charges).

¹⁵⁵ For example, Gazprom believed that when Sibur increased its stake in the Kemerovo-based firm Azot from 7.8% to 73.94%, it had done so based on a drastic over-valuation of the latter company (Reznik, Osetinskaya, & Novolodskaya, 2002). For the ability to challenge deals done by the management up to a year previously under bankruptcy, see Mikhailov (2002).

Once Gazprom had restored majority control over Sibur and was on its way to purchasing the Sibur-managed assets from Goldovsky, the bankruptcy proceedings became a liability: they put Sibur and the assets under threat from claims by Sibur's other creditors. Gazprom's management had previously said that bankruptcy was the only way to regain control of all of Sibur's assets¹⁵⁶, but Sibur's new President now said that they were not in possession of all the facts when they came to that view (Gubenko, 2002). They were now set on pursuing an out-of-court settlement with Sibur's creditors that would bring the company out of bankruptcy (Reznik & Novolodskaya, 2002).

Sibur's other debts included \$190m owing to various banks¹⁵⁷. Although this was a small portion of its total debt, it was the most dangerous. A specialist from one of the banks in question was quoted as saying Gazprom risked losing the Sibur-managed assets forever, because the banks would go to court to get their money back and would seize those assets which had been pledged as collateral for the bank loans: Gazprom would end up with "a company which was being torn to pieces" (Reznik & Novolodskaya, 2002). Privately-owned Alfa Bank in particular was to pose a threat out of all proportion to the amount of money it was owed (\$78m): it had adopted a tough position from the beginning of the bankruptcy process, had seized Sibur assets and was the only bank to vote against an agreement that was signed with Sibur's creditors in September 2002. Although it failed in its efforts to challenge that agreement in court, it did manage to persuade Gazprom to restructure its debt on exclusive terms, despite Gazprom's pledge that all creditors would be treated equally (Bushueva, 2002; Novolodskaya & Bushueva, 2002; Novolodskaya, 2002; "Ot redaktsii: Miller i den'gi," 2002).

¹⁵⁶ Both CEO Aleksei Miller and deputy CEO Aleksandr Ryazanov had made this claim (Reznik & Novolodskaya, 2002; Reznik, Osetinskaya, & Novolodskaya, 2002).

¹⁵⁷ These included state-owned VTB, privately-owned Alfa-Bank and Austria's Raiffeisenbank (Reznik, Osetinskaya, & Novolodskaya, 2002).

Stroitransgaz

Of the three core cases examined here, that of Stroitransgaz involved the least use of the state's coercive resources. To recap, Gazprom's primary objective was to obtain on behalf of the state the Gazprom shares that were on the balance sheet of Stroitransgaz. But it also sought to buy at least a blocking stake in the company itself. The takeover therefore proceeded on these two fronts.

The coercive tactics related to the original sale of the Gazprom shares to Stroitransgaz back in 1994-1995. This was subject to an investigation by the Federal Security Commission which was initiated in October 2000 (Butrin, 2000). The investigation was still on-going in June 2001, and it was suggested that it was in part aimed at pressuring Bekker to give up his seat on the Gazprom board of directors (Prezhentsev & Reznik, 2001). At the Gazprom AGM on 29 June Bekker duly withdrew his candidacy for re-election to the board, and was replaced by a state representative¹⁵⁸. This helped the state secure a majority of six out of eleven seats on the Gazprom board (Reznik, 2001a)¹⁵⁹.

The Federal Security Commission published its findings at the end of August, stating that it had found nothing illegal (Bushueva, 2001h). Bekker made another concession to Gazprom in September, stating that he was planning to sign over to Miller the right to vote Stroitransgaz's 6.2% Gazprom stake at the next Gazprom AGM (Bushueva, 2001h). But he was not prepared to *sell* the stake, because it provided excellent collateral that enabled his company to borrow from financial markets. Stroitransgaz even said at a November 2001 press-conference that it intended to *increase* its Gazprom stake (Aglamish'yan, 2001).

¹⁵⁸ Aleksandra Levitskaya, first deputy head of the government's administration ("*apparat pravitel'stva*").

¹⁵⁹ Bekker claimed later that he had done this simply because his excessive workload from Stroitransgaz prevented him fulfilling his duties to the Gazprom board (Bushueva, 2001h); however, one newspaper claimed Vyakhirev had warned him not to stand for re-election even though he had a good chance of gaining the necessary votes (Shiryaev, 2001).

At around this time, Gazprom was negotiating with Bekker and other Stroitransgaz managers, and separately with the families of Chernomyrdin and Vyakhirev, to buy shares in Stroitransgaz. At an early stage in these negotiations, Gazprom was reportedly seeking to buy from the Stroitransgaz management a *controlling* stake in the company; in exchange, Gazprom would pledge to retain it as its preferred general contractor. But Bekker had been prepared to sell only 10% and the talks foundered¹⁶⁰. Gazprom had more success in negotiating with the Chernomyrdin and Vyakhirev families. They had reportedly been keen to sell for some time, but had first offered their shares to Bekker, who was a personal friend. He had rejected their offer, believing it to be over-priced. They then offered their shares to Gazprom (though not directly, as will be explained below). In November 2001 Stroitransgaz announced that it would be issuing new shares, and journalists established that this would dilute the stakes belonging to the Vyakhirev and Chernomyrdin families (Aglamish'yan, 2001). It later emerged that this was Bekker's retaliatory response on learning that they were in talks with Gazprom¹⁶¹.

Aside from successfully driving a wedge between Bekker and the families, Gazprom's other main tactic was an economic embargo through an implicit threat to withdraw business from Stroitransgaz. With this in mind, Gazprom proposed at the beginning of March 2002 to create a new rival general contractor called Gazpromstroiiinzhiniring. While this initiative was pending approval, Gazprom was using another subsidiary, named Spetszagotovtrans, to deal with the same subcontractors that were used by Stroitransgaz (Reznik, 2002c). The new initiative did not receive board approval in April 2002 and was described by a Gazprom employee as a still-born idea ("Ot redaktsii: otsy i dochki," 2002; Reznik, 2002d). Nevertheless, the effect was to focus the minds of Stroitransgaz's existing shareholders on the

¹⁶⁰ Source close to Gazprom's management cited in Reznik (2002c).

¹⁶¹ Information from a source close to the deal, cited in Reznik (2002g). Vyakhirev said many years later: "Tat'yana had Stroitransgaz shares. But Bekker carried out several share issues and fleeced us" (Malkova & Igumenov, 2012).

fact that the value of their shares depended significantly on Gazprom's future business, which no longer looked guaranteed.

Bekker stood down as company president on 12 April 2002. There are indications that he left Russia for Germany soon afterwards: although no physically coercive measures were taken against him or Stroitransgaz, he was presumably keen to avoid Goldovsky's fate¹⁶². It was revealed later that Bekker sold his personal 20% stake in Stroitransgaz at around this time. But Gazprom was not the buyer: instead, he had sold the shares to companies close to his successor and former deputy, Viktor Lorents (Reznik, 2004b). As will be shown below, however, Gazprom continued after this sale to negotiate with Bekker on returning Stroitransgaz's Gazprom shares. This suggests that Bekker remained in *de facto* control of those Gazprom shares, and possibly also of Stroitransgaz itself.

In May 2002, Gazprom secured a legal victory in its campaign to take control of the Gazprom stake held by Stroitransgaz. The Moscow *Arbitrazh* Court ruled that Stroitransgaz must hand back the 4.83% it had received from Gazprom in 1995 (Butrin, 2002c). Stroitransgaz appealed this decision on 5 June ("Sudebnaya praktika," 2002). But on 27 June the two sides reached an out-of-court settlement which saw Stroitransgaz selling the 4.83% stake back to Gazprom (Igumenov & Malkova, 2012; Reznik, 2002g, 2002h). It later emerged that the agreed price for the stake was RUB 4.6bn (\$148m), as opposed to its market value of RUB 29bn (\$935m) on the day of the agreement (Grivach, 2003). As will be discussed below, the buyer was in fact Gazprominvestholding, which went on to buy the remaining Gazprom shares that were held by Stroitransgaz.

¹⁶² Goldovsky was at this time still in detention after his arrest in January 2002. As will be discussed below, Usmanov subsequently claimed that he flew to Germany to negotiate with Bekker at around this time.

By August 2002 Gazprom had also achieved its blocking stake in Stroitransgaz itself. It had bought shares primarily from the Chernomyrdin and Vyakhirev families, with a significant number of additional shares purchased on the secondary market (Reznik, 2002g, 2002h).

Zapsibgazprom and South Russkoe

The SLCT involving Zapsibgazprom was arguably the most complex from Gazprom's perspective: as discussed earlier, the main asset of interest had been separated from Zapsibgazprom but then additionally sold on to third parties.

To recall, it was confirmed in August 2001 that Zapsibgazprom no longer controlled the licence to the South Russkoe field. But Gazprom's management nevertheless resolved to take back control of Zapsibgazprom itself in addition to the new licence-holding entity, Severneftegazprom. Here Gazprom's takeover was coercive to a significant extent, if less so than at Sibur. At the beginning of January 2002, prosecutors paid a visit to Zapsibgazprom's offices. This was apparently in connection with other cases, and no criminal case was opened with respect to the company or its management as part of the takeover process (Reznik, Osetinskaya, & Nikol'skii, 2002). But after the takeover, in January 2003, some of its managers (with the exception of its CEO Vladimir Nikiforov) became the subject of criminal cases in relation to illegal attempts to bankrupt Zapsibgazprom subsidiaries. It also emerged at this time that the authorities had tried on several occasions to open a criminal case against Nikiforov (Mokrousova, 2003a). He checked himself into hospital in December 2001 before being dismissed in March 2002, quite possibly because he feared arrest (Reznik, 2002b).

As with Sibur, Gazprom employed bankruptcy against Zapsibgazprom as a strategy to regain control of its assets, based on Zapsibgazprom's RUB 2.9bn debt to Gazprom (then worth \$93m) (Reznik, Osetinskaya, & Nikol'skii, 2002)¹⁶³. In February 2002 it secured a court order placing Zapsibgazprom in bankruptcy administration, with a former employee of the FSB's

¹⁶³ Zapsibgazprom's total debt was in excess of RUB 6bn, or \$192m.

economic security department appointed as temporary bankruptcy manager (Reznik & Lysova, 2002; Reznik, Osetinskaya, & Nikol'skii, 2002). Gazprom hoped to use the bankruptcy process to annul the share dilution that had seen Zapsibgazprom lose control of its subsidiary Severneftegazprom¹⁶⁴. If successful, this would return the South Russkoe licence to Zapsibgazprom.

However, Gazprom was again concerned that it might not be able to control the bankruptcy proceedings it had initiated. Firstly, as noted above, it appears that Zapsibgazprom's managers took advantage of the company's bankruptcy to initiate additional bankruptcy proceedings against its subsidiaries - presumably in order to remove some of Zapsibgazprom's assets from the reach of its largest creditor. Secondly, another significant Zapsibgazprom creditor was Yukos, which was seeking also to establish a controlling ownership stake and was a potential threat to Gazprom's claim on South Russkoe (Reznik & Lysova, 2002).

Gazprom accordingly sought to achieve its objectives by other means. In April 2002, it obtained a court ruling which annulled the August 2000 share issue that had seen the dilution of its controlling stake in Zapsibgazprom (Reznik, 2002e)¹⁶⁵. Having regained majority ownership, it began the process of bringing the company's bankruptcy to a close by seeking agreement with the other creditors. It also called a Zapsibgazprom extraordinary shareholder meeting for 25 May 2002, at which it secured a board majority and effectively gained management control of the company.

Instead of pursuing bankruptcy to achieve the return of the South Russkoe licence to Zapsibgazprom, Gazprom chose to negotiate with the new owners of the licencing-holding entity, Severneftegazprom. As noted earlier, Itera had gained majority ownership of the latter company in May 2001 through a share issue that had seen Zapsibgazprom's stake reduced to

¹⁶⁴ As noted above, creditors were able to challenge deals concluded by the bankrupt company within the previous 12 months.

¹⁶⁵ The court case was initiated not by Gazprom, but by another minority shareholder in Zapsibgazprom which was (formally) unaffiliated with Gazprom.

11%. But Gazprom began with the minority shareholders: on 29 April 2002 it announced that it had been able to acquire a 49% stake in Severneftegazprom “through quite difficult talks” (Butrin, 2002b). It had reportedly done this by buying Zapsibgazprom’s 11% stake and an additional 38% held by companies linked to Zapsibgazprom’s management; according to a source linked to Itera, Gazprom had paid only the nominal value of the shares, a total of \$3200 (Reznik, 2002f). A Gazprom senior manager¹⁶⁶ also said that “now talks are underway – and I mean talks, without any court proceedings – to buy all the remaining shares. At the very least, we intend to increase our stake in Severneftegazprom to controlling”. However, Itera was at this time already in the process of attempting a defensive share dilution aimed at cutting Gazprom’s newly-acquired 49% stake in Severneftegazprom back down to 20% (Reznik, 2002f). Gazprom was forced to resort to legal action after all: at some point in the following two months, it succeeded in getting this share issue cancelled by the securities regulator (OAO “Gazprom,” 2002b, p. 31).

Gazprom’s CEO Aleksei Miller must have been holding talks with his Itera counterpart Igor Makarov either strikingly soon after this attempt at share dilution, or even before it, because agreement was reached between them as early as late June 2002 on resolving the conflict through an asset-swap. This saw Itera handing over its 51% stake in Severneftegazprom in exchange for Gazprom’s minority stakes in other Itera-dominated projects, Sibneftegaz (10%) and Tarkosaleneftegaz (7.78%) (Lysova & Reznik, 2002)¹⁶⁷.

Meanwhile Gazprom had been working to increase further its newly-gained controlling stake at Zapsibgazprom. It was reported in late March 2002 that it had persuaded Zapsibgazprom’s three other shareholder companies (all of which were suspected of being linked to the

¹⁶⁶ Deputy CEO Aleksandr Krasnenkov.

¹⁶⁷ Prior to this, Gazprom had reportedly suggested to Itera that it sell just 2% of Severneftegazprom (thus staying on as a minority shareholder with 49% and receiving a proportionate share of the gas produced). But according to an Itera source, “without a controlling stake we are no longer so interested in South Russkoe” (Lysova & Reznik, 2002). As noted earlier, the shares in Sibneftegaz proved to be of little value to Itera, because of Gazprom’s refusal to allow into its pipeline network the gas produced at the Beregovoe field.

management) to halt the sale of their 39% stake to companies affiliated with Yukos (Reznik, 2002b). But evidently this was only partially successful, because Yukos did succeed in acquiring a 25.2% stake. In July, Gazprom recovered these shares by means of another asset-swap agreement, handing Yukos a 12% stake in gas producer Artikgaz in exchange¹⁶⁸. As Yukos had also been a major creditor of Zapsibgazprom, this helped to pave the way for the agreement to end the bankruptcy process, which was reached in October 2002. Thus both Yukos and Itera had caused Gazprom considerable difficulty at Zapsibgazprom and Severneftegazprom respectively, and yet Gazprom reached an amicable share-swap agreement with both within a relatively short space of time.

Summary

Some of the methods used by the existing owners in the case studies above (in particular, share dilutions, the initiation of bankruptcy proceedings and the use of offshore companies) have been described by Adachi (2010) as “informal corporate governance practices” (ICGPs). Her central argument is that such practices are not always destructive: they were used in the 1990s to build viable businesses out of collections of atomised enterprises. However, she notes that similar tactics were used at Norilsk Nickel in order to protect the owners from “deprivatisation”. The case studies above highlight the fact that these are versatile methods that serve a range of purposes, including attacks on property rights as well as defensive measures against such attacks. Bankruptcy was used as a defensive tactic by Zapsibgazprom’s managers, but also as an (aborted) offensive tactic by Gazprom against Sibur and Zapsibgazprom¹⁶⁹.

¹⁶⁸ Artikgaz was sold in 2007 as part of the Yukos bankruptcy process. Unusually for Yukos’s assets, it was bought not by Rosneft’ or Gazprom but by Italian company ENI. The latter had been permitted to buy as part of an agreement which allowed Gazprom access to Italy’s retail market for gas (Sakwa, 2009, p. 243).

¹⁶⁹ Indeed, precisely who is “attacking” and who “defending” in such cases depends on where one’s sympathies lie. If one accepts Gazprom’s argument that many of these assets rightly belonged to it, then one might see its moves to regain them as a defence of its own property rights.

As noted in the cases of Yukos and Russneft' in the previous chapter, offshore ownership brings an international dimension which hinders attempts by the state to seize assets. But the share dilutions and other tactics used in the cases above are primarily *domestic* in nature, as was the case with many of the tactics used by Bashneft's owners in the previous chapter. It bears repeating that these domestic tactics only work against attacks on property rights by the state because they make use of domestic institutional constraints on coercion. In other words, in an ideal-typical kleptocratic state they would be meaningless in the face of the state's limitless ability to seize assets within its own borders.

The cases all ended relatively well for Gazprom, despite the defensive tactics used against it. But it was forced to think carefully about the real risk of assets being lost to new buyers or rival creditors. This reinforced the company's preference for a negotiated outcome over full-scale asset seizure. In the Sibur case this outcome was obtained in exchange for the existing owner's liberty, somewhat stretching the definition of 'negotiated'. But in the other cases, Gazprom used more subtle methods to make the existing owners more amenable to sell. These methods provide part of the explanation for the ownership outcomes, as the following section explains.

The ownership outcome: the role of Gazprominvestholding

In this chapter, explaining the ownership outcome goes further than simply confirming that state ownership is a possible outcome when the state reaches agreement with the existing owner. Although each outcome was "state ownership" in the sense that indirect state control was asserted via Gazprom, in each case a wholly-owned subsidiary named Gazprominvestholding played a role either as buyer, or negotiator, or both. This company had been headed since 1998 by Alisher Usmanov, who was better known as a successful private businessman with diverse business interests including in metallurgy, internet and media

companies¹⁷⁰. The task is to understand what Gazprom sought to achieve by using this subsidiary rather than buying and negotiating directly.

In fact, each takeover saw Gazprom and its subsidiary divide roles according to Table 3, below. Thus, when trying to pinpoint why Gazprominvestholding was used in certain situations, it is possible to compare these situations with those where Gazprom chose instead to play a direct role.

¹⁷⁰ Russian Forbes in April 2013 estimated Usmanov's personal wealth at \$17.6bn, and ranked him as Russia's richest individual ("Usmanov vozglavil reiting samykh bogatykh rossiyan po versii Forbes," 2013).

Target	Negotiator	Buyer	
		Gazprom	Gazprominvestholding
<i>Sibur</i>	Gazprom management	Controlling stake restored by court order	Became a beneficiary through its purchase of shares in Sibur-managed enterprises that were also Sibur shareholders.
<i>Sibur-managed enterprises</i>	Gazprom management	n/a	Shares purchased through agreement with existing owner (Goldovsky)
<i>Stroitransgaz</i>	Usmanov	n/a	Blocking stake purchased through agreement with existing owners plus on secondary market
<i>Stroitransgaz's Gazprom stake</i>	Usmanov	n/a	Purchased from Stroitransgaz
<i>Zapsibgazprom</i>	Gazprom management and Gazprominvestholding	Controlling stake restored by court order; increased by subsequent share-swaps	Controlling stake transferred to its trust management on eve of EGM
<i>Severneftegazprom (South Russkoe licence)</i>	Gazprominvestholding	51% obtained by share-swap	49% accumulated by agreements with minority shareholders

Table 3. Division of takeover roles between Gazprom and Gazprominvestholding¹⁷¹

¹⁷¹ Data compiled from the case evidence that is discussed below.

The following sections shed light on precisely why Gazprominvestholding came to play such a significant role in the takeovers.

Official explanations

One of Gazprominvestholding's official responsibilities within the Gazprom group was to handle the buying and selling of its non-core assets (Novolodskaya, 2003; Reznik, 2003). But this is not enough to explain away its role in the cases. For example, it was involved as buyer when Gazprom regained control of South Russkoe, which was unequivocally a *core* Gazprom asset. When this point was raised by a journalist, Gazprominvestholding Deputy CEO Oleg Skorik said that “we carry out Gazprom’s instructions in undertaking a whole series of core projects, including trust management and direct ownership of assets” (“Interv’yu s Olegom Skorikom,” 2002).

In a 2003 interview, Usmanov explained the company’s role as primarily carrying out securities transactions and portfolio investments to provide financial support for Gazprom’s core activity. These official explanations leave open a role for the company in almost any Gazprom takeover, and are therefore largely unhelpful in establishing precisely why Gazprom used it in particular situations.

Technical obstacles to Gazprom’s direct ownership

Panyushkin and Zygar’ (2008, p. 120) write that Usmanov “carried out deals for Gazprom in which the monopoly for various reasons did not want or was not able to be directly involved”. This downplays the fact that, in most such deals, Usmanov was acting through the Gazprom subsidiary Gazprominvestholding rather than in a personal capacity¹⁷². However, a satisfactory explanation for the company’s involvement in these cases is indeed found by identifying reasons why the main Gazprom entity (i.e. OAO “Gazprom”) could not or would not play a direct role.

¹⁷² Though, as will be discussed below, there was at least one occasion where Usmanov did act as buyer in his personal capacity in the first instance, before selling on to Gazprominvestholding.

Securities trading licence

Gazprominvestholding held the relevant licences which authorised it to carry out transactions on the securities market, while Gazprom did not¹⁷³. Gazprom was nevertheless able to make direct purchases of shares in other organisations, but unlike its subsidiary it could not buy or sell shares traded through exchanges. This gets us closer to a satisfactory explanation, but the cases show Gazprominvestholding acting as buyer *both* on the securities market¹⁷⁴ and in direct transactions.

Deal confidentiality

Usmanov has said that Gazprominvestholding was able to preserve the confidentiality of a deal until the moment of its completion, something which gave it an advantage over banks (Reznik, 2003). Russian banks are obliged to make detailed disclosures regarding their finances to the Central Bank, and these disclosures are publicly available. The main bank that could have acted instead of Gazprominvestholding at the time was Gazprom's subsidiary Gazprombank, which as an issuer of securities was further obliged to issue detailed quarterly reports containing more qualitative disclosures regarding its operations¹⁷⁵. As a limited-liability company, Gazprominvestholding was not obliged to make such disclosures. In that regard it also had an advantage over parent company Gazprom, which in addition to its various disclosure requirements was less able to maintain confidentiality due to the presence on its board of independent directors.

As will be discussed below, the Gazprom management needed prior approval from the board before making acquisitions. Independent director Boris Fyodorov in particular gave frequent commentary to the press, which meant that Gazprom board decisions (and even some details of how they were arrived at) came under particular public scrutiny. However, Gazprom's need

¹⁷³ <http://www.gazprominvestholding.ru/licenses>. On the subject of whether Gazprom's lack of such licences prevented it from buying shares, see Petrova and Reznik (2002).

¹⁷⁴ Usmanov has said that some of the shares Gazprominvestholding accumulated in Stroitransgaz were acquired "on the secondary market" (Reznik, 2002h).

¹⁷⁵ This obligation stems from the Federal Law "On the Securities Market", chapter 7, article 30.

to secure prior board approval for acquisitions presented other problems besides confidentiality, and these are likely to have been more important in determining its decision to use Gazprominvestholding as buyer on its behalf.

Bypassing board approval and the government directive

Gazprom's management was obliged to work within three different types of institutional constraint, which had the combined effect of substantially reducing its freedom of movement and (most importantly) its ability to respond quickly to developing situations. Firstly, in common with all Russian joint-stock companies, it was obliged to gain approval for deals over a certain size from the board of directors or (for particularly large deals) by a shareholder vote. The second constraint came from additional restrictions which were imposed by the board of directors on the company specifically in May 2001, and which were aimed at preventing further assets going astray. But the third and most important constraint stemmed from its status as a state-owned company. This meant that voting by the board of directors was subject to the 'directive' system: before state representatives on the board could vote, they had to obtain written instructions on how to vote that were duly signed off by various interested government departments. As Tompson (2008, p. 12) notes, the 'directive' system is a serious obstacle to the efficiency of state-owned companies in Russia. The system "is cumbersome and frequently ensures that decisions simply have to be put off." Although this problem was common to all state-owned joint-stock companies, it was particularly acute for Gazprom after the extra restrictions imposed in May 2001, which meant that even relatively small deals had to go through board approval and the 'directive' system.

The use of Gazprominvestholding was the Gazprom managers' response to these constraints. Rather than simply ignore them or override them as a state-owned company might be expected to do in a truly 'kleptocratic' state, they instead found innovative ways to work *within* them. Realising that they did not apply to subsidiaries (or subsidiaries of subsidiaries) of state-owned joint-stock companies, they were able to free themselves from legal constraints

in a way that was entirely compliant with the letter of the law. In the process, however, they also circumvented the government's own efforts to keep tighter control over the company's assets.

The relevant constraints on joint-stock companies stemmed from articles 79 and 83 of the Federal Law "On Joint-stock Companies". These dictated that companies needed to gain approval from the board of directors before carrying out major deals or deals involving interested parties. Major deals were defined as those involving assets equivalent to 25% of the balance-sheet value of the acquiring company; if the assets involved were equivalent to over 50% of the balance-sheet value of the acquiring company, the deals required approval instead by a shareholder vote¹⁷⁶.

The additional controls that were specific to Gazprom were first announced in October 2000 (Butrin, 2000; Manvelov, 2000; "Sovet direktorov Gazproma," 2000) and were originally aimed at making *all* deals involving Gazprom assets subject to board approval. However, it was clear that this would mean an excessive addition to the workload of the Gazprom board of directors, and some kind of practicable solution needed to be found (Pravosudov, 2001). The new rules, which came into force in May 2001, were laid out in an internal company document named the "Statute [*reglament*] for the approval of transactions involving Gazprom assets". This was not made publicly available, and thus the precise rules that were put in place can only be divined using circumstantial evidence. The best such evidence comes from a 2004 Audit Chamber report on Gazprom, one section of which is dedicated to an audit of Gazprom's management of its subsidiaries and affiliates (Schetnaya Palata RF, 2004, pp. 55–71). This report states that the Statute was in force between 17 May 2001 and 27 September 2002, and therefore covers most of the period when Gazprominvestholding was making share purchases in the three cases. The Statute was then replaced by the Procedure for Completing

¹⁷⁶ The text of the two articles can be found at <http://www.zakonrf.info/zakon-ob-ao/79/> and <http://www.zakonrf.info/zakon-ob-ao/83/>. Accessed on 3 July 2013.

Transactions (*Poryadok soversheniya sdelok*). The Audit Chamber report cites some examples of Gazprom board approvals given while the Statute was in force, for acquisitions and disposals made by Gazprom subsidiaries of shares in other companies (Schetnaya Palata RF, 2004, p. 63). All four of the examples of acquisitions show that they would result in Gazprom group gaining a majority stake in the target organisation¹⁷⁷. It therefore seems likely that, while the Statute was in force, approval from the Gazprom board of directors was required when Gazprom subsidiaries bought shares in other companies *only when this resulted in Gazprom group gaining a controlling stake*¹⁷⁸. Such was the solution that was found so that Gazprom's board did not have to approve every acquisition made by a Gazprom subsidiary of shares in other companies. Crucially, it left room for Gazprominvestholding to proceed without approval from the Gazprom board of directors when making share acquisitions that did not bring Gazprom group's overall stake in the target company up to controlling, or when buying additional shares in companies already controlled by Gazprom.

On its own, the need for prior approval from the board of directors was a restriction on Gazprom's ability to move quickly in situations that were often time-sensitive, because the board typically met just once a month (Pravosudov, 2001). In most cases, the Gazprom board would not be prepared to vote on a particular transaction without first receiving documentation prepared by the company which outlined the business case for the transaction. But as Tompson notes, it was the 'directive' system which acted as a particular encumbrance. For most of the period covered by these case studies, the directive was issued by the State Property Ministry. Reportedly, officials from that Ministry consulted with the Prime Minister's office before giving approval for major deals. Additionally, in July 2001 the

¹⁷⁷ For three out of the four examples, this is made explicit in the text of the report. In the fourth, the purchase of a 32% stake in Purgaz by Gazprom subsidiary Noyabr'skgazdobycha, the result was to increase Gazprom's stake back to controlling by adding to its existing 19% stake (Davydova & Reznik, 2001).

¹⁷⁸ Further circumstantial evidence in support of this view is provided by the fact that no contemporary reports have been found where Gazprom's board gave approval for a subsidiary's purchase that did *not* result in a controlling Gazprom stake.

Property Ministry agreed to consult with the Energy Ministry and reach a consensus before it issued directives for board and shareholder votes at state-owned energy companies including Gazprom. If consensus could not be reached, the decision would be postponed until a future board or shareholder meeting (Bushueva, 2001d). Then in January 2003 Prime Minister Mikhail Kas'yanov introduced tighter rules for Gazprom and 17 other “strategic” state-owned companies: thereafter, the directive needed to be personally signed off by the Prime Minister or one of his deputies (Nikol'skii & Bekker, 2003). Kas'yanov's new regulations applied *only* to purchases by the state-controlled companies, not by their subsidiaries. Such companies accordingly began using subsidiaries to bypass the new regulations, because it was taking too long to get the appropriate sign-off; the government moved to close the loophole only in 2013 (Tovkailo, 2013). Given that Gazprom's management was obliged to submit a particularly high proportion of deals for board approval via the directive system, it is unsurprising that it was enthusiastic in embracing the use of subsidiaries.

As the sections dedicated to the specific cases will show below, much of Gazprominvestholding's involvement as buyer can be explained by this need to bypass the requirement for Gazprom board approval in time-sensitive situations.

Importance as intermediary

The technical factors described above which dictated the role of Gazprominvestholding as *buyer* leave unexplained why (as Table 3 indicates) the company and its chief executive Alisher Usmanov additionally played a significant role as *negotiator* with the existing owners in the cases of Stroitransgaz and South Russkoe¹⁷⁹. There was no obvious reason why the buyer also needed to be the one to negotiate with the seller: indeed, at Sibur, it was Gazprom's management that negotiated with Goldovsky, but Gazprominvestholding that acted as buyer.

¹⁷⁹ Usmanov claimed that he was not personally involved in the negotiations over Sibur (see below).

At least one account has hinted that Usmanov's value as negotiator lay in his ability to get the agreement of the existing owners not through compromise but through coercion¹⁸⁰. However, this is difficult to reconcile with the fact that both Usmanov and Vyakhirev (whose family was among the selling shareholders in the Stroitransgaz case) have subsequently spoken about each other in only respectful terms¹⁸¹. Besides, it is unclear why Gazprom would need such assistance in providing coercion when it has been shown to have had good access to the coercive resources of the state.

There is significant evidence to indicate that Usmanov was valuable to Gazprom as a negotiator in a similar way to the private buyers in the Russneft' and Bashneft' cases in Chapter Two. To recap, Deripaska was a trusted associate of Gutseriev and Yevtushenkov had gained the trust of the Rakhimovs, but at the same time both were believed (wrongly, as it turned out for Deripaska) to have the Kremlin's backing as new owners. It was suggested in the previous chapter that they were valuable to the state as intermediaries who could facilitate a negotiated outcome to the bargaining process. The existing owners would have been more recalcitrant if they had been presented instead with the sole option of selling to the same people who were responsible for the coercion being used against them.

Usmanov was first and foremost acting in his capacity as a hired manager of a Gazprom subsidiary. In that sense, he could hardly be considered a "private buyer". But the blurred line between his role at Gazprominvestholding and his private business, and the fact that he had worked under Vyakhirev¹⁸², helped to make him more of an independent intermediary, and

¹⁸⁰ e.g. Panyushkin and Zygar (2008, p. 121) wrote "It is not known what Usmanov said to Bekker, what arguments he used or what he used to blackmail [him], but Bekker received 190 million dollars for the 4.83% stake in Gazprom, which today is worth around 13 billion dollars".

¹⁸¹ e.g. in one of his last interviews, Vyakhirev described Usmanov as "A good guy, he calls some times, always sends a present on birthdays". Vyakhirev also spoke bitterly about his family having been "fleeced" by Aleksandr Bekker in the Stroitransgaz share dilution, after which they decided to sell their stake to "Alisher" (Igumenov & Malkova, 2012). In his 2003 interview Usmanov described himself as "a Vyakhirev person", referring positively to Vyakhirev's qualities as an individual as well as a Gazprom manager (Reznik, 2003).

¹⁸² Usmanov joined Gazprominvestholding as First Deputy CEO in 1997, becoming CEO in 2000. Thus he was ultimately subordinate to Gazprom CEO Rem Vyakhirev for up to four years, from 1997 until

less of a Gazprom representative, when it came to the negotiations for Stroitransgaz and South Russkoe.

A former Gazprom employee said in a 2012 press article that when the new management took over at Gazprom in 2001, they had their doubts about whether to keep Usmanov on at Gazprominvestholding. They had ultimately been persuaded to do so not least by the fact that Vyakhirev and his allies refused to talk to anyone else about selling their assets back to Gazprom. Usmanov confirmed this impression by claiming that “the old team needed a new person who could guarantee to them all the payments. I said to them ‘Don’t worry, I am buying from you, I will buy’” (Igumenov & Malkova, 2012). As will be explained below, he revealed that this was literally true in one case: he bought the shares in a private capacity before selling them on to Gazprominvestholding. But in the other cases also, his link to the old Gazprom regime seems to have been crucial in winning the existing owners’ confidence that Gazprom’s new management would not renege on their side of any deal.

Thus the explanation for Gazprominvestholding’s role in the ownership outcomes centres on the legal advantages which made it a better buyer in certain situations from Gazprom’s point of view, and on Usmanov’s value as an intermediary who could bargain most effectively with the existing owners. The next task is to establish how far these two factors fit with the specific evidence from the cases.

Sibur

As noted above, Gazprom restored its controlling stake in Sibur in February 2002, when that company’s shareholders (with Goldovsky’s support) agreed to cancel the most recent share issue. This newly-restored controlling stake was directly owned by Gazprom. But Gazprominvestholding then purchased Goldovsky’s shares in the Sibur-managed enterprises. Some of these enterprises were also shareholders in Sibur itself, and thus

Vyakhirev’s dismissal in May 2001. Additionally, Usmanov was a consultant to Vyakhirev between 2000 and 2001 (“Usmanov Alisher,” n.d.).

Gazprominvestholding became a beneficial owner of Sibur through these acquisitions. To complicate matters further, the purchases were in fact carried out not by Gazprominvestholding itself but by five of its subsidiaries (Bushueva et al., 2002). By January 2003, Gazprom's combined direct and indirect stake in Sibur had reached approximately 75% (Reznik, 2003).

In a January 2003 interview, Usmanov said that he was not personally involved in the talks with Goldovsky, but that Gazprominvestholding had been given the technical task of assessing the value of his stakes in the Sibur-managed enterprises (Reznik, 2003). An interview given by Goldovsky in March 2003 would appear to confirm that Gazprominvestholding did not act as negotiator in the Sibur takeover: he said that the relevant agreements were prepared by Gazprom's lawyers and he first saw them when he was released from detention (Novolodskaya, 2003)¹⁸³. In that interview, Goldovsky was also asked why Gazprominvestholding, rather than Gazprom, had bought his stakes in the Sibur-managed enterprises. He answered only that it was the job of Gazprominvestholding to handle Gazprom's non-core assets (Novolodskaya, 2003).

As noted earlier, Gazprom had promised Goldovsky his liberty provided that he agreed to sell his stakes in the Sibur-managed enterprises. In order to fulfil its side of the bargain, Gazprom would drop its civil compensation claim against Goldovsky and his deputy; this would signal to the Prosecutor General's Office that it should no longer pursue the criminal case against them. The first hearing of the criminal case was scheduled for 31 July 2002 (Bushueva et al., 2002; Novolodskaya & Chertkov, 2002). Perhaps mindful of how the media baron Vladimir Gusinsky had earlier reneged on a similar agreement, Gazprom was reportedly determined to

¹⁸³ Similarly, when Gazprom sold its stake in National Reserve Bank in exchange for the bank's 0.2% stake in Gazprom, the bank's President Aleksandr Lebedev claimed he was not consulted on the fact that the buyer of the Gazprom shares was Gazprominvestholding; the sale agreement had been a Memorandum signed by Lebedev and Gazprom CEO Aleksei Miller. "I signed the documents, but I respect the right of Gazprom to structure the deal [as they see fit]. If they change something I will re-sign the documents, as long as this is legal and doesn't create tax-related or reputational problems for us" (Petrova & Reznik, 2002).

ensure that it had successfully taken ownership of *all* of Goldovsky's shares before the criminal case against him was dropped. Using Gazprominvestholding subsidiaries as the buyers almost certainly bypassed the need for Gazprom board approval, and hence for any government directives. It thus expedited the many transactions required, which involved shares in more than 10 petrochemicals companies¹⁸⁴.

Stroitransgaz

It was Gazprominvestholding that bought back all of Stroitransgaz's Gazprom shares (Reznik, 2002h). After reaching agreement with Bekker, it bought the 4.83% stake which Stroitransgaz had acquired from Gazprom back in 1995. This left the additional 1.1-1.2% stake which Stroitransgaz had since purchased on the secondary market. It emerged in March 2003 that these were also bought by Gazprominvestholding, though once again it had used various subsidiaries. They had borrowed money from Gazprombank (another Gazprom subsidiary) to make the purchases. The bank then took ownership of this entire 1.1-1.2% Gazprom stake as repayment of the loan. It was thought that the deal had been structured this way because the bank's reserve requirements prevented it buying directly (Bushueva & Berezanskaya, 2003)¹⁸⁵.

Gazprominvestholding was also the buyer for the blocking stake in Stroitransgaz itself. By August 2003, it had accumulated 26.1% of the company's ordinary shares and a further 15.54% of its non-voting preference shares (Reznik & Yegorova, 2004).

Legal considerations dictated the use of Gazprominvestholding as buyer of the Gazprom stake, but these considerations differed from those in the Sibur case. If the shares had been

¹⁸⁴ Whatever the precise regulations regarding the need for Gazprom board approval for purchases by Gazprom subsidiaries, they almost certainly did not extend to purchases by *subsidiaries* of Gazprom subsidiaries.

¹⁸⁵ Usmanov said in January 2003 that Gazprominvestholding now held a 6% stake in Gazprom (Reznik, 2003), confirming that it had bought the remaining shares held by Stroitransgaz. It was originally thought that only half of the 1.1% stake had then been passed on to Gazprombank (Bushueva & Berezanskaya, 2003). But in June 2005, when Gazprominvestholding and other Gazprom subsidiaries sold their combined 10.4% Gazprom stake, Gazprominvestholding's contribution was only 4.83%. Gazprombank contributed 1.25% (Butrin, 2005).

bought by Gazprom itself, they would have been treated legally as treasury shares which could not be voted by any party at Gazprom shareholder meetings. Company shares that were on the balance-sheets of company subsidiaries were *not* treated as treasury shares and could be voted according to the wishes of the company management. For the same reason, Gazprominvestholding in June 2002 bought a 0.2% Gazprom stake from National Reserve Bank (Petrova & Reznik, 2002).

These acquisitions were part of a wider campaign by the state to gain control of wayward Gazprom shares by placing them on the balance-sheets of Gazprominvestholding and other subsidiaries including Gazprombank. In June 2005, these subsidiaries sold a combined 10.4% stake to state-owned Rosneftgaz (which at the time owned 100% of the Rosneft' oil company), thereby enabling the state to formalise its direct majority control over Gazprom. By using subsidiaries, Gazprom was able to buy back its own shares and retain the ability to vote those shares. But this explanation requires some clarification: if the state wanted these Gazprom shares for itself, why did it not buy them directly rather than through Gazprom subsidiaries? Pappé and Galukhina (2009, pp. 166–7, 170) pose precisely this question, while at the same time noting that the Russian state had expanded its ownership role in the economy without making a single direct purchase (preferring instead to use existing state-owned companies as the acquisition vehicles). Regarding Gazprom, they suggest that the state could have bought the required shares directly, or achieved its controlling stake by having Gazprom transfer the shares held by its subsidiaries on to its own balance sheet, and then cancelling those shares. This latter method would not have been sufficient on its own: the state would have needed to buy some additional shares on the open market in order to achieve its controlling stake. The authors offer two explanations for the government's decision not to choose one of these options, and more generally for its tendency to avoid direct purchases to achieve expanded state ownership. Firstly, direct purchases of shares by the state need parliament to give prior approval for the required money to be allocated from the state budget:

even given Russia's parliament, which was by this time almost entirely subordinate to the executive, such budgetary approval was difficult to secure. Secondly (and in their view more importantly), "in our view the political leadership does not have too much trust in bureaucrats and is very cautious in its approach to broadening the functions of state bodies."

In the present author's view, the first explanation was in fact more important. Buying up shares on the open market implies a process that is both time-sensitive and fraught with uncertainty over price. Even if the state's vehicle for direct ownership (the Federal Agency for State Property Management, or Rosimushchestvo) were licensed to buy exchange-traded shares (which is doubtful), it would have been difficult to achieve this with a fixed amount of money set aside long in advance by the state budget. The amount of money allocated would have been public knowledge, which would have played into the hands of the selling shareholders. In other words, the institutional barriers to direct state purchases were similar to those preventing Gazprom itself buying up shares in price- and time-sensitive situations. But even outside such situations, the process of allocating money from the state budget was eschewed in favour of more market-based solutions. Tellingly, when Gazprom's subsidiaries sold their shares on to state-owned Rosneftgaz in June 2005, this too was done in a way that bypassed the need for budget money. Instead, Rosneftgaz took a bridging loan (probably from state-owned Vneshekonombank) while it waited to secure a syndicated loan from Western banks (Skorobogat'ko, Kiseleva, & Skorniyakova, 2005). The Western bank loan was eventually repaid from money raised through Rosneft's IPO in July 2006. While state-owned joint-stock companies were legally authorised to borrow from banks, Rosimushchestvo was (as Pappé and Galukhina note) obliged to seek financing from the state budget¹⁸⁶.

¹⁸⁶ Once Rosneftgaz had repaid its loan from Western banks, it was meant to be liquidated and its Gazprom stake transferred to Rosimushchestvo. This did not happen, and Rosneftgaz instead went on to acquire further important assets on behalf of the state (and to withhold from the state budget dividends it earned on its shares in those assets). This is typically explained by reference to the self-enriching or self-aggrandising motivations of Igor' Sechin, who effectively controlled Rosneftgaz. However, Vernon (1984, p. 48) provides an alternative explanation: "there are major advantages in distinguishing the income and expenditures of [...] state-owned enterprises from those of the

So far, the explanation for the ownership outcome of Stroitransgaz's Gazprom shares applies to any Gazprom subsidiary. The best available explanation why Gazprominvestholding was chosen specifically over other Gazprom subsidiaries in this case probably lies in Usmanov's value as negotiator. He said in 2012 that, while Gazprom was fighting through the courts to obtain Stroitransgaz's Gazprom stake, he met with Bekker (who was now living in Germany) to persuade him to sell. Most significantly, Usmanov claimed that Bekker was so mistrustful of Gazprom's new management that he only agreed to sell the Gazprom stake when Usmanov volunteered to buy it in his *personal* capacity. Usmanov then sold the Gazprom shares on to Gazprominvestholding, supposedly at zero mark-up (Igumenov & Malkova, 2012)¹⁸⁷.

In the same 2012 article, a separate source claimed that the Vyakhirev and Chernomyrdin families had refused to talk to any of the new Gazprom senior managers on the subject of selling their shares in Stroitransgaz. As noted above, their first choice had been to sell their shares to Bekker, but when they failed to reach agreement with him they agreed to talk to Usmanov. Usmanov claimed that he told "the old team" that *he* would be the buyer of the Stroitransgaz shares. Although there are no indications that he bought these shares also in a private capacity, his remarks do suggest that his personal guarantees helped to make the deal possible (Igumenov & Malkova, 2012).

Usmanov's role as negotiator would not necessarily have ruled out a different Gazprom subsidiary acting as the buyer of these shares. But that would have made less credible his claim to be an *intermediary* for the new Gazprom management rather than their direct

government proper [...] [this] helps make managers of such enterprises accountable for their performance and helps protect ministers from charges of profligacy; it creates a separate cache of resources in some instance, unavailable or unknown to public and parliament, that the government can draw on at strategic junctures".

¹⁸⁷ No independent confirmation has been found in the public domain that Usmanov first bought this Gazprom stake in a personal capacity. It is hard to imagine why Usmanov would have invented such a detail, however, and it seems unlikely that Forbes would have opened itself up to legal difficulties by misquoting Usmanov.

representative (that “he” was buying rather than Gazprom). It would also have reduced his freedom to negotiate terms.

Zapsibgazprom and South Russkoe

Gazprominvestholding’s involvement in the takeovers of Zapsibgazprom and the South Russkoe gas field was as follows. Gazprom’s controlling stake at Zapsibgazprom was restored by a court order in mid-April 2002, and this stake was directly owned by Gazprom. But on the eve of a crucial Zapsibgazprom shareholder meeting on 25 May that was called by Gazprom, Gazprominvestholding was handed temporary control of the stake (“Sostoyalos’ sobranie aktsionerov OAO ‘Zapsibgazprom,’” 2002; Yambaeva, 2002). It was also involved as buyer in Gazprom’s takeover of Severneftegazprom, the licence-holder for the gas field. Usmanov and his deputy at Gazprominvestholding were involved as negotiators both in the Severneftegazprom takeover, and in Gazprom’s buying out Zapsibgazprom’s minority shareholders after its majority stake had been restored by court order.

The transfer of the Zapsibgazprom stake to Gazprominvestholding was not a sale (which would have required approval from the Gazprom board of directors) but was almost certainly *trust management*, which in Russian law approximates to granting power of attorney¹⁸⁸. The Zapsibgazprom shareholder meeting elected a new board of directors which was now dominated by Gazprom representatives, and appointed Oleg Skorik, Usmanov’s deputy at Gazprominvestholding, as the new chief executive¹⁸⁹. The company was still in bankruptcy administration at the time, and thus Skorik was subordinate to the court-appointed

¹⁸⁸ This explanation of trust management (*doveritel’noe upravlenie*) was provided by a partner in the Moscow office of a major law firm. In a brief newspaper interview soon after the EGM, Zapsibgazprom’s new CEO and Gazprominvestholding First Deputy CEO Oleg Skorik mentioned “trust management and direct ownership of assets” as one of the functions Gazprominvestholding fulfilled on behalf of Gazprom, and then cited as an example its leadership of the project to return Severneftegazprom to Gazprom’s control (“Interv’yu s Olegom Skorikom,” 2002).

¹⁸⁹ Skorik had joined Gazprominvestholding from Usmanov’s private business Interfin; he left Gazprom group in 2004 to work for the Swiss division of Coalco (another privately-owned business linked to Usmanov) (OAO “Regiongazkholding,” 2003, pp. 12–13). This provides another indication that the boundaries between Usmanov’s private business and his role as a Gazprom employee were somewhat blurred.

administrator, who continued to be the highest-ranking executive at the company. Precisely how long Skorik remained as CEO is not clear, but a new CEO was appointed soon after agreement was reached with Zapsibgazprom's creditors in October 2002 to bring it out of bankruptcy.

A disclosure document published by Severneftegazprom in early 2003 (OAO "Severneftegazprom," 2003) provides all the evidence necessary to divine how ownership roles were divided in Gazprom's takeover of that company. Gazprominvestholding bought Zapsibgazprom's remaining 11% stake in the company and the other 38% that was held by Zapsibgazprom's managers. When Gazprom subsequently acquired an additional 49% stake in Severneftegazprom via a share-swap with Itera, it took ownership of this latter stake directly¹⁹⁰. There is no sign that the Gazprominvestholding purchases received prior approval from the Gazprom board; by contrast, the share-swap that gave Gazprom its additional 49% stake *did* receive such approval on 20 August 2002 ("Vchera," 2002). This is consistent with the interpretation given above of the rules that applied at the time: namely, that Gazprom's board needed to pre-approve purchases of shares in other companies (even those made by its subsidiaries) if they resulted in Gazprom group gaining a controlling interest¹⁹¹.

Gazprominvestholding was involved in the negotiations with Itera that led to the agreement between Miller and Makarov to bring Gazprom's stake in Severneftegazprom up to 100% (Lysova & Reznik, 2002). Indeed, as noted above, Gazprominvestholding claimed to be in charge of the whole project of returning South Russkoe to Gazprom's control ("Interv'y u s Olegom Skorikom," 2002). Usmanov said in 2012 that he had gone to court to get control of

¹⁹⁰ The disclosure document shows that at the end of 2002, Gazprominvestholding held 49% and Gazprom 49%. Gazprominvestholding acquired its stake on 8 April 2002, and Gazprom on 9 December 2002.

¹⁹¹ The wording of the press-release from the relevant board meeting was that approval had been given for Gazprom to become the sole owner of Severneftegazprom by increasing its stake from 49% to 100%. Thus the approval actually covered two transactions: the share-swap and Gazprom's subsequently taking ownership of the remaining shares in the company. This it did on 31 January 2003 (OAO "Severneftegazprom," 2007, p. 11).

the gas field from Itera (Igumenov & Malkova, 2012). Presumably he was referring to the legal action which blocked Itera's attempt to dilute the Gazprominvestholding stake in Severneftegazprom from 49% back down to 20%. In a 2003 interview, Usmanov had referred to this case as an example where his company had been used to maintain confidentiality pending completion of the deal. Regarding Zapsibgazprom, he added that "we learned that there were attempts to initiate the bankruptcy of this company, but we were able to reverse the process and return the company to Gazprom's control" (Reznik, 2003)¹⁹².

It is not apparent why, as Usmanov claimed, there was a particular need for confidentiality in the acquisition of shares in Severneftegazprom. The precise reason for Gazprom transferring its Zapsibgazprom stake to trust management by Gazprominvestholding also remains something of a mystery. Because this took place on the eve of the shareholder meeting, it seems highly likely that the transfer was needed for the purposes of that meeting, which was aimed at consolidating Gazprom's newly-regained control over the company. There is nothing in the list of decisions that were made at the meeting that would have prevented Gazprom voting its own stake¹⁹³. The meeting was held under controversial circumstances, amid tensions with the remaining Zapsibgazprom shareholders. It took place on a Saturday and inside Gazprom's Moscow headquarters (rather than at the Zapsibgazprom headquarters in Tyumen'), in a transparent effort to exclude those remaining shareholders. Gazprom claimed to have duly notified all shareholders in advance of the meeting, but this claim was contested. The meeting was only just quorate (with only the owners of 51.6% taking part), which effectively means that few or no other shareholders were present (Yambaeva, 2002). Gazprominvestholding was most likely brought in as part of Gazprom's efforts to exclude

¹⁹² Given that it was Gazprom itself that initiated Zapsibgazprom's bankruptcy, this seems to first glance to be an odd comment to have made. However, in December 2001, i.e. prior to Gazprom's 14 January 2002 application to bankrupt Zapsibgazprom, a different creditor (namely the bankruptcy administrator of Inkombank) had made its own application (OAO "Zapsibgazprom," 2002; Reznik, Osetinskaya, & Nikol'skii, 2002). Usmanov may well have been referring to his company's role in ensuring that this earlier application was disregarded.

¹⁹³ The list of decisions was published in a Gazprom press-release ("Sostoyalos' sobranie aktsionerov OAO 'Zapsibgazprom,'" 2002).

minority shareholders from the meeting, though it is not clear precisely how it contributed to those efforts.

Conclusion

The first section of this chapter looked at what prompted Gazprom to undertake its campaign to take back assets. It took some time for this campaign to take shape after Putin's appointee Aleksei Miller had taken over as Gazprom's new CEO: his first months at the company saw considerable debate over whether it was commercially prudent to take over some of the assets lost to Gazprom under the previous management. It seems clear that an intervention by Putin put an end to these debates, and set Gazprom's managers on an essentially indiscriminate campaign to take back all of the assets that "rightfully belonged" to the company. Although the commercial objective of boosting market capitalisation was cited in justification, it is clear that other considerations influenced what was essentially a political decision.

The conclusion from the case studies was that the twin political objectives of consolidating state control over Gazprom and boosting its power as a political and economic resource played an important role in the campaign. Consolidating state control over Gazprom was the reason for taking back the Gazprom stake held by Stroitransgaz. Taking back the South Russkoe gas field was strategically important given its future role as supplier to the Nord Stream pipeline. Gazprom was intended to be used as a tool of economic development through its ownership of Sibur and Zapsibgazprom: ownership would allow Gazprom to provide a steady stream of orders to these companies. Sibur's fortunes were important to the petrochemicals industry (prioritised as part of a developmental drive to move exports 'up the value chain' from primary natural resources), while Zapsibgazprom was an ailing company which the government was apparently unwilling to allow to fail. Gazprom also sought to take an ownership stake in Stroitransgaz in order to solve the strictly commercial problem of its relationship with a key supplier. In the decisions to take ownership of Sibur, Zapsibgazprom

and Stroitransgaz, the aim was to bring under common ownership transactions that had previously taken place ‘across the market’. Williamson (1981) provides the key to understanding why such ‘vertical integration’ can under certain circumstances be preferable to relying on the market to provide the best outcomes¹⁹⁴.

Thus there is in fact a wide range of explanations required to account for all the decisions involved in Gazprom’s campaign, and for how the newly-acquired assets were subsequently managed. This suggests that a form of ‘mission creep’ was at work. Vernon (1984, p. 51) argues that state-owned companies around the world are often vulnerable to this problem, because they are accountable not to one but to several state agencies: “the enterprise operates according to multiple objectives, some originating from inside the firm, some from without; the influence of the various objectives on the behaviour of the state-owned enterprise varies with time; and the environment in which the enterprise operates usually contains substantial elements of instability.”

As a final observation before turning to the ownership outcomes, one of Gazprom’s justifications for undertaking these SLCTs, and its wider campaign of re-taking lost assets, was simply that these assets “rightfully belonged” to it. They had been lost due to the inadequate controls exercised by the state over the former Gazprom management. In the literature on the “commitment problem”, the state is seen both as having a responsibility to protect the property rights of private economic actors, and as a major potential threat to those property rights. But in the cases in this chapter, it is far from clear which side was attacking property rights and which was defending. Gazprom’s private minority shareholders agreed with the new management that the company’s campaign was justified as an effort to remedy past attacks on its own property rights.

¹⁹⁴ A further example of the state attempting to foster the development of industry through vertical integration is provided in the following chapter focussing on engineering company OMZ.

The cases studied in this chapter provide further evidence that SLCTs can be a two-way bargaining game rather than straightforward “expropriation” by the state. There was considerable acrimony between Gazprom and existing owner in all three cases. The fact that the assets Gazprom particularly wanted were not the same as the companies that were the takeover targets, and in two out of three cases had been placed at one remove from those target companies, made the situation particularly precarious for Gazprom. Care needed to be taken to ensure that the prized assets were not sold on to third parties, or claimed by rival creditors. Attempting to pursue full-scale asset seizure against a hostile existing owner would have heightened the risk that the prized assets would be lost forever, and this made securing a negotiated outcome particularly preferable.

The defensive tactics employed by the existing owners go a long way towards explaining why the prized assets were in such danger of being lost. Sibur’s owner (as in the Yukos and Russneft’ cases) had had the foresight to structure his ownership through offshore companies, and Gazprom showed a reluctance to take action against them in international courts. But his fate shows that such tactics are of little value if the owner is then arrested and not (as with Khodorkovsky) prepared to face a lengthy prison sentence. At Stroitransgaz, the owner had the foresight to evade arrest by leaving the country (as had Gutseriev in the Russneft’ case). But these case studies add to the impression gained from the Bashneft’ case that constraints on the executive do not simply begin where Russia’s jurisdiction ends. The existing owners also used a variety of defensive tactics, such as share dilutions and bankruptcy, that had no international dimension. These tactics were only effective because Gazprom was obliged by *domestic* institutional constraints to accept their results, despite its privileged access to the state’s coercive resources and other “administrative resources”.

Gazprom’s preference for a negotiated outcome helps to explain why it made considerable use of its subsidiary Gazprominvestholding in these takeovers. The case studies show that Usmanov’s ambiguous status (as a private businessman as well as a hired manager of state-

controlled Gazprom, and as a ‘Vyakhirev man’ as well as a loyal subordinate to the new Gazprom management) enabled him to facilitate agreement with the existing owners. Similarly, in the cases of Russneft’ and Bashneft’, the private buyers had played an important role in facilitating agreement between the existing owners and the state. Thus, Gazprom found in Gazprominvestholding a way to finesse the issue of its own ‘state-ness’ in order to improve its ability to negotiate with the same people against whom it was employing the state’s coercive resources.

Gazprominvestholding’s other role was technical and legal in nature. By going deeper into the “state ownership” outcome of these cases to understand why it was used as owner on behalf of Gazprom, it has been possible to identify significant domestic legal constraints within which Gazprom was forced to operate. Some of these constraints were common to all joint-stock companies. But Gazprom was under additional controls stemming from its status as a state-owned company, which had been tightened further in response to the loss of assets under the former management. The ‘directive’ system at Russia’s state-owned companies made governance of these companies a cumbersome process. The involvement of various state agencies in the sign-off of directives heightened the problem noted by Vernon of state-owned companies being subject to state interference in multiple and sometimes opposing directions, which may explain why Gazprom’s takeover campaign served a multitude of potentially contradictory political and commercial purposes. But the assets ‘lost’ by the previous management show that the directive was not a meaningless piece of red-tape: this and the additional controls placed on Gazprom were aimed at ensuring the company would no longer be asset-stripped by a management that was not subject to sufficient shareholder control.

Gazprom’s management felt the need to bypass the institutional controls on its actions not so much because it resented meddling from multiple interested state agencies, but because the controls substantially reduced its ability to respond in an agile and flexible manner in tense and time-sensitive situations. The more acrimonious the takeovers of the lost assets, the more

tense and time-sensitive they were likely to be. With the existing owners strategizing to place assets offshore or otherwise hamper Gazprom's ability to seize them, the Gazprom management could not afford to wait for months for appropriate sign-off for particular acquisitions.

By using Gazprominvestholding (and subsidiaries thereof) as buyers, the Gazprom management was able to bypass these constraints while remaining compliant. Compliant, that is, with the letter of the relevant laws and regulations, but hardly with their spirit. Woodruff (2013) points out that "rule of law" requires not just a well-defined, open and stable legal framework and its adequate enforcement, but also a sensitivity to how the law is manipulated by those to whom the law allocates authority, and a preparedness to re-calibrate the law in response. The ownership structures used by Gazprom in these takeovers were examples of such manipulation: without breaking any rules, they largely undermined the effectiveness of the controls that the state had placed on the company for apparently good reasons¹⁹⁵.

It is perhaps surprising that the loyal management of a state-owned company found ways to bypass controls that were imposed by the state, but less surprising that they did so in a way that was legally compliant. Presumably the state's representatives on the Gazprom board were aware of how Gazprominvestholding was being used, but did not object because they understood the more pressing imperative of making sure the takeovers proceeded as planned. It would have been less easy for them to look the other way if the company was directly infringing (rather than bypassing) the controls put in place by the state.

More significant is the fact that Gazprom was subject to other types of "coercion-constraining institutions". Gazprom was a state-owned company which had full state backing for its project to take back lost assets, and was able to employ "administrative resources" to help bring it about. But it was not above the law: its concern about losing control of bankruptcy was real,

¹⁹⁵ Similarly, in the OMZ case studied in the next chapter, Gazfond was used as buyer in a way that undermined the antitrust regulator's efforts to maintain a competitive market.

and when tactics such as share dilution were used in order to undermine Gazprom's control of a company, those tactics had a tangible effect (even if Gazprom was in some cases able to reverse them later through the courts). These considerations contributed to Gazprom's preference for a negotiated solution to the takeovers, and this was particularly theoretically significant where the constraints on coercion were exclusively domestic, rather than international, in nature. That such things mattered at all shows that Russia was some way from being an ideal-type kleptocracy.

Chapter 4: OMZ and Atomstroieksport

Introduction

This study centres on a state-led coercive takeover (SLCT) in Russia's heavy engineering industry, which took place in November 2005 and involved a company named OMZ¹⁹⁶. The company specialises in manufacturing heavy equipment for the mining, metallurgy, oil and gas, and nuclear energy industries. The main focus of this case study is its work for the nuclear energy industry, which is based at the Izhorskie Zavody plant in St Petersburg. However, it will occasionally touch on OMZ's other main asset, the giant Yekaterinburg-based factory complex Uralmashzavod, which was in Soviet times called the "factory of factories" because most of the metallurgical and mining plants in the country were built with equipment made there (Colton, 2008, p. 54).

OMZ was founded in 1998 by Kakha Bendukidze. An ethnic Georgian who had moved to Moscow in 1977 at the age of 21, he had trained and worked as a biologist until 1987, when he first went into business (European Stability Initiative, 2010). In 1993, companies he controlled participated in the privatisation of Uralmashzavod, acquiring sufficient shares to gain control over what was a highly dispersed set of other shareholders. Bendukidze boasted that he had bought Uralmashzavod for "one thousandth of its real worth" (Freeland, 1995). By his account, he and his partners had been the only serious contenders to appear at the privatisation auction.

In 1998, Uralmashzavod acquired Izhorskie Zavody through a share-swap (Thornhill, 1998). Bendukidze noted that Izhorskie Zavody's technology was more advanced, but that its market capitalisation was only half that of Uralmashzavod because it had been less open to investors.

¹⁹⁶ Ob''edinennye Mashinostroitel'nye Zavody, which the company renders in English as "United Heavy Machinery".

OMZ was created in the same year as parent company to these two major enterprises. It was an early convert to the idea of attracting Western finance. By late 2001 it had listed American Depositary Receipts (ADRs) on the New York Stock Exchange, had become the first engineering company in Russia to publish GAAP accounts, and was described by one investment bank analyst as “one of the most open companies on the Russian market” (Clark, 2001).

In November 2003, OMZ gained control over Atomstroiekспорт, Russia’s general contractor for the construction of nuclear power stations abroad, which had until that point been state-owned since its creation in 1998. This event, which is the starting-point for the present case study, triggered the coercive campaign to bring Atomstroiekспорт back into state ownership. However, as will be shown below, some analysts believe it was additionally what persuaded the state to go further and bring OMZ itself under state control. In both of these state-led takeovers, the buyers were closely related, if not the same. Furthermore, the way they designed the particular ownership outcome of the Atomstroiekспорт takeover holds the key to explaining the outcome in their later acquisition of OMZ. For all of these reasons, the takeover of Atomstroiekспорт is included as a complementary case study in this chapter.

As in chapters 2 and 3, the case studies here have two objectives: firstly, to provide causal explanations for the takeovers which assess the motivations of the buyers and of the state, and secondly, to explain the outcome of those takeovers in terms of their new ownership status. Before explaining the motivations of the buyers, it is necessary to understand precisely who these buyers were and to what extent their actions reflected the will of the state (or of a particular group within the political leadership). The research outlined below established the identity of the buyers and found that they were effectively the same in both cases. But arriving at this conclusion was not a straightforward task for either case. Both acquisitions were carried out in a non-transparent way, with the buyers admitting to their involvement only some time after the transaction had taken place. Gazprombank, which was at the time a direct

subsidiary of *de facto* state-controlled Gazprom, declared itself to be the new controlling shareholder of Atomstroiekспорт in November 2004, but there are indications that it did not make the purchase directly. In this regard, the OMZ takeover is more extreme: precisely who was behind the entities which bought the controlling stake in November 2005 was never disclosed¹⁹⁷. But there is sufficient evidence in the public domain to come to a confident conclusion about who the new beneficial owners were, to glean a significant amount about how they structured the acquisition, and to understand why it was done in this way.

Because the identity of the buyers is not self-evident, the present chapter departs from the structure of its two predecessors by tackling this question before examining the motivations behind the takeovers. The ownership outcome at OMZ is particularly difficult to categorise on a scale ranging from “state ownership” to “private ownership”. It involved a “non-state” pension fund that was (despite this potentially misleading term) affiliated to state-controlled Gazprom. Managing OMZ on behalf of the pension fund was a group of senior managers of Gazprombank, which was at the time still a subsidiary of Gazprom. But both the pension fund and the bank would soon cease to be part of Gazprom group and hence to be subject to any formal (but indirect) state control. Furthermore, there are indications that this process was already underway at the time of the OMZ acquisition. As will be explained below, some analysts see the pension fund and its assets as having been ‘privatised’ in favour of a group of businessmen who have strong informal ties to President Vladimir Putin. However, in the present chapter it is argued that the pension fund and its assets (including OMZ) remained under the control of the Gazprom group. Hence, both Atomstroiekспорт and OMZ had been placed under a form of state control following the takeover, albeit this control was tenuous from a formal perspective in the case of OMZ.

The next section seeks to understand the motivations of the buyers in the two takeovers, and how this related to the government’s own plans for the sector. In Chapter 2, it was argued that

¹⁹⁷ Correct as of this writing.

the state instigated the three coercive takeovers in the oil industry without a specific ownership outcome in mind: either state ownership or transfer to a new private owner was acceptable, provided that the existing owners were deprived of their assets, thereby removing the political threat that they posed. In Chapter 3, however, the state's goal was clearly to restore Gazprom's control over its 'lost' assets. Similarly in the cases of Atomstroiekспорт and OMZ, there is evidence that the state actors who instigated the takeovers intended the Gazprom group to be the new controlling beneficiary, at least for an interim period. Consequently, understanding the motivations of the buyers (and their backers in government) plays an important role in answering *both* why the takeovers happened *and* their particular ownership outcome. The objective is to understand whether the buyers were seeking to profit from an opportunity created by the state's intervention, whether they had arranged that intervention to increase company profits (or the personal wealth of company insiders), or whether they were instructed by the state to take ownership of the asset for primarily political (rather than commercial) reasons.

The takeover of OMZ came just before the announcement of a massive programme to boost Russia's nuclear energy production. OMZ stood to benefit substantially from government orders from this programme because Izhorskie Zavody was the only Russian plant capable of producing nuclear reactors. Thus at first glance it seems that the OMZ acquisition was motivated primarily by profit: the buyers may well have been acting on insider information regarding the nuclear expansion and the role OMZ was set to play in it. However, decisions were taken subsequently by the new owners that suggest their pursuit of profit was sometimes at odds with the expectation that they play a role as tools of government policy. Most notably, when the promised turnaround in OMZ's fortunes did not happen and doubts set in regarding its ability to continue as a going concern, OMZ's buyers continued to provide financial support. It appears that the government, intent on retaining this important part of Russia's

remaining heavy engineering capability, put pressure on OMZ's owners (who were also its main creditors) not to pull the plug on its operations.

At the same time, however, OMZ failed to cooperate productively with the Federal Agency for Nuclear Energy (Rosatom), the government body responsible for the nuclear expansion programme and the gatekeeper for all government orders stemming from that programme. Not only was this failure a significant contributor to OMZ's financial problems, it also undermined the implementation of the government's nuclear energy strategy. Thus we see the same business actors on the one hand keeping ailing industrial enterprises alive on behalf of the government and at the expense of their own profits, yet on the other hand letting their corporate self-interest undermine an important facet of government industrial policy. This puzzle demands an explanation both from the perspective of the motivations of OMZ's buyers, and from that of the state, which failed to use its influence to ensure OMZ and Rosatom cooperated effectively.

As in the previous chapter, questions also arise from the precise way in which the acquisitions were structured, and (in the case of OMZ in particular) why this was done in an atmosphere of secrecy. Once again, legal considerations prove to have played the main role in determining these specific ownership structures and the secrecy surrounding them. In the previous chapter the buyers found innovative ways around the need for prior approval from the Gazprom board of directors (and hence also for the government 'directive') before the takeover could proceed. But in the takeovers of the present chapter, which took place slightly later, the main obstacle was the need to gain prior approval from a newly-empowered and somewhat hostile antitrust regulator. Thus once again, evidence is provided that powerful state-backed corporate players, who are able to benefit from various types of 'administrative resource' including state coercion in support of takeovers and influence over the outcomes of court cases, are at the same time paying attention to mundane laws relating to the establishment of a market economy. At the same time, however, there were occasions where Gazprom simply ignored

the same institutions that were supposed to be constraining their behaviour. The chapter ends with a discussion of whether the sanctions that were available to the antitrust body, and its willingness to use them against Gazprom group, are sufficient to explain Gazprom's partial compliance with the relevant law.

Government strategy and nuclear engineering

As noted above, the focus of this case study is on OMZ's engineering operations for the nuclear energy industry, based at Izhorskie Zavody in St Petersburg. As Russia's general contractor in the construction of nuclear power stations abroad, Atomstroieksport was the gateway for all OMZ's export orders in this area. Before turning to what triggered the coercive takeovers at Atomstroieksport and OMZ, it is necessary to understand the Russian government's strategic thinking at the time regarding heavy engineering and nuclear energy. Government strategy for heavy engineering was not given published documentary form until 2010, when the Ministry for Industry and Trade approved the "Strategy for the Development of Heavy Engineering for the period to 2020" (Minpromtorga Rossii, 2010)¹⁹⁸. Izhorskie Zavody was discussed in the document, but its main focus was on the non-nuclear side of Russia's heavy engineering industry, which was the main focus of OMZ's other main enterprise, Uralmashzavod. The document noted that although this industry provided just 1.2% of GDP in 2009, its clients (the oil and gas, mining and metals industries) provided over 80% of budget revenues, and were responsible for 81% of exports. Around two-thirds of the costs in these industries were from the purchase, servicing and use of heavy equipment. There were very few heavy engineering companies on the world market, as well as on the Russian market, and the government feared that "the complete degradation of Russian heavy

¹⁹⁸ This document was approved several years after the main events discussed in this chapter, and government strategy may have changed somewhat in the intervening period. However, it retains some value in providing an indication of the government's preoccupations at the time of the takeovers.

engineering would lead to an increase of tens of percentage points in the costs of acquiring and servicing fixed assets for the raw materials industries” (Minpromtorga Rossii, 2010, p. 3).

These remarks highlight the government’s preoccupation with “technological sovereignty” and industrial self-sufficiency, and provide some rationale for it. They illustrate the government’s particular interest in preventing the total collapse of the heavy engineering industry, which helps to explain why it was not prepared to maintain a *laissez faire* attitude when it came to the fate of OMZ.

Of more direct relevance to the coercive takeover at OMZ was a government strategy that was announced in January 2006 by Rosatom head Sergei Kirienko. This was a dramatic scaling up of existing plans to increase the country’s nuclear energy production, so that 40 new generating units would be built over the next 25 years at an estimated cost of \$60bn. Additionally, and of direct relevance to Atomstroiekспорт, Kirienko said that he anticipated Russia building another 40-60 generating units abroad (Nikol’skii, 2006)¹⁹⁹. Kirienko’s announcement was followed by the approval in October 2006 of the Federal Target Plan (FTP) named “Development of the nuclear energy industrial complex of Russia for 2007-2010 and towards 2015” (“Federal’naya tselevaya programma ‘Razvitie atomnogo energopromyshlennogo kompleksa Rossii na 2007-2010 gody i na perspektivu do 2015 goda,’” 2006). This plan envisaged beginning the construction of two new nuclear generating units per year (with construction taking five years). Ten new units would be completed by 2015, and by 2020 32 units would either be completed or under construction (“Kto investiruet, tot i vyigryvaet,” 2009)²⁰⁰.

¹⁹⁹ Each generating unit was based around a nuclear reactor, and there was typically more than one unit at a given nuclear power station. At the time of Kirienko’s announcement there were 31 generating units operating at Russia’s 10 nuclear power stations. On average, each generating unit had capacity of 0.75 GW (Alekseev, 2006).

²⁰⁰ The scale of the expansion under the FTP was reduced in June 2010 owing to the financial crisis (“Pravitel’stvo RF utverdilo korrektyrovku General’noi skhemy razmeshcheniya ob’ektov elektroenergetiki do 2020 goda s perspektivoi do 2030 goda,” 2010). However, it remained the case (as

A key reason given by the FTP document for the nuclear expansion was to bolster the country's energy security by improving the diversity of fuel sources. The document cited years of underinvestment in nuclear energy and rising energy demand in Russia and globally, thus raising concerns regarding the possibility of "a large-scale energy crisis, which would be systemic in nature." High world oil prices threatened to inflate domestic gas prices and undermine plans to meet Russia's energy demand through the construction of new gas-fired power stations. Furthermore, increasing the share of nuclear energy in Russia's energy balance would help it meet its carbon emission commitments under the Kyoto Protocol. But in addition to increasing the share of nuclear energy production inside Russia, the FTP's goals included promoting exports of Russian companies involved in the nuclear energy cycle, and the construction of nuclear power stations abroad.

The FTP made no mention of the need to use Russian equipment as far as possible in the construction of the new generating capacity, but it is clear from what followed that there was a determination to source the equipment for the new nuclear reactors domestically, rather than from abroad²⁰¹. The government's preoccupation with saving Russia's heavy engineering from collapse helps to explain why, on the contrary, it was hoped that the state-funded nuclear expansion would provide a stable flow of orders to Russia's heavy engineering enterprises, which could borrow against these future orders to finance their own modernisation (Pushkarskaya & Kornysheva, 2006; Yemel'yanenkov, 2006). Another consideration was energy security: as OMZ's CEO Igor Sorochan put it in 2010, "How could the state plan a large-scale programme for development of nuclear energy if the creation of new reactors didn't depend on domestic production but instead depended on foreign supplies? What kind of energy security could we talk about then?" (Osin, 2010). There were also technical problems

of this writing) that there would be considerable new nuclear generating capacity built in the next two decades, and the determination remained to use domestic engineering capacities as far as possible.

²⁰¹ As will be discussed later, when Rosatom encountered problems in its dealings with Izhorskie Zavody, it went to great lengths to find an alternative supplier of reactors *inside* the country. The possibility of overcoming Izhorskie Zavody's monopoly by sourcing reactors abroad was apparently never seriously considered.

involved in trying to introduce imported components in the construction of new reactors, according to Izhorskie Zavody's CEO (Imamutdinov, 2006).

This determination to rely on Russia's domestic industry in the nuclear expansion programme placed OMZ's St Petersburg plant Izhorskie Zavody at centre stage, because (as noted above) it was the only Russian factory capable at the time of producing nuclear reactors and certain other equipment for the new generating units. It was therefore essential to the fulfilment of the FTP, giving the government a key reason to be interested in its fate.

Triggers for the takeovers

OMZ's takeover of Atomstroieksport

In November 2003, OMZ gained sufficient shares to wield control over Atomstroieksport, and Bendukidze took over as its CEO (Lemeshko, 2003b)²⁰². As noted above, this event served as the first main trigger of the state-led coercive takeovers which followed. The company had until that point been majority-owned by state-owned companies subordinate to what was then the Ministry for Atomic Energy (Minatom)²⁰³. As Russia's sole general contractor for the construction of nuclear power stations abroad, it was the exclusive gateway to international orders not just for Izhorskie Zavody but for other Russian companies involved in nuclear engineering - in particular Silovye Mashiny, a heavy engineering company owned by the Interros group. The economist Yakov Pappe later commented that "When Kakha bought Atomstroieksport, I said: that's the end. No-one is going to allow Bendukidze to manage the

²⁰² Atomstroieksport had had been founded in 1998 by two state-controlled entities, one a joint-stock company named Atomenergoekspost (49%) and the other a state unitary enterprise named Zarubezhatomenergostroi (51%). OMZ acquired a 19.9% stake in Atomenergoekspost, whose remaining shares were widely dispersed among its managers and employees. Thus OMZ's small stake was sufficient for control over Atomenergoekspost, and hence gave it control of the 49% stake in Atomstroieksport. Subsequently Atomenergoekspost gained a small number of additional shares in Atomstroieksport, making it the controlling shareholder (Lemeshko, 2003b).

²⁰³ In March 2004, Minatom was deprived of its ministerial status and supervision of the nuclear industry was handed to the Federal Agency for Nuclear Energy (Rosatom). The Minister in charge at Minatom, Aleksandr Rummyantsev, continued as head of Rosatom until his replacement in November 2005 (see below).

nuclear industry” (Kozyrev, 2008). There was understandable concern that Atomstroieksport would now favour OMZ’s bids for its contracts over those from its competitors (Lemeshko, 2003a). But Minatom was also concerned that Atomstroieksport’s export contracts, which involved Russian state guarantees, would be threatened by the company’s new privately-owned status (Rybal’chenko & Kornysheva, 2003). It later emerged that the Chinese government had demanded an explanation as to why the Russian state was acting as guarantor for the construction of a nuclear power station at Tianwan, when the general contractor for the work was now privately-owned. This question was raised “at the highest diplomatic level” (Kozyrev, 2008)²⁰⁴.

OMZ claimed that it was prepared to sell shares in Atomstroieksport back to state-owned companies and to Atomstroieksport’s other key partners. Bendukidze agreed that some kind of state involvement in the company’s management was necessary in order to simplify its work on international markets. But at the same time he criticised what he saw as Minatom’s two diametrically opposing attitudes to ownership in the sector: “one allows private capital to take part in the management of nuclear energy, and the other opposes it” (Rybal’chenko & Kornysheva, 2003).

By November 2003 Minatom was reported to be in talks with OMZ on regaining state control of Atomstroieksport, but so far without success (Rybal’chenko & Kornysheva, 2003). In December, it emerged that agreement had been reached in principle on OMZ selling shares in Atomstroieksport to one or more unspecified state-owned companies as well as to Silovye Mashiny and privately-owned Alfa Bank. The state would be the largest single shareholder, but control was expected to be exercised by an alliance of Silovye Mashiny and OMZ. Minatom was now sounding conciliatory, saying that “our position is not so strict, there is no

²⁰⁴ In an April 2004 interview Yevgeny Yakovlev, then CEO of OMZ, made reference to China’s concerns over the loss of state control over Atomstroieksport (Lemeshko, 2004a).

serious conflict with OMZ. Ultimately, we both have the same goal: developing the business” (Lemeshko, 2003c; Yambaeva, 2003).

On 18 December 2003 it became clear that the sale of Atomstroiekспорт shares to Silovye Mashiny was part of a wider plan: OMZ and Silovye Mashiny had agreed on a merger (Jack, 2003). This entailed the takeover of Silovye Mashiny by OMZ, with Silovye Mashiny’s main owner Interros taking a 50% stake in OMZ. But executive management of OMZ was to be transferred to Interros, with Bendukidze moving from CEO to Chairman. The merger began to be implemented long before its completion, with Silovye Mashiny’s CEO Yevgeny Yakovlev taking the helm at OMZ in March 2004 (Dobrov, 2004).

It appears that Minatom’s fears for Atomstroiekспорт were allayed by the prospect of this merger. In an April 2004 interview, OMZ’s new CEO revealed that his company and Silovye Mashiny had reached agreement with the government on the issue of restoring state control over Atomstroiekспорт. The change of government in March 2004 (with Prime Minister Mikhail Kas’yanov dismissed in part over his stance on the Yukos affair) meant that the companies needed to secure fresh agreement on this plan from the incoming government led by Mikhail Fradkov. Yakovlev said OMZ was planning to resume the dialogue once the situation regarding the composition of the new government had stabilised (Lemeshko, 2004a).

Bendukidze joins the Georgian government

On 1 June 2004 it emerged that Bendukidze was resigning his post as Chairman of OMZ and joining the government of Mikheil Saakashvili, who had recently been elected President of Bendukidze’s native Georgia (“Russian tycoon to reform Georgia,” 2004).

From a formal point of view, Bendukidze could not influence affairs at OMZ or Atomstroiekспорт while he held his new post: Georgian legislation meant he had to place his OMZ shares in trust and give up any management role (Lemeshko, 2004c). This technicality might not have done much to allay the Russian government’s concerns. However,

Bendukidze's government appointment cannot have been the trigger for the state-led takeover of Atomstroieksport, because efforts to regain state control of that company pre-date the appointment. Furthermore, the appointment was a relatively spur-of-the-moment decision both on the Georgian government's part and on Bendukidze's, thus ruling out the possibility that the Kremlin knew about it when it began taking steps to restore state control of Atomstroieksport²⁰⁵.

The offer to join the Georgian government came while Bendukidze was already contemplating an exit from most or all of his Russian business activities. It was being suggested that he might return to academia (Dobrov, 2004), and it was later claimed that he had been planning to retire to the south of France at this time (Peel, 2007). Therefore it would also be wrong to suggest that Bendukidze's decision to quit ownership of Atomstroieksport and OMZ was entirely in response to pressure from the Russian political leadership after it learned of his appointment to the Georgian government.

Nevertheless, the Russian government was undoubtedly concerned about the appointment, and this was compounded when the OMZ-Silovye Mashiny merger hit the rocks a few weeks later: in July 2004 it became clear that it would not proceed (Lemeshko, 2004b)²⁰⁶. The merger's unwinding meant that Atomstroieksport was back under the control of Bendukidze rather than Interros, even if he was formally prevented from exercising that control. There was no longer a plan in place to bring Atomstroieksport back under state control, and these efforts

²⁰⁵ The offer from the Georgian side came from Prime Minister Zurab Zhvania on 29 May 2004 at a Russian-Georgian business forum in Tbilisi. Bendukidze took only the weekend to make up his mind. Putin was informed after the fact, in a telephone call from Saakashvili which was apparently made at Bendukidze's insistence. According to Saakashvili, Putin was somewhat caught off guard by the news but did not raise any objections (Bekker, Nikol'skii, & Ivanov, 2004; Bekker, 2004; Borozdina, Sharipova, Biyanova, & Davydova, 2004; Korop & Ratiani, 2004).

²⁰⁶ The most credible explanation for the failure of the merger is that Bendukidze was not happy with the fact Silovye Mashiny's owners Interros had been holding separate talks on selling the merged company to German firm Siemens. The specific bone of contention was Interros's insistence that the OMZ company charter be changed to allow it to sell a stake to Siemens without offering it first to OMZ's other shareholders (Ponomarev, 2004). The Siemens deal later also foundered, because of Russian government concerns over a foreign company gaining control of enterprises that formed part of the country's military-industrial complex (Borisov, 2005; "Siemens zavershil prodazhu blokpaketa 'Silovyykh mashin' A. Mordashovu," 2011).

needed to begin again from scratch. According to one of the participants in the talks which led to the sale of Atomstroieksport to Gazprombank, these talks began immediately following the collapse of the OMZ-Silovye Mashiny merger (Lemeshko & Petrova, 2004). Within less than four months, state control had been restored: in October 2004, OMZ sold its stake in Atomstroieksport to *de facto* state-controlled Gazprombank (Lemeshko & Petrova, 2004).

If the state's only goal had been to restore state control over Atomstroieksport, there would have been no need for the subsequent takeover of OMZ. Pappé and Galukhina claim, however, that Bendukidze's takeover of Atomstroieksport made up the minds of the government to bring "not only the core, but also the periphery of the nuclear energy complex" back under state control (Pappé & Galukhina, 2009, p. 174). Whether or not that is correct, the failure of the OMZ-Silovye Mashiny merger and Bendukidze's joining the Georgian government no doubt provided additional reasons for the Russian state to pursue the takeover of OMZ, given its importance to the heavy engineering industry. Not only was it now in 'foreign' hands, it was in poor shape as a stand-alone business after the failure of the merger with Silovye Mashiny. It had narrowly avoided defaulting on its debts in 2004 (Vin'kov, 2006), and in advance of the merger Bendukidze had sold off many of its non-nuclear assets including its most profitable shipbuilding enterprises (Kudryashov, 2005).

Takeover tactics: the use of state coercion

Bendukidze has claimed that both companies were sold on his own initiative, in response to what he perceived to be a generally negative business climate in Russia rather than any specific actions that the state might have taken against him or his business. He was also claiming to be quite content with the amount of money he received for OMZ²⁰⁷. If this were

²⁰⁷ Written communication from Bendukidze to the author, May 2012. See also Kotin (2005), in which Bendukidze claims that he decided to sell OMZ because he was tired of being engaged in the same line of business for ten years, and had always intended to sell the business on at a profit; and Yegorova et al (2005), in which the political analyst Stanislav Belkovsky claims that Bendukidze had been wanting for

the whole story, then neither Atomstroieksport nor OMZ would constitute *bona fide* cases for the current project because they would not constitute coercive takeovers. However, there is sufficient evidence that the state used various coercive tactics in order to encourage the takeovers to happen. These tactics continued *after* Atomstroieksport was safely returned to state control; the last form of pressure was dropped only after Bendukidze had sold OMZ.

In chapter 3, the concept of the state-led coercive takeover was broken down into various tactics used by the state that are more or less clearly coercive in nature. These are (in ascending order in terms of their coercive nature): negotiations and/or purchase of stake to regain control; economic embargo; non-law enforcement investigations; civil court cases (including bankruptcy); searches by prosecutors; and criminal cases. Using these categories as a framework, the coercive tactics used by the state around the Atomstroieksport and OMZ takeovers were as follows:

- *Economic embargo*: soon after OMZ's takeover of Atomstroieksport in November 2003, sources at Minatom were discussing the possibility of an economic embargo of the company. The company operated under contracts signed by Ministerial decrees, and in principle Minatom could have issued new decrees handing these contracts to other parties. This was unlikely in practice because it would have entailed altering inter-governmental agreements – a lengthy process which would have damaged Russia's international reputation (Silin, 2003).
- *Non-law enforcement investigations*: in May 2004 (i.e. while the OMZ-Silovye Mashiny merger was still thought to be in process but while OMZ was still seeking to reach agreement with the new government on returning state control of Atomstroieksport) the Control and Intelligence Agency of Russia's Presidential Administration reportedly carried out an investigation of Atomstroieksport and found

a long time to quit his business interests in Russia to concentrate on his business activities in Georgia, where he intended to become Prime Minister.

numerous violations. These formed the basis for investigations by the Audit Chamber which continued after the restoration of state control. The Audit Chamber investigation was based on allegations that the company's managers were responsible for financial violations worth RUB 665m (around \$22m) in relation to its fulfilment of the programme to build Iran's Bushehr nuclear power station (Latynina, 2005; Perekrest & Spirin, 2005). In January 2006, i.e. two months after Bendukidze had sold OMZ, the Audit Chamber announced that this matter was closed (Granik, 2006).

- *Searches by prosecutors:* According to Kozyrev (2008), OMZ's head office was searched by unspecified law-enforcement officers after the inspection of Atomstroieksport by the Control and Intelligence Agency²⁰⁸.
- *Criminal cases:* in December 2003, the Sverdlovsk regional division of the FSB opened a criminal case relating to suspicions that commercial secrets were being sold by an employee at Uralmashzavod. This was announced on the same day as the news that OMZ was to merge with Silovye Mashiny. A spokesman said that normally the FSB would not get involved in such matters, "but we have found indications of espionage activity at the factory" ("FSB nashla shpionov na 'Uralmashe,'" 2003). According to Kozyrev (2008), there was also a criminal case opened on the basis of the alleged financial violations at Atomstroieksport²⁰⁹.

Bendukidze's claim to have sold the two companies voluntarily is in fact contradicted by some other statements he has made. In a 2008 interview, he denied that he had been forced to sell OMZ at a below-market price, but he also commented on his decision to sell that "there is no point spitting against the wind". Apparently in the context of the state's negative reaction

²⁰⁸ This claim could not be corroborated elsewhere. In a written communication with the author, Bendukidze said that he was unable to confirm or deny the search of OMZ's offices, explaining that by this time he had no involvement in the company's management so would not necessarily have known about such an event. Although he no longer had any formal role, it seems unlikely that the company's largest beneficial owner would not have been informed by the management of a police search of the head office.

²⁰⁹ Again, Kozyrev's claim has not been corroborated elsewhere.

to OMZ's gaining control of Atomstroiekспорт, he commented "I didn't think about that – it was my mistake²¹⁰" (Kozyrev, 2008).

Reportedly, Bendukidze received a "harsh offer" [*zhestkoe predlozhenie*] of just \$10m for OMZ (as against its market value at the time of \$77m) several months prior to the November 2005 sale. Such a low amount would suggest that the bidder believed Bendukidze had no choice but to sell. Granted, in the intervening period Bendukidze had been able to negotiate this upwards, and the final sale price was thought to be somewhere between \$50m and \$70m, which a source in a rival heavy engineering company commented was "definitely below market price" (Kudryashov, 2005; Yambaeva, Grib, & Belikov, 2005)²¹¹. The investment bank UFG, which acted as organiser and settlement agent for the transaction, said it had been organised in a hurry, while stressing that it had been a "market transaction" (Yambaeva et al., 2005). There are several possible reasons for this hurry: for example, Bendukidze might have needed to raise the cash from the sale for other purposes. But it is quite likely that whoever was responsible for the coercive tactics had imposed a deadline on his exit from OMZ.

Thus there would seem to be sufficient evidence to categorise both Atomstroiekспорт and OMZ as SLCTs. As with all of the cases discussed in the previous chapters save that of the Yukos affair, this was a negotiated takeover where the existing owner accepted the "carrot-and-stick" offer provided by the state and the buyers. This was a more 'voluntary' takeover than those other cases, because here the existing owner was already contemplating an exit. But the state was anxious to separate the assets from their existing owner and used a range of coercive tactics to ensure that this happened. Presumably because Bendukidze was in any case interested in selling, there are fewer indications than in the previous chapters that the existing

²¹⁰ In Russian, "*moi nedochet*".

²¹¹ OMZ's buyers were not the only ones to make an offer. Rival bids came from ex-UES manager Mikhail Abyzov and Oleg Deripaska. In a written communication with the author, Bendukidze commented that the rival bids were far too low. It therefore seems likely that the negotiations swiftly focussed on the possible sale to the buyers represented by UFG.

owner took steps to improve his negotiating position and prevent this becoming a case of full-scale asset seizure by the state²¹².

Assessing the ownership outcome

Before explaining the outcome of the two takeovers, it is necessary to understand precisely who the new buyers were, what their relationship was to the state (i.e. whether the SLCTs resulted in state ownership), and how they structured ownership of their new assets.

Atomstroieksport

Figures 7 and 8 show the ownership of Atomstroieksport before and after the SLCT. As Figure 8 indicates, the October 2004 sale of OMZ's 54% stake in Atomstroieksport represented the restoration of state control that the government sought: the buyer, Gazprombank, was at this time a subsidiary of Gazprom, which was comfortably under the state's *de facto* (but not yet *de jure*) control²¹³.

²¹² It has been argued that the OMZ merger with Silovye Mashiny was precisely such a step, based on the calculation that the superior political standing of the Interros group would protect OMZ from the Kremlin's anger (Dobrov, 2004; Gotova, 2004; Moroz, 2003); however, this interpretation would appear to underestimate the importance of the commercial considerations behind the merger.

²¹³ As discussed in Chapter 3, direct majority ownership of Gazprom was not achieved by the state until June 2005.

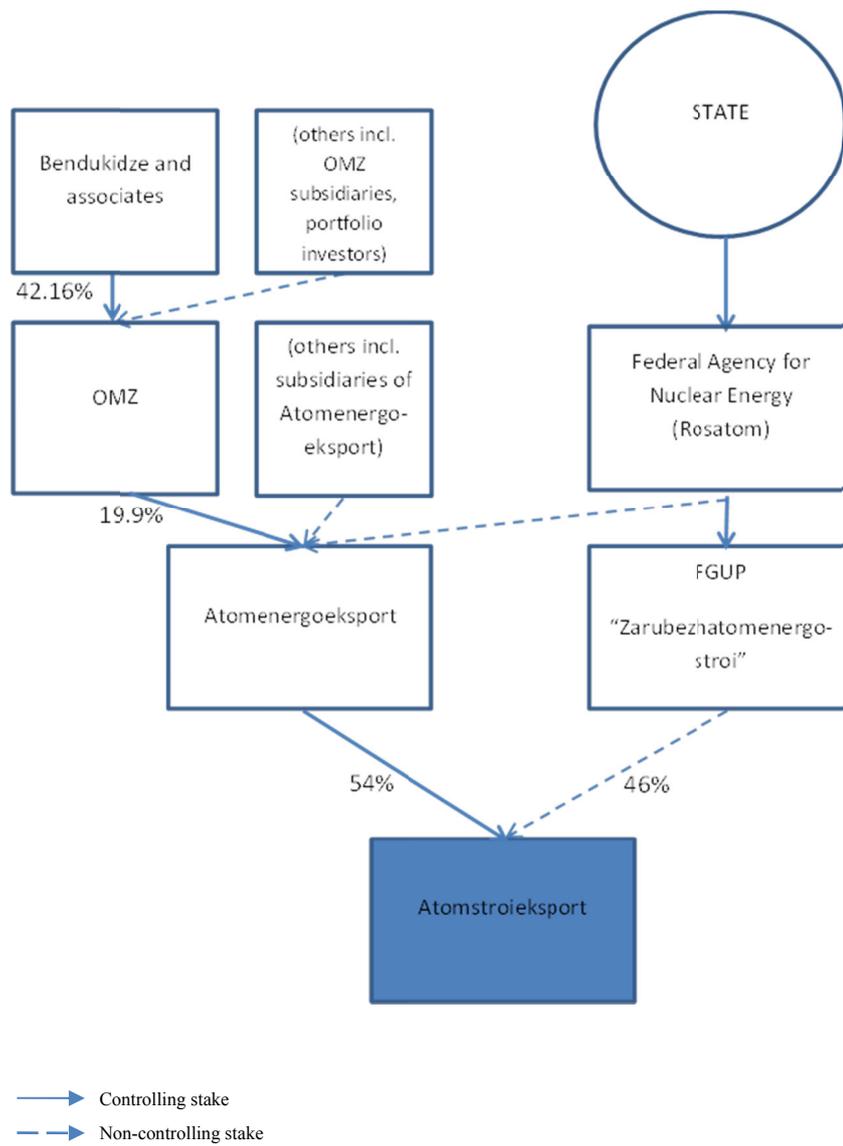


Figure 7. Atomstroieksport ownership before SLCT

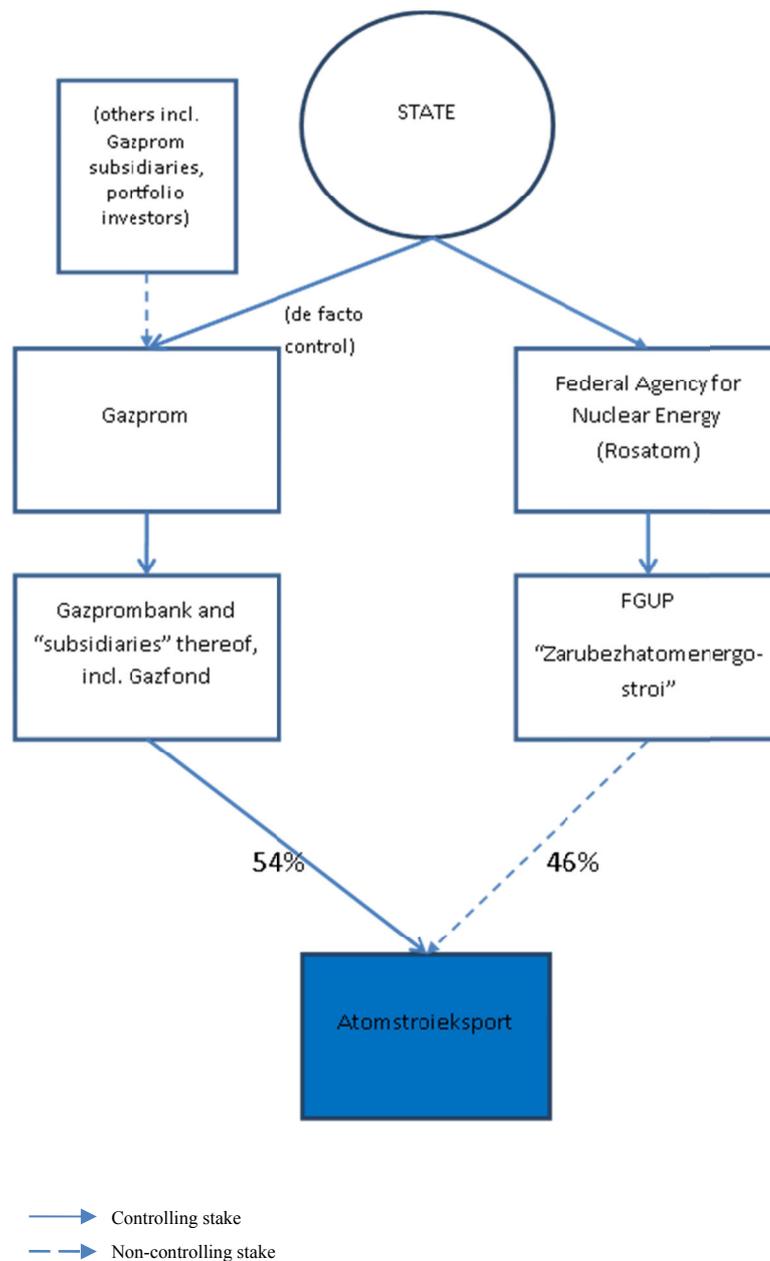


Figure 8. Atomstroieksport ownership after SLCT

Although the state now controlled Atomstroieksport via Gazprombank, the bank was not subordinate to Rosatom, the federal agency which had replaced Minatom in March 2004, meaning that that government body still had not restored control over a strategically important company for the entire nuclear industry. Rosatom was therefore keen to have control of Atomstroieksport transferred from Gazprombank to one of its own directly subordinate state-

owned companies, namely TVEL or Tekhsnabeksport. Tellingly, in February 2006, Rosatom head Sergei Kirienko spoke of the need to return Atomstroieksport to “state control”, despite the fact that it was already controlled by the state via Gazprombank (Naumov, 2006).

Like the subsequent takeover of OMZ, Gazprombank’s acquisition of Atomstroieksport was a complex transaction that was carried out in an atmosphere of some secrecy. When it was completed on 7 October 2004, Gazprombank would not confirm this fact or its involvement: it merely acknowledged that it was interested in the asset (Lemeshko & Petrova, 2004). Atomstroieksport held an extraordinary general shareholders’ meeting (EGM) the following day so that the new shareholders could vote in a set of new directors (Yambaeva, 2004). The sale was confirmed on 15 October 2004 by a government official²¹⁴, but still no comment was forthcoming from either Gazprombank, Gazprom, Atomstroieksport or Rosatom (“Gazprombank poluchil kontrol’ nad ZAO ‘Atomstroieksport,’” 2004). Gazprom group’s first official acknowledgement came in November 2004, when it disclosed in a financial report that the group now held a 54% stake in Atomstroieksport (Makeev & Siluyanova, 2004)²¹⁵.

The object of the sale was a 54% stake in Atomstroieksport. The seller was OMZ-controlled *Atomenergoeksport*. Because of its legal form as a closed joint-stock company, Atomstroieksport was not obliged to disclose the precise identity of its new shareholders²¹⁶. The buyers were in fact not solely Gazprombank, but also a number of its subsidiaries (Grivach, 2005; Yambaeva, 2004). The reasons for Gazprombank’s use of multiple buying entities, and for its refusal to acknowledge the transaction until later, will be explained below.

²¹⁴ The head of the Federal Service for Environmental, Technical and Nuclear Monitoring, Andrei Malyshev.

²¹⁵ OAO Gazprom, IFRS Consolidated Interim Condensed Financial Information (unaudited), 30 June 2004, p. 20. Available at http://www.gazprom.com/f/posts/20/985450/4-21ifrs_eng_6m04_151104_last.pdf, accessed 3 February 2014.

²¹⁶ The Law on Joint-Stock Companies and the Law on the Securities Market place substantial disclosure requirements on open joint-stock companies and on those closed joint-stock companies which have carried out a public issue of securities (Atomstroieksport has not issued securities). For a good overview see Fatikhova (2012).

OMZ

Identity of the buyer

Significantly greater secrecy surrounded the identity of the buyers in the November 2005 takeover of OMZ. Presumably bound by a confidentiality agreement, Bendukidze subsequently maintained that he had no idea who the buyers were (Kozyrev, 2008)²¹⁷.

OMZ was an open joint-stock company, which in theory obliged it to disclose details of any shareholders with a stake of 5% or greater. However, in its first quarterly report following the acquisition, OMZ stated that over 85% of its shares were in the hands of nominal shareholder companies. No other single entity held a stake of 5% or greater²¹⁸. In separate Russian regulatory disclosures known as “material events” (*sushchestvennye sobytiya*), OMZ reported that three companies which jointly held 42.16% had exited as shareholders on 2 November 2005²¹⁹. These were almost certainly the entities through which the sellers (Bendukidze and his partners) had held their 42.16% stake (Yambaeva et al., 2005)²²⁰. No disclosure was made of the identity of any new shareholders.

While Atomstroiekspor’s new owners had held an EGM the day after their acquisition so that they could replace the existing directors and take other steps to impose control, OMZ’s buyers omitted to do so, waiting instead for the routine AGM scheduled for June 2006 (Kir’yan, 2006; Vin’kov, 2006). This delay was presented in some press articles as an indication that OMZ’s buyers were incompetent and/or unable to make coordinated decisions regarding what to do with their new asset. While (as discussed below) there is some corroborating evidence that the buyers did not have the required expertise to manage these industrial assets, it is almost certain that they chose not to call an EGM specifically because that would have risked

²¹⁷ Confirmed as still being the case in Bendukidze’s written communication with the author, May 2012.

²¹⁸ OAO “OMZ”, quarterly report (Russian) for Q4 2005, p. 100-1.

²¹⁹ The names of these entities were Leron Investments Limited (11.32%), Lotterby Limited (10.91%) and HKPI Promyshlennye Investory (19.93%).

²²⁰ Bendukidze’s personal stake in OMZ was 25.93% (Yambaeva, Grib, & Belikov, 2005).

revealing their identity²²¹. Additionally, the company refused to disclose to its auditors the identity of its ‘ultimate controlling party’ for the purposes of its annual consolidated financial statements, despite a requirement to do so for accounts conforming to International Accounting Standards (IAS)²²².

A source close to the deal claimed soon after its announcement that it had been preceded by several months of talks “in a close circle. Four people had taken part. Among them were senior managers of Gazprombank” (Yambaeva et al., 2005). The press office of the Sverdlovsk regional administration (home to the Uralmashzavod factory) declared OMZ’s buyer to be Gazprombank (“Sverdlovskie vlasti vydali pokupatelya OMZ,” 2005). This was the information that was conveyed to the region’s Governor, Eduard Rossel’, by the CEO of Uralmashzavod. The CEO was then promptly sacked by the new controlling shareholders because of the leak (Samedova, Tikhomirova, & Terletsky, 2005; V. Stepanova & Yambaeva, 2005). Gazprombank insisted that it was *not* the buyer but was merely representing unspecified third-party investors (Vin’kov, 2006; Yambaeva et al., 2005; Yegorova & Malkova, 2005). Only in February 2006 did it acknowledge that it was working with those investors, who had by this time consolidated a 75% stake (“Gazprombank khochet sdelat’ OMZ nepublichnoi kompaniei,” 2006). OMZ’s Chairman Aleksei Matveev reiterated in October 2006 that Gazprombank was *not* a shareholder in OMZ, but was a “strategic financial partner”, implying that it was providing long-term credit (Vin’kov, 2006).

²²¹ At the very least, the institutional affiliations of any new directors voted on to the board would have given a hint as to the identity of the new controlling beneficiaries.

²²² IAS 24 *Related party disclosures*, which first came into force in 1986, states that the reporting entity “shall disclose the name of its parent and, if different, the ultimate controlling party.” See <http://www.iasplus.com/en/standards/ias/ias24>. In OMZ’s consolidated financial statements for the years 2006 through 2008, the auditors PwC noted this requirement, adding that it had not been able to establish whether there was an ultimate controlling party. For example, for the 2008 report PwC’s wording was: “The Company has not disclosed the name of its ultimate controlling party, if any [...] It was impracticable to satisfy ourselves as to whether there was an ultimate controlling party [...]”. The statements are available from www.omz.ru/eng/investors/statements/, accessed on 18 November 2013.

The above naturally presents some difficulty when attempting to understand the ownership outcome and the relationship of the buyers to the state. However, with further investigation it is possible to determine with some confidence the true identity of the buyer.

In April 2006, OMZ disclosed that an entity named Forpost-Management now held a 19.93% stake. Then in June 2006 Forpost applied to the Federal Antimonopoly Service (FAS) to increase its stake to 95%. This did not, however, end the secrecy as to who ultimately controlled OMZ. The FAS turned Forpost's application down in May 2007 on the grounds that the information provided as to the size of its stake in OMZ was inaccurate, and no information had been supplied regarding the identity of its ultimate beneficiaries (Aliev, 2007; Malkova & Mazneva, 2007; Malkova, 2007a).

A source close to OMZ's shareholders later said that Forpost had informed the FAS in autumn 2006 that its beneficial owner was an equities fund named Citadel, which had been founded by UFG and Gazprombank. The FAS objected to the fact that the identity of Citadel's investors had not been disclosed; additionally, it had discovered that by December 2006, Forpost-Management already controlled a 44% stake in OMZ, which was sufficient to wield voting control at the company²²³. Therefore the information Forpost had provided in its application was no longer accurate, and it had proceeded to take control of OMZ without waiting for approval from the FAS (Belikov, 2007a).

The ownership of OMZ as of December 2006 (just over one year after the acquisition from Bendukidze et al) is represented in Figure 9.

²²³ This was because a 12% stake in the company was held by its own subsidiaries.

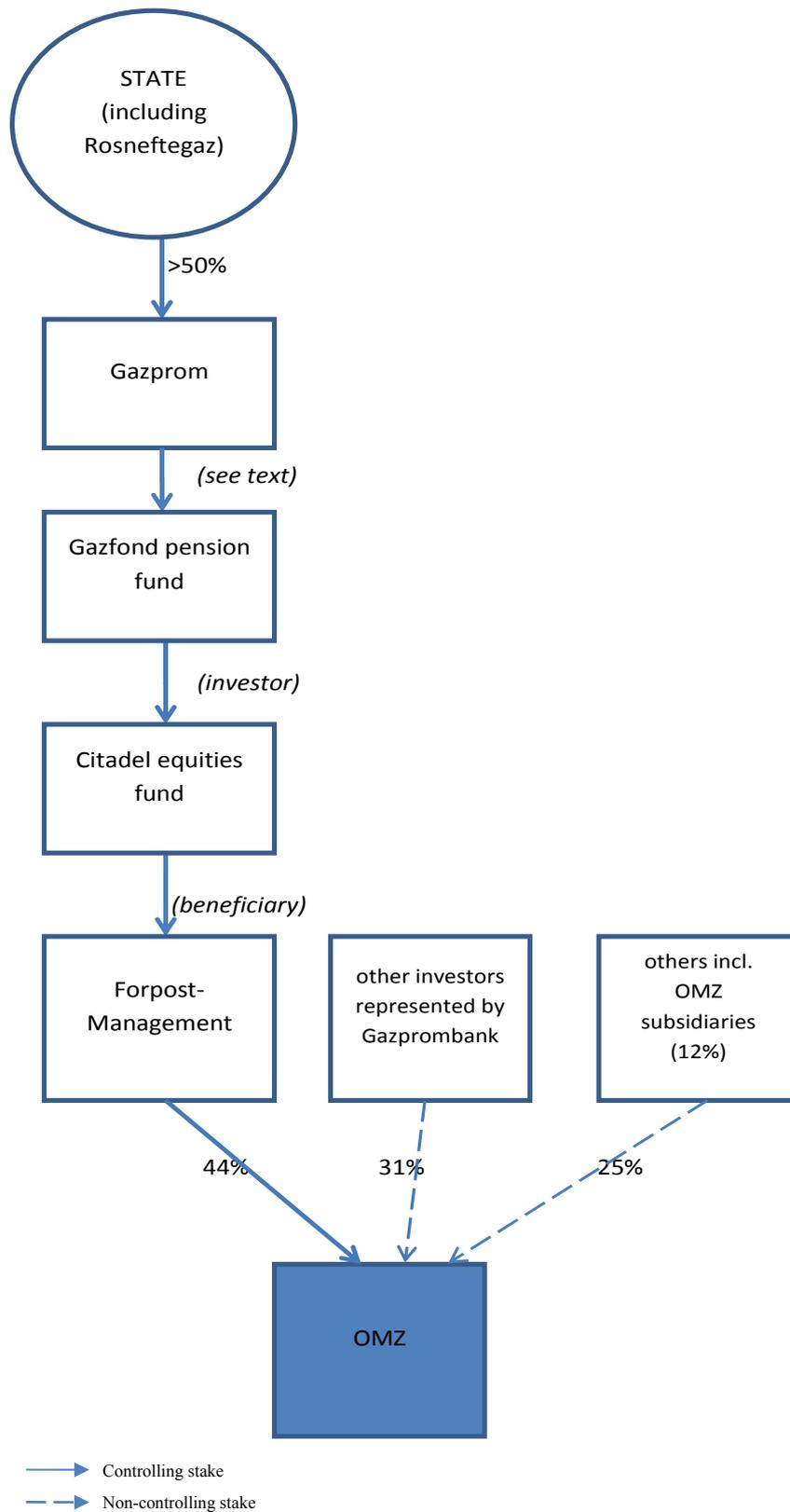


Figure 9. OMZ ownership as of December 2006

The mystery surrounding the identity of the buyers led to different theories being put forward in the media. It was suggested that they were individuals whose origins were deep inside the security services²²⁴; or that Gazprombank was indeed the buyer (despite its denials)²²⁵; or that the buyers were Gazprombank senior managers acting in an individual capacity²²⁶. It was later claimed that the purchase might have been made in the interests of the shareholders of St Petersburg-based Bank Rossiya, which (as will be discussed below) became the manager of a controlling stake in Gazprombank in 2007 (Kozyrev, 2008).

Forpost-Management's board of directors was dominated by Gazprombank senior managers²²⁷. Its Chairman from 2007 was Farid Kantserov, a deputy CEO at Gazprombank and adviser to its CEO Andrei Akimov²²⁸. Another director was Sergei Ivanov, who had joined Gazprombank in 2004 initially as an aide to Akimov, and who joined Forpost's board in 2008²²⁹. Ivanov was the son of the politician Sergei Ivanov, who was Deputy Prime Minister between 2005 and 2011, during some of which time (as will be explained in detail below) he had specific oversight of the heavy engineering and nuclear energy industries²³⁰. On the executive management side was Aleksandr Stepanov, who became an official aide to Akimov at Gazprombank in 2004, and retained this post when he also became deputy CEO at Forpost in 2006²³¹. Forpost's CEO in 2007, Vladimir Yurkov, was the former head of a subsidiary of Sibur (Malkova & Mazneva, 2007)²³².

²²⁴ e.g. Vin'kov (2006). A similar claim had been made in Yambaeva (2004) regarding Atomstroiekspor's buyers.

²²⁵ e.g. Kir'yan (2006); Mitrova & Pappé (2006, p. 83); Yegorova, Simakov & Malkova (2005).

²²⁶ e.g. Kornysheva, Yambaeva & Grib (2006); Yegorova & Malkova (2005).

²²⁷ Note that in February 2009, Gazprombank took formal ownership of Forpost-Management. If the presence of Gazprombank managers on Forpost's board had only begun after this date, it would be entirely expected. But there is documentary evidence in OMZ's disclosures that Gazprombank managers were already on Forpost's board at least as early as 2007.

²²⁸ Source: OAO "OMZ", quarterly report (Russian) for Q1 2012, pp. 98-99.

²²⁹ Source: OAO "OMZ", quarterly report (Russian) for Q3 2009, p. 100.

²³⁰ At the time of writing, Sergei Ivanov senior is (since May 2012) head of Vladimir Putin's presidential administration.

²³¹ Source: OAO "Kriogenmash", quarterly report (Russian) for Q2 2008.

²³² For Sibur's relationship to Gazprom, see Chapter 3.

Despite this evidence and the fact that OMZ's sale had been preceded by talks between Bendukidze's representatives and those of Gazprombank, the bank and its parent company Gazprom were at pains to stress that they were not affiliated with OMZ's buyers (Yegorova & Malkova, 2005).

Prior to the takeover, there was already a Gazprom-affiliated shareholder at OMZ, namely the pension fund Gazfond. It had begun buying OMZ shares on the open market at the end of 2002, and had built up a 15% stake by 2004. This was originally thought to be a short-term portfolio investment, but the opinions of investment bank analysts began to diverge on this issue as the Gazfond stake increased (Seregin, 2004).

By examining some later transactions, it is possible to establish with some confidence that Gazfond was the beneficial owner behind the OMZ takeover. The first such transaction came in April 2007, when Gazfond acquired a controlling stake in Gazprombank (Grib & Chaikina, 2006; Moiseev, Grib, Chaikina, & Gosteva, 2007). Then in April 2009, Gazprombank became the direct owner of Forpost-Management, thereby becoming OMZ's controlling beneficiary. Gazprombank was still majority-controlled by Gazfond at this time, making Gazfond the ultimate controlling owner of OMZ. Crucially, the OMZ board of directors did not change in the weeks and months following Gazprombank's purchase of Forpost²³³. As noted above, new owners will normally seek to exert control as soon as possible over their purchase, including by electing their own representatives to the board (typically at an EGM called for that purpose). That this was not done at OMZ provides a strong indication that beneficial ownership of OMZ had not changed in any significant way despite Gazprombank's purchase of OMZ's controlling shareholder. It follows that Gazfond was already Forpost's beneficial owner prior to the February 2009 transaction.

²³³ Source: OMZ's quarterly reports (in Russian) for Q4 2008, Q1 2009, Q2 2009 and Q3 2009.

Similarly, when the OMZ shares which were bought from Bendukidze and his associates were transferred from the original buying entities to the balance sheet of Forpost in 2006, it was understood that this was a purely technical transaction that made no difference to the ultimate beneficial ownership of those OMZ shares (Belikov, 2007a). This impression is reinforced by the fact that the FAS had in May 2007 established that Forpost's OMZ stake in December 2006 was 44% (scarcely above the 42% sold by Bendukidze and other OMZ senior managers in November 2005) (Malkova, 2007a). In other words, whoever had been behind the original buyers from Bendukidze in November 2005 were still the ultimate owners of the OMZ shares at the end of 2006, and were most likely still the owners in 2009 (when the sale of OMZ to a company owned by Gazfond apparently made no change to OMZ's ultimate beneficial ownership). Gazfond was, therefore, the ultimate controlling owner from November 2005 onwards. Precisely how it had structured the initial acquisition in November 2005 is not known, but it is possible to deduce that when Forpost Management took over the controlling stake in OMZ in June 2006, it was Gazfond that was the investor behind Forpost's parent entity, the Citadel equities fund.

A state or private ownership outcome? Gazfond's relationship to the state

Gazfond was a "non-state" (*negosudarstvennyi*) pension fund. This term referred not to its being ultimately owned by a private entity, but rather to the fact that it offered pension provision outside of the state pension system. In fact, Gazfond was effectively a state-controlled entity at the time of the OMZ takeover in November 2005. Founded in 1994 by Gazprom and various subsidiaries including Gazprombank, its original goal was to provide social protection for retired gas industry employees ("O fonde," 2014)²³⁴.

As a non-state pension fund, Gazfond was classed as a non-commercial organisation, which meant that by law it had no owners (only "founders" [in Russian: *uchrediteli*]) ("Minfin

²³⁴ In 2008 it became an "open" pension fund which could accept contributions from any individual or company (Mazunin, 2008).

obyazhet negosudarstvennye pensionnye fondy naiti sebe vladel'tsev," 2013; Zubova, 2013). Former deputy Energy Minister Vladimir Milov in 2004 described it as an entity that was affiliated with Gazprom without formally being part of the group (Miledin & Reznik, 2004). But Milov was mistaken: Gazfond was until 2007 still being listed by Gazprom (by this time a majority state-controlled entity) as part of the latter's group of companies, both in its financial reports to international accounting standards (IAS)²³⁵ and in its obligatory disclosures to the Russian financial regulator²³⁶.

However, Gazfond began to move away from Gazprom's control soon afterwards. Its financial resources had been under trust management by a company named ZAO Lider, which was 96%-owned by Gazfond (Rozhkov, Reznik, Baraulina, & Myazina, 2006). But in April 2006, ZAO Lider was sold to a subsidiary of the St Petersburg-based, privately-owned Bank Rossiya, whose owners were reported to be close personal friends of Vladimir Putin (Kozyrev & Sokolova, 2008). Gazfond's charter stated that the trust manager (i.e. Lider) had exclusive rights over the disposal of the assets invested in the fund: the pension fund's founders, i.e. Gazprom and its subsidiaries, had no such rights (Kozyrev & Sokolova, 2008). Thus the sale of Lider began to cast doubt on whether Gazfond's resources were really under Gazprom's (and thus the state's) control.

In fact there are indications that Bank Rossiya had already gained considerable influence over ZAO Lider by the time of the OMZ purchase. At the beginning of 2003, Bank Rossiya's CEO had said that Gazfond was one of its principal clients. Then in the middle of that year, Yury Shamalov, the son of one of Bank Rossiya's main shareholders Nikolai Shamalov, became

²³⁵ e.g. Gazprom, Financial Report 2005 (in English), p. 76. Gazfond was here listed as a wholly-owned subsidiary of Gazprom. Arguably this was an error, given that Gazfond had no legal owners. In 2007, Gazprom explained why it had to date included Gazfond as a member of the group: this had been done "primarily due to the fact that the Group management exhibited control over the financial and investment decisions of NPF Gazfund" (Gazprom, Financial Report 2007, p. 86).

²³⁶ e.g. OAO "Gazprom", List of Affiliated Entities (*Spisok affilivannykh lits*) as of 31 December 2005. Gazfond is listed as an affiliated entity of Gazprom on page 32 of this document, on the basis that it "belongs to the Gazprom group of companies".

President of Gazfond (Rozhkov et al., 2006)²³⁷. In 2004, Bank Rossiya bought from Gazprom a majority stake in the Sogaz insurance company (Miledin, Myazina, & Kudinov, 2004; Miledin, Shcherbakova, & Petrova, 2005; Miledin & Reznik, 2004). Sogaz was the entity through which Bank Rossiya gained control of ZAO Lider in April 2006.

In 2007, Gazfond became as Milov had earlier described: an entity that was *de jure* no longer part of the Gazprom group. On 1 February, the law was changed for Gazfond and other non-state pension funds, which meant that it was no longer appropriate to include them among the affiliated entities of their founders. Gazprom decided accordingly not to include Gazfond in its future consolidated accounts to IAS²³⁸.

An extremely vexed question is whether the *de jure* removal of Gazfond from the Gazprom group of companies constituted any real loss of control on Gazprom's part, and thus whether it meant Gazfond and its assets were no longer subject to any formal state control. It has been claimed that Gazfond effectively became an extension of the business empire of privately-owned Bank Rossiya, though it was acknowledged that it was a "weak link" in that empire because Bank Rossiya only owned the company which managed Gazfond's resources under contract (Milov, 2012). Gazfond reserved the right in theory to cancel its contract and appoint a new trust manager, whereupon Bank Rossiya would lose all access to Gazfond's assets including OMZ. This always looked unlikely to happen in practice, because Gazfond's President was still Yury Shamalov, the son of one of Bank Rossiya's major shareholders. However, an additional indicator that Gazprom would retain controlling influence over Gazfond was provided by the appointment of Gazprom CEO Aleksei Miller as Chairman of Gazfond in May 2007, at the same time that Gazfond's formal removal from the Gazprom group was being announced (Grivach, 2007).

²³⁷ Yury Shamalov was also Deputy Chairman of Gazprombank (source: OAO "Gazprombank", quarterly report (Russian) for Q4 2010).

²³⁸ The specific change in legislation was Government Regulation ("*Postanovlenie*") no. 63 dated 1 February 2007. See Gazprom, Financial Report 2007, p. 86.

Further indications as to whether it was Bank Rossiya or Gazprom that wielded the main controlling influence over Gazfond after 2007 are provided by how its main assets were run after that date. One of these assets was Gazprombank itself, which, as mentioned above, became majority-owned by Gazfond in April 2007. Prior to this transaction Gazprom signed an agreement with Gazprombank which allowed it to continue to have a board majority at the bank as if it were still the controlling shareholder (Moiseev et al., 2007). Similarly, Bank Rossiya was said to play no role either in the editorial policy or the business affairs of Gazprom-Media, which as a subsidiary of Gazprombank might be thought to have been under Bank Rossiya's control²³⁹. In his January 2012 pre-election article on economic strategy, Vladimir Putin called on Gazprom to end its involvement in non-core businesses, including the media (Putin, 2012). Either he was unaware that Gazprom no longer had any formal affiliation with Gazprom-Media, or he was acknowledging its continuing *de facto* control over the media business²⁴⁰.

If (as argued above) Gazfond remained a *de facto* extension of state-controlled Gazprom group after its *de jure* removal in 2007, then its continuing usefulness to the group thereafter can be explained as follows: it was now a convenient place for Gazprom to store non-core assets (including Gazprombank and OMZ) without having to include them (and, more importantly, their associated liabilities) on the consolidated balance-sheet of Gazprom itself (Frumkin, 2009).

Given the presence of Gazprombank senior managers on the board of OMZ's parent company Forpost-Management, it appears that Gazfond had delegated to Gazprombank the task of

²³⁹ Author's interview with media expert Anna Kachkaeva, Higher School of Economics, May 2012.

²⁴⁰ As a final example, when Sibur later came to be owned by Gazprombank, a source close to Sibur's board of directors said that Bank Rossiya's shareholders had never taken an interest in the business. Sibur's CEO said that he had never met Bank Rossiya's then-Chairman Yury Koval'chuk (Malkova, 2011).

managing its investment in OMZ²⁴¹. Thus, in the following section aimed at understanding the buyers' motivations behind both the Atomstroieksport and OMZ takeovers, it makes sense to treat those buyers as being essentially the same group of individuals in both cases.

Research question 1: causes of the state-led coercive takeovers

Having finally reached some conclusions regarding the identity of the buyers in the two takeovers and their connection to the state, we now turn to the first central research question, i.e. what prompted the Gazprom group to make these acquisitions and how its motivations squared with the state's interest in the takeovers.

As explained in the previous chapter, Gazprom was already under solid *de facto* state control at the time of the Atomstroieksport takeover, and had become *de jure* state-controlled by the time OMZ was sold in November 2005. But it was also a joint-stock company with a diverse base of non-state minority shareholders. Thus, like any state-controlled but 'commercialised' company, its interest in profit-maximisation was potentially at odds with its susceptibility to being used by the state for political purposes. In addition, Tompson (2008) notes that "in general, Russian state-owned companies are run for the benefit of corporate insiders and their patrons in the state administration." There are accordingly three possible explanatory factors behind Gazprom group's involvement in the takeovers: either there was some sound commercial logic behind it despite these companies being distinctly outside of Gazprom's core business, or the company was acting under political instructions, or the investment decision was dictated by the rent-seeking motivations of a group of individuals within Gazprom and their political patrons. Quite possibly, the best explanation lies in some combination of these three factors.

²⁴¹ Indeed, there was a precedent for precisely such an arrangement. In September 2004, Gazprom announced that Gazprombank had sold a 15.76% stake in Mosenergo to Gazfond (see below). Gazprom's press-secretary said that the stake would continue to be managed by Gazprombank "on the basis of agreements with the buyer [i.e. Gazfond]" (Aglamish'yan, 2004a).

Atomstroieksport: gifting control to Rosatom

Gazprombank remained as the controlling shareholder of Atomstroieksport for only a year and a half. In May 2006, it sold a 4% stake to the nuclear fuel producer TVEL, thereby bringing its own stake below controlling. TVEL was both state-owned and directly subordinate to Rosatom. It now held a 6.2% stake, and another 44% was held by another company controlled by the state via Rosatom, named Zarubezhpromstroi (Malkova, 2006).

Gazprombank had described its acquisition of Atomstroieksport as “temporary” in its quarterly report for Q4 2005²⁴². This did not prove to be strictly accurate: as will be discussed below, it stayed on as a minority shareholder after ceding control to Rosatom. But it does seem quite clear that Gazprombank had intended from the outset to hand control of Atomstroieksport to Rosatom soon after its acquisition. It later disclosed that it had paid around \$25m for its 54% stake (Malkova, 2006). The amount it received from TVEL for its 4% stake was not officially disclosed, but a high-ranking Rosatom source claimed on the eve of this sale that the bank would only receive the nominal value of the shares (Malkova & Yegorova, 2006)²⁴³. If correct, this would mean that the amount paid was just RUB 4,000 (then worth \$142)²⁴⁴. Thus it would appear that its services in handing control to Rosatom were effectively *pro bono*. In this narrow sense at least, there was no commercial logic to Gazprombank’s involvement in Atomstroieksport.

²⁴² OAO “Gazprombank”, quarterly report (Russian) for Q4 2005, p. 348. Furthermore, a Gazprombank source said in February 2006 that, when the bank had bought the company from OMZ, it had been planning from the outset to sell it on (Malkova & Yegorova, 2006).

²⁴³ Gazprombank disclosed in the second half of 2006 that it had sold 23% to “third parties” for \$11.47m (source: Gazprombank Group, Interim Consolidated Financial Statements (unaudited), six months ended 30 June 2006, p. 41). This amount does not distinguish between the amount it received from Forpost-Management for its 19.9% stake, and the amount received from TVEL for the 4% stake.

²⁴⁴ Atomstroieksport’s accounts for 2006 show that its share capital was then worth just RUB 100,000. The nominal value of a 4% stake was therefore RUB 4,000. In February 2006, \$1 was worth approximately RUB 28.2 (source: oanda.com).

In July 2006, Gazprombank disclosed that it planned to sell off its remaining 49% stake (Malkova, 2006)²⁴⁵. It later emerged that it had already begun this process, having sold a 19.9% stake in June. The buyer, which intended also to buy the remaining 30% in due course, was none other than Forpost-Management (Aliev, 2007; Malkova, 2007a). As discussed above, Forpost was effectively an affiliate of Gazprombank, and thus the bank was in essence not exiting Atomstroieksport at all, but staying on as a minority shareholder. Its longer-term rationale for its involvement in the company was tied up with its strategy for OMZ's Izhorskie Zavody, which is explained below.

OMZ: commercial rationale stemming from government strategy

When the OMZ acquisition was first announced, analysts appeared to be in agreement that it made no commercial sense. As noted earlier, the company had narrowly avoided defaulting on its debts in 2004, and entire business lines had been sold off by Bendukidze in order to optimise the planned fit with Silovye Mashiny. The speciality steels produced by Uralmashzavod and used by the nuclear industry were seen as the only interesting business line that remained (Kudryashov, 2005). There was already speculation that nuclear energy was on the verge of an international boom (Koksharov, 2005; Vin'kov, 2004), and while the merger with Silovye Mashiny was still on the cards there was optimism that the merged company would be able to capitalise on this. But after that deal was unwound, OMZ's future looked bleak. Rumours were circulating that Atomstroieksport and OMZ might be included in a new "mega-corporation" under Rosatom (Nikol'skii & Yegorova, 2005), but a source inside Russia's engineering industry dismissed the prospect of OMZ profiting from such a plan, noting that "it's a doomed idea. The nuclear reactor produced by Izhorskie Zavody is obsolete, and the new model only exists on paper. And no-one needs our [i.e. Russia's] nuclear engineering" (Yambaeva et al., 2005).

²⁴⁵ The disclosure came in Gazprombank Group's Independent Auditors' Report and Consolidated Financial Statements, Year Ended 31 December 2005, p. 32.

These analysts were clearly not aware of plans that were about to be announced that would change the potential profitability of OMZ's nuclear engineering business (i.e. of Izhorskie Zavody). As mentioned earlier, just two months after the takeover of OMZ, in February 2006, Rosatom head Sergei Kirienko announced the dramatic scaling up of plans to increase Russia's nuclear energy generation capacity, in which Izhorskie Zavody was set to play a key role as the only available supplier of equipment for the new nuclear reactors. Around one quarter of spending on a new generating unit goes on the reactor shell, and it was estimated in 2006 that Izhorskie Zavody could be guaranteed state orders of up to USD 15bn over the next 25 years (Borisov, 2006). The FTP also emphasized the need to promote Russian construction of nuclear power stations abroad, which (if successful) would both add further to Izhorskie Zavody's order book and provide revenue for Atomstroieksport. It seems plausible that OMZ's buyers were party to information that had not yet reached the public domain regarding the government's nuclear expansion plans, and thus saw tremendous potential for profit.

There were additional reasons why the OMZ investment was of interest to Gazprom group specifically, despite its being a long way from Gazprom's core business. The nuclear expansion plan promised to free up gas exports by reducing the dependence on gas-fired power stations. At the time, the export price was substantially higher than Gazprom could sell its gas for domestically (Henderson, 2011)²⁴⁶. According to figures provided to one newspaper by a former deputy minister at Minatom, each new nuclear generating unit built would free up for export by Gazprom an additional 3.2bcm of gas per year which would otherwise have to be sold to domestic gas-fired power stations. At 2006 prices, this meant it would receive \$800m in revenue instead of \$128m (Derbilova, Nikol'skii, & Yegorova, 2006)²⁴⁷.

²⁴⁶ As Henderson shows, this situation had changed by 2011, because increases in Gazprom's regulated domestic gas price meant it was now possible to sell gas to domestic industry profitably for the first time.

²⁴⁷ The former deputy minister claimed that freeing up gas for exports would also yield a \$336m increase in annual budget revenues (Derbilova, Nikol'skii, & Yegorova, 2006).

This was a compelling argument, which the government reportedly used to persuade Gazprom that it ought to become involved in financing the nuclear expansion. But the argument had one flaw: as long as the planned nuclear expansion happened, Gazprom would enjoy the predicted financial benefit even if it decided to remain as a ‘free-rider’. That Gazprom was nevertheless interested in becoming involved stemmed from the decision by its senior management, first revealed to the world by CEO Aleksei Miller in April 2004, that the company should become a fully diversified energy conglomerate similar to international giants such as E.ON (Aglamish’yan, 2004b; Ostrovsky & Jack, 2004). This was justified in terms of shielding the company from the risks of cyclical world gas prices, but also as a way to profit from electricity sector reforms that promised substantial increases in regulated prices for consumers in the coming years.

Accordingly, just one week after Kirienko’s announcement regarding the nuclear expansion (and even as they were denying any involvement in the OMZ acquisition), Gazprom’s managers discussed with the Kremlin how they might be involved in the construction of the new nuclear generating capacity. A plan was being considered at this time to offer Gazprom ownership of the newly-built nuclear power stations if it agreed to finance their construction (Derbilova et al., 2006). This would have required a change in the law, which stipulated that all nuclear power stations must be directly owned by the state. In July 2006, Kirienko signalled that the idea had been dropped, by announcing that the construction of new nuclear generating units would be financed directly from the budget instead. At the same time, however, he said that *no* budget money would be used to finance the required modernisation of Russia’s nuclear engineering capacities (Pushkarskaya & Kornysheva, 2006). This included upgrading the “obsolete” nuclear reactor model at OMZ’s Izhorskies Zavody, and left the door open for Gazprom group to provide the necessary financing.

Implementing government strategy, or holding it to ransom?

Around the time of Kirienko's February 2006 announcement, OMZ's buyers were saying publicly that their actions at the company would be coordinated with Rosatom (Kudryashov, 2006a). The company's quarterly reports explicitly linked its own strategy to government economic programmes including the long-term strategy for Rosatom, Russia's energy strategy through to 2030, and the timetable for nuclear energy expansion. They also stated that its strategy would "help to strengthen the technological sovereignty of the Russian Federation in the realm of energy- and heavy engineering"²⁴⁸.

However, a source close to OMZ's new shareholders, who was quoted in the press in February 2006, painted a different picture of their motivations: "the construction of new nuclear power stations is an attractive field for which a battle is now underway. And OMZ's majority owners have in their possession a heavy club [*tyazhelyoi dubinoi*] – their monopoly over reactor production. And they are now putting this club into action" (Kornysheva, Yambaeva, & Grib, 2006).

These two contrasting interpretations of the buyers' plans for OMZ, and how they fit with government strategy, go to the heart of a deeper question. Treisman (2007) has suggested that since 2000, Russia's "oligarchy" has given way to a new "silovarchy": a defining characteristic of Putin's regime being the takeover of corporate boardrooms by "a new business elite drawn mostly from the network of security service and law enforcement veterans known as the siloviki". Treisman claims (2007, p. 144) that Gazprom "clearly belongs in the silovarch empire". This is based on the less than compelling evidence that three out of 17 members of Gazprom's management committee are from the security services and another an FSB reservist. But there is better evidence available to link OMZ's buyers to the "silovarch empire". Official disclosures by OMZ-owned companies show that Forpost-Management's Chairman since 2007, the Gazprombank deputy CEO Farid Kantserov,

²⁴⁸ e.g. OAO "OMZ", quarterly report (Russian) for Q3 2010, p. 39.

graduated from the KGB Higher School with the rank of “officer with a higher vocational training”²⁴⁹. Media reports indicate that his KGB ties went further: he was the “former head of military counterintelligence in the Republic of Belarus” and a career officer of the Soviet KGB (“Dmitry Medvedev nagradil Farida Kantserova,” 2010; Kozyrev, 2008)²⁵⁰. Kantserov’s superior at Gazprombank, CEO Andrei Akimov, was rumoured to hold the rank of general of the active reserve in one of the KGB’s successor organisations (Birman, 2005). Deputy Prime Minister Sergei Ivanov, whose son was also on the Forpost-Management board of directors, made no secret of his past in the KGB and in Russia’s Foreign Intelligence Service (Parfitt, 2013).

Treisman (2007, p. 145) suggests that the “silovarchs” “would indignantly reject comparisons to the oligarchs they are displacing”. They “see their mission as precisely to fix the problems the oligarchs created”, but “the image of the siloviki as selfless crusaders for order, rooting out corruption, is getting harder to sell to the Russian public”. The consensus, though, appears to be that there is little or no substance to their patriotic rhetoric. Hanson (2007b, p. 33) suggests that “different groups in the leadership may be using rhetoric about ‘sovereignty’, ‘security’ and ‘strategic assets’ to secure their political positions, their personal wealth or both”. Murtazaev (2006) claims that such rhetoric only comes into play once powerful people have taken a “mercenary” interest in acquiring an asset. They are required to pay lip-service to concepts such as sovereignty and security so that the Kremlin will turn a blind eye to their predatory acquisitions.

At first glance, subsequent events at OMZ would favour the view that the buyers’ patriotic rhetoric was merely a fig-leaf for self-interest. As will be explained below, OMZ failed to cooperate effectively with Rosatom. And given Izhorskie Zavody’s monopoly on reactor

²⁴⁹ OAO “Uralmashzavod” Ezhekvartal’nyi otchet za 2 kv. 2010 g., p. 62.

²⁵⁰ According to the same media sources, Kantserov was “one of the first high-ranking KGB generals to decide not to serve the current Belarusian authorities. After retiring from all posts in Minsk he moved to Moscow and began working in the gas industry”. Soon afterwards he was made an advisor to Gazprombank’s CEO Andrei Akimov, and deputy CEO of the bank.

production, this threatened to undermine the entire government programme for the nuclear industry. But the notion that the buyers were effectively holding government strategy to ransom (using the “heavy club” of Izhorskie Zavody’s monopoly on reactor production) is at odds with the fact that they effectively gifted control of Atomstroiekспорт back to Rosatom. In fact, the evidence shows that the buyers had a single plan for Atomstroiekспорт and Izhorskie Zavody that relied on successful cooperation with Rosatom.

On 8 February 2006, Rosatom’s head Sergei Kirienko announced that Rosatom planned to create a state-controlled holding company that was subordinate to the agency. It would bring together the whole chain of production of civilian nuclear energy production, from uranium production to dealing with nuclear waste, and including nuclear heavy engineering. The holding company would include some firms that were currently privately-owned. Precisely how this would work had not yet been clarified, but it was suggested that the private companies might only be *managed* by the state-owned holding, rather than being nationalised (Kornysheva et al., 2006). Gazprombank had announced the day before that it was representing the unspecified buyers of OMZ, and at the same time noted that Rosatom’s reforms of the nuclear energy industry were “likely to affect the structure of OMZ and its nuclear equipment division” (Ermakova, 2006)²⁵¹. This signalled that OMZ’s buyers were both aware of, and on board with, Rosatom’s plans; furthermore, it hinted that OMZ was prepared to hand over Izhorskie Zavody to Rosatom’s control. In March, Rosatom’s press officer confirmed the agency’s interest in obtaining “guarantees of management and control” over Izhorskie Zavody’s reactor production, adding that without these, the fulfilment of the nuclear expansion plan would be impossible (Malkova & Simakov, 2006).

In July 2006, Kirienko announced that Rosatom and Gazprombank had signed a framework agreement on strategic cooperation, and a separate agreement on placing Izhorskie Zavody

²⁵¹ The press-release, dated 7 February 2006, was available via Google’s cached version of <http://www.omz.ru>, accessed 4 February 2014.

under the management of a joint venture that would be 51%-owned by Rosatom, and 49% by Gazprombank (Pushkarskaya & Kornysheva, 2006). Two days later, Rosatom issued a press-release stating that the new joint venture would be the owner (rather than merely the manager) of Izhorskie Zavody, and that the deal was expected to be closed by the end of the year (Gritskova & Kornysheva, 2006).

By August 2006 it was clear that OMZ's owners were searching for a very similar arrangement for the company's other key asset, Uralmashzavod. Talks were underway with the privately-owned metals company Metalloinvest, whose main owner was the business tycoon Alisher Usmanov (Malkova, Fedorinova, Rozhkova, & Yegorova, 2006). This came to fruition in February 2007 with the creation of a 50-50 joint venture called ZAO MK Uralmash, with management control given to Metalloinvest. MK Uralmash became parent company to Uralmashzavod as well as to the Yuzhuralmashzavod enterprise located in Orsk (Orenburg region), which was Metalloinvest's contribution to the joint venture (Lander, 2007). Thus OMZ's buyers appear to have been aware that they did not have the professional knowledge and experience necessary to manage OMZ's key enterprises by themselves. A source told one newspaper that "Gazprombank's representatives [at OMZ] are not industrialists, and they have a weak conception of what to do with industrial assets" (Kudryashov, 2006b)²⁵².

Unlike the joint venture for Uralmashzavod, the Izhorskie Zavody tie-up ultimately failed to come to pass, for reasons that will be examined below. However, towards the end of 2007

²⁵² Indeed, there are indications that OMZ's buyers initially had no other strategy for the company beyond the plan for the two joint ventures. Sergei Lipsky, whom they had inherited as OMZ's CEO, quit in October 2006 apparently in response to a lack of direction from Forpost Management (Kudryashov, 2006b). As one press article put it, "If earlier there was one person who took the strategic decisions at OMZ [i.e. Bendukidze], now they have to be made collectively – no-one wants to take personal responsibility for the development of OMZ." At the June shareholder's meeting at which the new owners had finally installed a new set of directors, "the new shareholders did not reveal their development strategy for OMZ. The company recommends asking the shareholders" (Vin'kov, 2006). After the new owners' arrival "the lives of the managers, who were used to relative independence under Bendukidze, became seriously more complicated. To decide any question required multiple approvals. And what was worse, sometimes it was completely impossible to obtain any kind of answer" (Kozyrev, 2008).

both sides were still working to achieve it. Kirienko and Atomstroieksport CEO Sergei Shmatko visited Izhorskie Zavody on 26 November, accompanied by First Deputy Prime Minister Sergei Ivanov and St Petersburg governor Valentina Matvienko. After some disagreements between Rosatom and Gazprombank, the two sides were now planning to make Atomstroieksport (which was still 51%-owned by Rosatom) the parent company of Izhorskie Zavody, and Ivanov's presence at this visit to the factory signalled the government's support for this plan (N. Stepanova, 2007). Atomstroieksport would issue new shares worth RUB 12bn (then worth approximately \$460m) to raise finance for an investment programme. Its existing shareholders would buy all the new shares, leaving the ownership structure unchanged. Rosatom would provide its share of the \$460m investment in cash, while Forpost Management's contribution would be in the form of shares in Izhorskie Zavody (Malkova, 2007b).

OMZ's buyers repeatedly replaced its chief executive in the years after the takeover, and in each case the need to improve relations with Rosatom was a significant factor. This provides further evidence that they were not seeking to hold the government programme to ransom. Sergei Lipsky, whom OMZ's buyers inherited from Bendukidze as company CEO, resigned in October 2006, and it was claimed that the new owners felt the company should be headed by someone with sufficiently good contacts to facilitate winning government orders²⁵³. This theme continued as OMZ underwent two more changes of chief executive within a short space of time: Lipsky's permanent replacement Valery Chernyshev, who was appointed in June 2007, was dismissed eight months later over tensions with Rosatom. His replacement, Viktor Danilenko, was seen as someone who could improve the relationship (Belikov, 2008a).

The above provides convincing evidence that OMZ's owners had in mind a cooperative relationship with Rosatom, rather than seizing Izhorskie Zavody's monopoly status as a way to hold Rosatom hostage. If Gazprombank was uncertain of its own abilities to manage

²⁵³ Board member Sergei Skatershchikov cited in Yambaeva et al. (2006).

industrial assets under its ownership, this begs the question as to why it had believed the acquisition made commercial sense. As one might expect from a bank, Gazprombank saw its primary role as provider of long-term finance for OMZ. In July 2006, it said that it would be responsible for providing the credit for Rosatom's wider plans to bring a range of nuclear industry enterprises under its ownership over the next three years (Yegorova, Medvedeva, & Nikol'skii, 2006). It was rumoured in November 2007 to be prepared to invest \$1bn in modernisation at Izhorskie Zavody (N. Stepanova, 2007). In this light, Gazprom group's equity investment in OMZ can be viewed as secondary to its relationship as lender, and as having been aimed primarily at providing additional guarantees for those loans.

Gazprombank's credit life-line

The history of Gazprombank's lending to the OMZ companies provides compelling evidence that Gazprom group was committed to developing OMZ over the long term, even after doubts arose regarding its viability as a going concern. This decision made little sense from a purely commercial perspective and provides further convincing evidence that the altruistic, patriotic rhetoric of the 'silovarchs' at the bank was not in this case a mere smokescreen for venal self-interest.

OMZ's quarterly report for the third quarter of 2010 shows that it had been borrowing in recent years from Gazprombank, with loans totalling RUB 4.8bn (\$150m) at the time. The company described itself as highly leveraged, and its financial position as "unstable"²⁵⁴. Eighteen months later, the company was using more measured language to describe its plight. However, the company's negative net working capital²⁵⁵ (amounting to RUB 1.17bn, or approximately \$37m) was still noted. The company still owed RUB 4.06bn (\$127m) in short-term debt, with just RUB 89m (\$2.8m) in long-term debt²⁵⁶.

²⁵⁴ OAO "OMZ", quarterly report (Russian) for Q3 2010, p. 65.

²⁵⁵ A measure of operating liquidity determined as current assets minus current liabilities.

²⁵⁶ OAO "OMZ", quarterly report (Russian) for Q1 2012, p. 76.

The credit rating agency Standard and Poor's (S&P) in 2009 gave OMZ a credit rating of B- (stable). Granted, this was an increase on its previous rating, but S&P cited among other factors behind this increase "the apparent willingness of Gazprombank OJSC, the group's major shareholder, to provide financial support"²⁵⁷. The rating was the same in April 2012, when S&P described the company's liquidity position as "less than adequate" (one step up from "weak") because of its reliance on "short-term credit lines that they have historically renewed on a routine basis" (Standard and Poor's, 2012, p. 9). The implication was that Gazprombank as controlling shareholder and main creditor would continue to provide the necessary support for OMZ, rather than pulling the plug on its credit lines. However, later in the year S&P suspended its OMZ rating due to inadequate information from the company, and soon afterwards withdrew the rating altogether at the company's request ("S&P drops OMZ suspended ratings at issuer's request," 2012). This suggested that OMZ had for the time being abandoned any thought of tapping international credit markets, reinforcing its dependence on Gazprombank's continued support for its survival as a going concern.

The lion's share of Gazprombank's lending was to OMZ's subsidiary Izhorskie Zavody rather than the main company OAO "OMZ", because the subsidiary had physical assets that could be pledged as collateral. Izhorskie Zavody borrowed from a relatively diverse base, including state banks Sberbank and VTB. As of 2010, Izhorskie Zavody had borrowed from Gazprombank \$175m out of total borrowing of \$467m; \$135m was still outstanding to Gazprombank, out of total outstanding debt of \$332m²⁵⁸.

OMZ's 2011 consolidated financial statements (which show figures for the group as a whole, not just for OAO "OMZ") in fact show relatively modest debt, with short-term loans totalling \$142.4m and long-term debt of \$95.8m. But this reduction had not been achieved by improving performance. In August-September 2010, OMZ sold stakes in Izhorskie Zavody

²⁵⁷ <http://www.omz.ru/eng/investors/ratings/>

²⁵⁸ Source: OAO "Izhorskie Zavody", quarterly report (Russian) for Q4 2010, pp. 11-15.

and the specialist steels division OMZ Spetsstal' to Forpost-Management for \$152.6m²⁵⁹. This deal improved the balance sheet of OMZ, but was effectively a debt-for-equity swap that saw Gazprombank (through its subsidiary Forpost) take equity in OMZ's subsidiaries, in addition to its controlling stake in the parent company.

The fact that OMZ's working capital was exceeded by its short-term loans, as noted above, suggests that some of Gazprombank's lending was simply keeping the company afloat. However, Gazprombank was also making the kinds of investments envisaged by Kirienko aimed at modernising OMZ's engineering capacities. At Izhorskie Zavody, the main focus was an arc steel smelting furnace which was launched in early 2009 and was financed by Gazprombank to the tune of RUB 5bn (approximately \$160m) ("Kto investiruet, tot i vyigryvaet," 2009).

Why not Rosatom?

If the buyers in the two state-led coercive takeovers were acting as channels for government policy, rather than as opportunists seeking to exploit government strategy for their own advantage, then this raises the question as to why Atomstroieksport and OMZ were not instead taken over by companies subordinate to Rosatom, the government body charged with supervision of the nuclear industry.

One source at a state-owned company was quoted as saying that Rosatom's companies had been deterred from buying Atomstroieksport by its debts of \$200m (Yambaeva, 2004). They could in principle have approached a bank to borrow the money required to buy Atomstroieksport and service its debt, and if there was sufficient political will, then presumably one of the state-owned banks would have obliged. However, in what was a time-sensitive situation owing to the need to bring the company back under state control as soon as

²⁵⁹ Source: OMZ, "International Financial Reporting Standards Consolidated Financial Statements and Independent Auditors' Report", 31 December 2011, p. 52.

possible, Gazprombank (as a bank itself) was in a better position to quickly raise the funds necessary to make the purchase.

Nevertheless, a source inside Rosatom claimed that it had proposed several options that would have seen control of Atomstroieksport transferred to one of its own companies. None of these had received approval from the highest levels of government, suggesting that it was ultimately a high-level political decision that saw Gazprombank rather than Rosatom take ownership of Atomstroieksport²⁶⁰. The talks leading up to that takeover were reportedly conducted by Rosatom deputy head Boris Yurlov, who had joined the agency in March 2004 after a year spent working as a Deputy CEO of Gazprom. Prior to his work at Gazprom he had worked for two years as deputy (and later first deputy) head of the Department of Presidential Affairs (*Upravdelami*)²⁶¹ in Putin's presidential administration (Yambaeva, 2004).

Yurlov was reportedly an active lobbyist for Gazprom's interests within Rosatom (Yambaeva, 2004) and a "competitor" to the agency's existing head Aleksandr Rumyantsev (Andrianov, 2008). Sources close to Rosatom claimed that he had "prepared the ground for [Gazprom] to gain control of the industrial enterprises [...] that were subordinate to [Rosatom]. He began with Atomstroieksport" (Yambaeva, 2004)²⁶². The implication here is that Rosatom was being undermined from within by a 'mole' working for an acquisitive Gazprom. But the fact that Gazprombank subsequently handed Atomstroieksport over to Rosatom, and apparently gained nothing from its involvement, does not fit easily with this interpretation. An alternative explanation is that Yurlov's appointment to Rosatom was symptomatic of the political decision to bring Gazprom in as a partner for Rosatom's future plans.

²⁶⁰ A source in Rosatom described the purchase of Atomstroieksport by Gazprombank as "an allocation from above" [*raznaryadkoi sverkhui*], adding that Gazprom was not the best outcome but was still "more acceptable than Bendukidze. He had a very bad reputation in the industry" (Yambaeva, 2004).

²⁶¹ This division of the Presidential Administration is charged with managing its physical assets, financial affairs and business interests.

²⁶² Yurlov died suddenly in September 2004, weeks before the Atomstroieksport takeover (Yambaeva, 2004).

By contrast to the earlier Atomstroieksport takeover, no Rosatom companies showed any serious interest in OMZ. As noted earlier, Gazprombank issued a press release in February 2006 making clear that OMZ's buyers were coordinating their activities with Rosatom, and that the reform process in the sector was likely to have an impact on OMZ's structure. Since this came so soon after the November 2005 takeover, Rosatom's lack of interest in purchasing OMZ was most likely because it already had agreement in principle that Gazprombank would split OMZ and place Izhorskie Zavody into some kind of joint venture with Rosatom.

Why did the tie-up with Rosatom fail?

Although the notion has been discounted above that OMZ's buyers were holding the government programme to ransom, it remains puzzling why they failed to reach agreement with Rosatom, given the importance of such agreement to the government's plans for the nuclear industry.

According to one account, the failure of the joint venture plan was down to self-interested rivalry between two political factions: the new owners of OMZ and their political backers on the one hand, and the bureaucrats of Rosatom on the other ("Kto investiruet, tot i vyigryvaet," 2009). These two factions were depicted as competitors for the budget money that would be spent on the nuclear expansion programme. But it was shown above that OMZ's buyers apparently sincerely sought a cooperative relationship with Rosatom, and aimed to play a constructive part in realising government strategy. This section aims to explain the failure of this cooperation, given that both sides were apparently working towards it rather than simply fighting over budget money. It also seeks to understand the government's failure to intervene successfully to resolve the dispute between the two sides, despite the threat it posed to government strategy.

OMZ and Rosatom were mutually dependent when it came to the provision of nuclear reactors. OMZ had no other buyers for its reactors besides Rosatom and Atomstroieksport.

Rosatom was dependent on Izhorskie Zavody for reactor equipment because it was not prepared to source that equipment abroad and Izhorskie Zavody was the only Russian factory capable of producing them. This is the “lock-in” situation which, as Williamson (1981) explains, arises from high asset-specificity, i.e. when investments have been made that are “specialized to a particular transaction”. In the present case, the high level of technical specialisation (i.e. *physical* asset-specificity) involved in the production of nuclear reactors means that there are always likely to be very few (if any) alternative buyers and suppliers. Williamson predicts that under such circumstances, “buyer and seller will make special efforts to design an exchange that has good continuity prospects”. In line with this prediction, Rosatom and OMZ negotiated in apparent good faith between 2006 and 2008 in the hope of settling on the terms of a joint venture.

Williamson only predicts that both sides will be interested in resolving the problem, either by bringing future transactions ‘within the firm’ (so that both sides in the transaction are under common ownership) or through some partial move towards this “such as franchising, joint ventures, etc.”. However, his reasoning also suggests that the two sides might face problems in agreeing on a resolution to the problem: the same transaction costs that would be reduced by integration may also create obstacles to an agreement on such integration. The “lock-in” is problematic for both sides because, in the absence of alternative buyers and sellers, the market mechanism no longer provides any meaningful price signals. There is no independent guidance for either side in the transaction on what might be a ‘fair’ price for the product being transacted. Both sides are inevitably motivated to a significant extent by their own institutional profit-maximising self-interest. They are also operating within ‘bounded rationality’, i.e. as well as the uncertainty over price, they do not fully know or understand the motivations of the other side. This complicates reaching an agreement on the price of the product being transacted. But that price in turn affects the terms of a joint venture deal that in this case both sides saw as the resolution of the problem. Izhorskie Zavody’s value for the

purposes of the joint venture was dependent on the price it could expect to receive for its reactor equipment.

The FTP had laid out Rosatom's expectations for the prices of its equipment purchases, but Kirill Komarov, CEO of Rosatom's company Atomenergoprom, claimed that Izhorskie Zavody was in 2007 demanding double the expected prices for its equipment. He argued that Rosatom was left with no choice but to search for an alternative supplier. OMZ countered that it had proposed a bilateral or trilateral commission to formulate a "market-based price", and had received no response from Rosatom. It also claimed that it could offer lower prices if Rosatom were in exchange prepared to offer a guaranteed stream of orders (Vin'kov, 2010).

The disagreements over price meant that Izhorskie Zavody was effectively idle for most of 2006 and into early 2007 (Kuzin, 2007). It was reported in August 2007 that Rosatom had suspended its contract with Izhorskie Zavody for two reactor shells for the Novovoronezh nuclear power station (Belikov, 2007b). This was the only order it had received from Rosatom since the approval of the FTP in 2006. By the end of May 2008, there were still no confirmed orders from Rosatom²⁶³. Gazprombank had decided to go out on a limb and provide interim financing for construction of the Novovoronezh reactors while it waited for Rosatom to unfreeze the contract (Belikov, 2008b). The contract *was* eventually unfrozen, and a similar order was received from Rosatom for two reactors for the Leningrad-2 nuclear power station, helping Izhorskie Zavody to post a profit of RUB 144m (then worth \$4.6m) in the first half of 2009 (Bychina, 2009). But Rosatom had proceeded with this purchase with great reluctance, and continued to search for a way to break its dependence on Izhorskie Zavody.

Meanwhile, signs had emerged as early as January 2008 that the planned joint venture agreement was in danger. OMZ held an EGM where two Rosatom representatives were running for seats on the board, so that the two sides could better coordinate implementation of

²⁶³ Meanwhile, Rosatom was pressing ahead with other aspects of the programme, having reached agreement to buy turbines and generators worth \$1.7bn from Silovye Mashiny.

the joint venture. But neither of Rosatom's representatives was voted on to the board. Gazprombank was now saying that it would subscribe to the new share issue at Atomstroiekспорт in cash, rather than handing over Izhorskie Zavody. A source close to the OMZ board commented that the two sides were in disagreement over the value of OMZ's assets (Sikamova, 2008). When Atomstroiekспорт's new share issue finally took place at the beginning of 2009, Gazprombank declined to participate. Izhorskie Zavody thus remained in OMZ's ownership, and Gazprombank's stake (now held via Forpost Management) was diluted to 10.7% ("Gazprombank ostalsya s Izhoroi, a Rosatom - s Atomstroiekспортom," 2009; Godlevskaya, 2009). This marked the collapse of the joint venture plan and signalled a wider breakdown in relations between OMZ's owners and Rosatom.

In April 2009, Rosatom announced that it was embarking on a project to bring reactor construction 'within the firm'. It intended to purchase the Soviet-era Atommash enterprise in Volgodonsk, which had been capable of building nuclear reactors until being re-profiled in the 1990s for different types of production. At the beginning of 2010 it opted instead to buy the Petrozavodskmash plant, which had previously been used to make heavy machinery for the paper industry, and which Rosatom set about converting to the production of nuclear reactor equipment (Belikov, 2011; Vin'kov, 2010).

Rosatom's plans were at odds with the signals coming from the top political leadership. A visit by Putin to Izhorskie Zavody's main plant in Kolpino (Leningradskaya region) in June 2009 suggested that the political leadership had ruled in favour of OMZ. Putin was there to inspect the results of Gazprombank's substantial investments in modernisation at the plant, which would enable Izhorskie Zavody to produce higher-spec reactors, as well as helping to increase from two to four the number of reactor equipment sets it could produce annually ("Putin osmotrel proizvodstvennye moshchnosti 'Izhorskikh zavodov,'" 2009). According to one account, the financial crisis, and the consequent scaling down of the nuclear expansion programme, had been instrumental in Putin's choice, as upgrading Izhorskie Zavody's

existing facilities was more cost-effective than Rosatom's alternative plans ("Kto investiruet, tot i vyigryvaet," 2009).

Nevertheless, Rosatom continued its efforts to develop its own production. In late November 2010 it placed an order for a reactor unit for the Baltic nuclear power station in Kaliningrad not from Izhorskie Zavody but from Petrozavodskmash. Rosatom had used retained earnings to make \$40m of investments so far (out of a planned total of \$80m) in re-profiling the plant (Kudiyarov, 2011; Vin'kov, 2010). Petrozavodskmash was described in 2012 as pressing ahead with what was now described as a \$155m investment programme which would allow it to deliver its first finished nuclear reactor in 2014 (Prokhorov, 2012).

The failure of the two sides to cooperate was also a failure on the part of the government, which was interested in seeing the nuclear expansion strategy successfully realised. The government's failure can be attributed to a lack of coordination between those state institutions and actors who were tasked with overseeing the operations of Rosatom and OMZ. When the federal agency Rosatom had taken over responsibility for the nuclear sector from Minatom in March 2004, it was initially made subordinate to the Ministry for Industry and Energy (then headed by Viktor Khristenko), which also had responsibility for heavy engineering. However, just a few months later Rosatom was instead made directly subordinate to the office of new Prime Minister Mikhail Fradkov (*Ukaz Prezidenta Rossiiskoi Federatsii ot 20 maya 2004 g. N 649 Voprosy struktury federal'nykh organov ispol'nitel'noi vlasti*, 2004). Khristenko's responsibility for the energy sector meant that he naturally retained an interest in (but no formal supervision over) nuclear energy production (Andrianov, 2008).

The intention had reportedly been to divide the civilian and military aspects of the nuclear industry, giving the civilian operations to Khristenko's Ministry and the military side to the Defence Ministry ("Minatom RF preobrazuyut v federal'noe agentstvo," 2004). The decision instead to leave it directly subordinate to the Prime Minister may have been linked to a

realisation that implementing such a split was going to be a major task in itself. When Kirienko was appointed as Rosatom's new head in November 2005 (coinciding with the OMZ takeover), it was with President Vladimir Putin's public blessing. Putin stated that Kirienko's role was to solve organisational problems in the nuclear energy sector, and a former Atomic Energy Minister (who claimed to have spoken to Kirienko) stated that what Putin had in mind was splitting the civilian and military sides of the industry (Nicol'skii & Yegorova, 2005).

In the same month, Sergei Ivanov was made Deputy Prime Minister in addition to his existing role as Defence Minister. He was given responsibility for overseeing the military-industrial complex, a role which entailed some supervision of the military aspects of Rosatom's activities (Nicol'skii, Mazneva, & Petrachkova, 2005). In February 2007, Ivanov was promoted to First Deputy Prime Minister and given additional responsibilities for civilian industry, including both nuclear energy and heavy engineering (Grozovsky, 2007)²⁶⁴. In May 2008, Ivanov was demoted back to Deputy Prime Minister, but although oversight of civilian industry (including heavy engineering) was transferred to Deputy Prime Minister Igor' Sechin, Ivanov retained his oversight of the nuclear energy sector (Nikolaeva, Sterkin, & Kaz'min, 2008).

In December 2007 the Rosatom federal agency was transformed into a state corporation²⁶⁵ with the same name, which continued to be headed by Kirienko. The laws underlying the creation of Rosatom and other state corporations stated that the chief executive reported to a Supervisory Council, whose Chairman was appointed by the Russian President (Volkov, 2008b, pp. 10–11). It might have made sense to appoint Ivanov to this position at Rosatom, given his role as overseer of the nuclear industry. But instead, the Chairmanship was given to

²⁶⁴ Ivanov said in an April 2007 interview: "My main task is the real sector of the economy minus energy. I don't get involved in energy apart from the nuclear sector, because the nuclear industry is a scientific sector [...] I have been given the brief of looking after everything connected with innovation and diversification of sectors of the economy" (Buckley & Belton, 2007).

²⁶⁵ The state corporation was a specific legal form of Russian company, with a special law passed by the President for the creation of each corporation. In each case, the assets contributed by the state to the corporation became the property of the corporation itself. See Volkov (2008b).

another political heavyweight, Sergei Sobyenin, who had been head of Putin's Presidential Administration since 2005. After Medvedev became Russia's President in March 2008 and Putin became Prime Minister, Sobyenin was made Deputy Prime Minister ("Sobyenin, Sergei: mer Moskvyy," n.d.). Medvedev re-appointed him as Chairman of Rosatom's Supervisory Council in July 2008 ("D. Medvedev naznachil chlenami Nablyudatel'nogo soveta Rosatoma A. Dvorkovicha i Yu. Yakovleva," 2008).

Thus for most of the period when OMZ and Rosatom were holding talks on the creation of a joint-venture, the lines of reporting from the two sides in the talks to their political overseers were both complicated and shifting. Writing towards the end of the Yeltsin era, Huskey (1999, pp. 98–124) examined in detail the conflicting loyalties that arise when governmental institutions in Russia have overlapping responsibilities for particular sectors or policy areas. For a few months in 2007, Ivanov had authority over both sides in the negotiations. This was at a time when he was being groomed by Putin as a possible successor. It is quite possible that Ivanov had a particular loyalty to Gazprombank in its bargaining with Rosatom, not least because his son (also named Sergei Ivanov) was one of a handful of senior Gazprombank managers who were in charge of strategic management at OMZ. Under these circumstances, Kirienko did not have sufficient authority to impose conditions on Gazprombank. Since Ivanov had numerous other responsibilities and apparently had his sights set on the presidency, it may be that his interest in the outcome of the talks between Rosatom and OMZ did not extend beyond supporting the bargaining position of the latter at this time. After December 2007, the arrival of Sobyenin at Rosatom must have substantially weakened Ivanov's personal authority.

Research question 2: explaining the ownership outcomes

Turning now to the ownership outcomes of the SLCTs, it is possible to state that Atomstroieksport was brought back to “state ownership” through its controlling interest in Gazprombank, the new controlling shareholder. State control was also established over OMZ, albeit more tentatively via a pension fund which by definition had no owners. In both cases, Gazprom group (loosely defined) can be said to have been the buyer. The reasons for its interest in these acquisitions, and for the state’s own interest in seeing Gazprom group as the buyers, have been explained above.

Following on from the previous chapter, one question that arises is why Gazprom group was now selecting Gazprombank to make its purchases (albeit via Gazfond in the case of OMZ), rather than using Gazprominvestholding. As another Gazprom subsidiary, Gazprombank was as well-placed as Gazprominvestholding to bypass the need for the government’s directive in deal approvals. It had also provided the finance for some of the Gazprominvestholding acquisitions made in the previous chapter. But in those earlier acquisitions (which took place largely in 2002), the particular value of Gazprominvestholding over Gazprombank was its ability to present itself as being ‘on the side of’ the existing asset owners. In the more recent takeovers made by Gazprombank, the atmosphere was less acrimonious and Usmanov had no historical affinities with the existing owner.

Another factor is that Gazprominvestholding was tasked with returning assets previously owned by Gazprom, or on the brink of being lost. Gazprombank, by contrast, was becoming a channel for new non-core investments by Gazprom group (Kozyrev & Sokolova, 2008). It began to take on this role following the appointment of Andrei Akimov as its new CEO in 2002, and by some accounts, acquisitions such as Atomstroieksport and OMZ were his initiative (Birman, 2005; Milov, 2012). Meanwhile Gazprominvestholding’s role reportedly

shifted towards cracking down on non-payments by Gazprom's clients (Igumenov & Malkova, 2012).

The remainder of this section deals with the specific ownership outcomes of the two takeovers, i.e. the particular ownership structures that were used by the buyers. As described in the earlier section assessing the ownership outcomes, both takeovers involved the use of multiple affiliated entities, and the buyers refused to confirm the acquisitions until some time after the fact. On the face of it, this would seem to fit with the notion that the takeovers were aimed at rent-seeking by insiders: the complex and non-transparent nature of the acquisitions was, by this interpretation, designed to maximise the opportunities for insiders to extract value from the target companies and/or the buying entities. However, close examination of the evidence indicates that the specific ownership outcomes were instead (as in the Gazprom takeovers examined in the previous chapter) a response to legal restrictions that stipulated the need for prior approval of company acquisitions.

In the previous chapter, this prior approval needed to come from the board of directors of the company making the acquisition; if that company was state-owned as in the case of Gazprom, then approval from state representatives on the board first required additional approvals from relevant government bodies. Gazprom used subsidiaries, and subsidiaries of subsidiaries, in an effort to circumvent these restrictions so that it could respond more flexibly in time-sensitive situations. In the present chapter, the buyers designed the acquisitions primarily in reference to a different restriction, namely the need for prior approval by the Federal Antimonopoly Service (FAS).

By law, this approval was required if a single group of entities (as defined in antitrust legislation²⁶⁶) purchased more than 20% of a company. The threshold had been set in Article

²⁶⁶ Since 2006 the legal definition of a group of entities has been found in Article 9 of the Law on the Defence of Competition (*Zakon "O zashchite konkurentsii"*), available in its 2006 edition at http://www.consultant.ru/document/cons_doc_LAW_61763/. Accessed 23 January 2014.

18 of the Law “On competition and restricting monopolistic activity on commodity markets”, first passed in 1991²⁶⁷. There was an additional qualification aimed at preventing a flood of applications for minor transactions: prior approval was only required if the combined asset value of the group of companies making the acquisition and the target company exceeded 30 million “minimum wages”. Below this threshold, post factum notification of an acquisition was sufficient. The minimum wage was set by the government at RUB 600 at the time of the Atomstroieksport acquisition, and had been raised to RUB 800 by the time of the OMZ acquisition²⁶⁸, so the combined asset value threshold was RUB 18bn for the former, and RUB 24bn for the latter. Given that this applied not just to the acquiring company but to the wider group, and Gazprom group’s total assets were valued at the end of 2004 at RUB 2.51 trillion²⁶⁹, there was no doubt that Gazprom group companies would require prior FAS approval for any new acquisitions.

Before turning to how this law affected the ownership outcomes at Atomstroieksport and OMZ, it is helpful to examine an earlier case in which Gazprom group purchased a 25.1% stake in Mosenergo, the Moscow-based electricity company that was then a subsidiary of the company United Energy Systems (UES). Gazprombank bought a 15.76% stake in May 2003, but no formal acknowledgement was made of this fact until the publication of a Gazprom Eurobond prospectus in April 2004 (Reznik & Yegorova, 2004). In July 2004, Gazprombank sold the shares to a buyer who was not named in Gazprom’s accounts. Although the sale was described as an exit in those accounts, Gazprom’s press-secretary revealed that the buyer was Gazfond. There followed a buying frenzy for Mosenergo shares on the open market. Gazprom refused to comment on the widespread suspicion that it was the buyer, but then on 19 November 2004 it revealed in its consolidated accounts that the group now owned a 25.1%

²⁶⁷ *Zakon “O konkurentsii i ogranichenii monopolisticheskoi deyatel’nosti na tovarnykh rynkakh”*, available at http://www.consultant.ru/document/cons_doc_LAW_58244/?frame=5. Accessed 23 January 2014. In 2006, the threshold was raised to 25% by Article 28 of the Law “On the defence of competition”.

²⁶⁸ http://www.consultant.ru/document/cons_doc_law_15189/. Accessed 23 January 2014.

²⁶⁹ Gazprom Financial Report for 2004, pp. 7-8.

stake, sufficient to block key decisions at the company. Gazprom said that it hoped to regularise its purchase with the FAS once the shares, which were distributed among several entities, had been transferred to the balance-sheet of a single company (“FAS zainteresovalas’ pokupkami ‘Gazproma,’” 2004; Makeev & Siluyanova, 2004).

In an earlier section it was pointed out that, despite having no legal owners, Gazfond was treated as being part of Gazprom group both in Gazprom’s financial reports to international accounting standards (IAS) and in its Russian regulatory disclosures. In that sense, it held no value to Gazprom in terms of circumventing the need for prior approval for its acquisitions from the FAS. The decision to involve Gazfond in Gazprom’s acquisition of Mosenergo has a different explanation: crucially, the founders of a non-state pension fund were not obliged to include details of the pension fund’s assets and liabilities in its consolidated accounts. Furthermore, there were no obligations on the pension fund itself to disclose its own finances in any detail (Grivach, 2005)²⁷⁰. Transferring assets to Gazfond therefore kept those assets within Gazprom group²⁷¹ but concealed them from any form of outside scrutiny, including regulatory oversight.

The attraction of this option in the Mosenergo purchase stemmed from the fact that that company’s shares were publicly traded. If Gazprom had bought shares directly²⁷², it would have been expected to apply for prior approval from the FAS before bringing its stake above 20%. If instead it planned to delay this application until after the fact, then it could not have kept what it was doing hidden: its disclosure requirements would have obliged it to reveal the true size of its stake. Either way, its actions would have entered the public domain, signalling

²⁷⁰ Further background on this issue came to light in 2013, when the government proposed turning non-state pension funds into joint-stock companies in order to increase transparency and regulatory supervision (Biyanova & Papchenkova, 2013).

²⁷¹ As Gazprom’s press-secretary put it, “Gazfond is a pension fund and when shares are transferred to it, this is not reflected in the accounts [of Gazprom]. But Gazprom retains its interest in gas-powered electricity generation [*gazovoi generatsii*]. Mosenergo’s shares have changed owner in a formal sense, but in essence, they have remained inside the group” (Grib, 2004).

²⁷² Or through Gazprominvestholding, which unlike the parent company held a licence to buy exchange-traded shares (see Chapter 3).

to potential speculative investors that Gazprom was intent on a buying spree at Mosenergo. The cost to Gazprom of building up its desired stake would have been substantially higher as a result.

There was also a financial advantage in using Gazfond as a buyer of new assets. Hanson (2009, p. 21) has pointed to finite financial resources as a potentially significant factor which limits Russia's appetite for expanded state ownership: "as long as policymakers stop well short of isolating Russia from the international business community by acts of outright expropriation, the acquisition of assets by state companies has to be paid for, and Rosneft and Gazprom cannot increase their borrowing indefinitely to finance a rapid rate of acquisition". Gazfond gave Gazprom access to additional funds in the form of pension reserves, which could prove useful if the Gazprom group was experiencing problems relating to liquidity or indebtedness. This money could be spent without affecting the financial position of the group itself²⁷³. It was also suggested that selling shares to Gazfond (rather than leaving them on its own balance sheet) enabled Gazprombank to remain within the capital adequacy requirements set by the Russian Central Bank (Grib, 2004)²⁷⁴.

Atomstroieksport

As at Mosenergo, Gazprom group most likely made use of Gazfond in its acquisition of Atomstroieksport, and for similar reasons. Once again, the way in which the acquisition was structured was clearly influenced by the requirement to gain prior approval from the FAS.

As noted earlier, when the Atomstroieksport takeover was first reported on 8 October 2004, the buyers were described as "Gazprombank and several of its subsidiaries" (Yambaeva, 2004). Gazprombank refused to confirm the transaction even after it had been announced by a

²⁷³ Though it is not clear how much Gazprom group paid to accumulate the Mosenergo stake, some idea of the cost can be gleaned from the fact that Gazfond paid RUB 11.7bn (then worth \$400m) to Gazprombank for the 15.76% stake in September 2004 (Grib, 2004).

²⁷⁴ Although these were relatively liquid assets because they were listed shares, they would have added to the bank's total risk-weighted assets, against which it was obliged to make sufficient capital provision.

government official on 15 October (“Gazprombank poluchil kontrol’ nad ZAO ‘Atomstroieksport,’” 2004). The first formal confirmation came at the end of November 2004, when Gazprom revealed in a consolidated financial report that the group now controlled 53.85% of the company (“FAS zainteresovalas’ pokupkami ‘Gazproma,’” 2004). It did not apply to the FAS for permission for this purchase until December. The applicant was a wholly-owned subsidiary of Gazprombank named OOO Finkom, which was now the owner of the entire 53.85% stake. In other words, in the weeks after the 7 October transaction, the original buying entities had transferred their Atomstroieksport shares to Finkom.

This use of multiple entities to buy the controlling stake in Atomstroieksport was almost certainly a repeat of the methods used in the Mosenergo case. Again, it was done in order to delay the moment when application was made to the FAS. It is likely that the buyers again included Gazfond or affiliates thereof, which for the reasons outlined above would have helped conceal the real size of the Gazprom group stake. Unlike Mosenergo, Atomstroieksport was not a listed entity, so the motive here was not to deter speculative investors. Instead, it was most likely the time-sensitive nature of the deal that prompted Gazprombank to use these methods again. To recap, the government headed by Mikhail Kas’yanov had an agreement with OMZ-Silovye Mashiny on restoring Atomstroieksport to state control. Then in March 2004, a new government headed by Mikhail Fradkov was put in place, and OMZ-Silovye Mashiny was obliged to wait and see whether the new government would honour the existing agreement. Shortly afterwards, the OMZ-Silovye Mashiny merger unwound and Bendukidze (who resumed control of Atomstroieksport as a result) joined the government of a foreign country. Although technically this meant placing his shares in OMZ (through which he controlled Atomstroieksport) in blind trust, the new Russian government no doubt resolved at this point that Atomstroieksport needed to be restored to state control as quickly as possible. Under the circumstances, Gazprombank presumably judged that it was worth cutting corners on the FAS approval for the sake of expediting the takeover.

When the bank subsequently sold a 4% stake in Atomstroieksport to TVEL, it then sought to sell its remaining 49% to Forpost-Management, and once again the FAS regulations shaped how this was done. It first sold Forpost a 19.9% stake (i.e. just below the threshold requiring FAS approval) in June 2006, and then in the same month it applied to increase this stake to 49%. Thus the aim was to sell as many shares as possible before having to wait for FAS permission. Presumably, this was motivated by Gazprombank's capital adequacy requirements, i.e. its wish to offload as much of this relatively illiquid asset as possible without having to wait for approval from the FAS.

OMZ

In the earlier section which assessed OMZ's ownership outcome, it was determined that Gazfond must have been the company's hidden controlling beneficiary from November 2005 onwards. Using Gazfond as the buyer helped Gazprom to deny its involvement in the same way as it had for a time at Mosenergo. Initially, OMZ's buyers faced a similar predicament: like Mosenergo, OMZ was a listed company, and the application to FAS would signal to speculative investors that Forpost intended to build up a substantial stake²⁷⁵.

In terms of secrecy, however, the OMZ takeover in November 2005 was a more extreme version of the earlier Mosenergo and Atomstroieksport cases. In those earlier acquisitions, Gazprom group had been prepared to admit its involvement once it had obtained the desired number of shares in the target company. But at OMZ, the identity of the ultimate controlling beneficiaries between November 2005 and February 2009 was never revealed. Something made Gazprom want to keep its involvement secret long after it had gained control over the asset.

²⁷⁵ In February 2006, when Gazprombank announced that it was representing OMZ's buyers, who had gained a 75% stake, it also said it was considering de-listing the company and changing its legal form from open to closed joint-stock company. This may have been the intention at the time, but the delisting and change in legal form never happened, and there was speculation that the announcement was designed at least in part to dampen investor appetite for OMZ shares ("Povestka dnya: OMZ stanet ZAO," 2006).

Vedomosti newspaper cited a source close to the negotiations leading up to the OMZ takeover, who said that it became clear during the talks that Gazprom and its affiliates would not be able to buy the company. This was because it included two engineering companies in the Czech Republic named Skoda JS and Skoda Steel, and this meant prior approval would need to be sought from the “European antitrust body”, i.e. the European Commission (Yegorova & Malkova, 2005). These Czech companies had been acquired by OMZ-Silovye Mashiny in April 2004 (Lemeshko, 2004a; “OMZ-Silovye Mashiny’ prishli v Chekhiyu,” 2004). The source noted that relations between Gazprom and the European Commission were not good, implying that permission for the deal was not expected to be forthcoming (Yegorova & Malkova, 2005)²⁷⁶.

Clearly, a simpler way for Gazprom to avoid problems with the European Commission would have been to cut these Czech assets out of the OMZ purchase. But there are indications that the buyers saw them as an important part of the OMZ business. Sergei Lipsky, who took over as OMZ’s CEO *after* the company bought the Czech assets (and who therefore might have had reason to point to his predecessor’s mistakes), said in a December 2004 interview that those new assets were “a logical addition to OMZ’s existing businesses. Thanks to these assets the company has gained access to European markets [...] We would have needed at least five years to gain access to those markets ourselves.” He also noted that there would be considerable technology transfer from the Czech plants to OMZ’s existing Russian plants (Lemeshko, 2004c).

The European Commission hypothesis comes from just this one source cited in a single (albeit highly reputable) Russian newspaper. Efforts to find corroborating evidence elsewhere proved fruitless. It is, however, consistent with the fact that the mystery surrounding OMZ’s controlling beneficiaries ended in February 2009, when Gazprombank acquired OMZ’s parent

²⁷⁶ It is indeed the case that there have historically been tensions between Gazprom and the European Commission, albeit the main focus of those tensions has been Gazprom’s allegedly anti-competitive practices in its European gas sales (Riley, 2012).

company Forpost-Management (“Gazprombank stal sobstvennikom 85% aktsii ZAO ‘Forpost-Menedzhment’, kontroliruyushchego OMZ,” 2009). As explained earlier, Gazprombank had ceased legally to be part of Gazprom group in 2007. Therefore the European Commission no longer had any legal grounds to cite difficulties with Gazprom as an objection to Gazprombank’s ownership of OMZ²⁷⁷.

Using Gazfond as buyer did not in itself pre-empt possible objections from the European Commission, since (as explained above) the pension fund was at the time still being treated by Gazprom as a member of its group of companies. But because neither Gazprom nor Gazfond needed to disclose details of the assets held by the pension company, channelling ownership through Gazfond was crucial in maintaining the secrecy surrounding OMZ’s controlling beneficiaries. It allowed Gazprom and Gazprombank to deny publicly that they had any affiliation to OMZ’s buyers, secure in the knowledge that this could not be proved otherwise.

However, the OMZ acquisition was again structured in a complex way, rather than simply involving Gazfond as the buyer. When it was first announced in November 2005, the investment bank UFG, which acted as settlor and organiser, claimed that the buyers were several entities who were not affiliated with each other, and that accordingly the deal did not require antitrust approval (Yambaeva et al., 2005). The fact that UFG felt the need to make the latter point explicit indicates that the deal may well have been deliberately structured in order to bypass the need to seek prior approval from the FAS. As at Mosenergo and Atomstroieksport, the multiple entities which made the initial acquisition then transferred their shares to a single company (in this case, Forpost-Management). Once again, this single company duly applied to the FAS for permission at a time that the buyers deemed most appropriate for them. In June 2006, Forpost applied to the FAS both to increase its

²⁷⁷ At the time of Gazprombank’s purchase of Forpost-Management in February 2009, OMZ still had its Czech assets. It subsequently sold one of these assets in July 2010, but was still in possession of Skoda JS at the time of writing.

Atomstroieksport stake from 19.9% to 49%, and to increase its OMZ stake (which it claimed was 19.93%) to 95% (Aliev, 2007; Malkova & Mazneva, 2007; Malkova, 2007a).

Once again, Gazfond (whose pension reserves stood at RUB 244.8bn (\$8.6bn) as of the end of 2005 (“Pensionnye rezervy,” n.d.)) provided a useful alternative source of funds at a time when Gazprom group’s financial situation was strained. In the two months preceding Gazfond’s acquisition of OMZ, Gazprom had acquired a 75.68% stake in oil company Sibneft’ (Gazprom, 2006, p. 7). This was financed via a \$13bn bridging loan from a consortium of Western banks (Ostrovsky, 2005), and left Gazprom highly leveraged, with net debt of just under \$30bn as of the end of 2005 (“Fitch upgrades Gazprom,” 2006). Granted, the OMZ purchase price (believed to have been between \$50m and \$70m) was trivial to a company of Gazprom’s scale. However, in making the acquisition Gazprom was also assuming OMZ’s debt, which stood at \$221m at the end of 2005 (“Finansovye rezul’taty za 2005 god po MSFO svidetel’stvuyut ob uspekhakh programmy optimizatsii kommercheskikh i administrativnykh zatrat,” 2006)²⁷⁸.

Response of the FAS to Gazprom’s actions

The interactions described above between Gazprom group and the FAS provide a mixed picture of partial compliance with the relevant law and some direct contraventions. In this respect, the picture differs from the account in the previous chapter of Gazprom’s relationship to constraints relating to corporate governance. In that previous chapter, Gazprom was seen to be frequently distorting the spirit of the relevant laws and regulations, but no evidence was found of any direct contraventions. Gazprom’s more cavalier attitude can doubtless be explained to a significant extent by the fact it could rely on only a limited response from the FAS, and the following account shows that Gazprom did indeed largely escape sanction for its violations.

²⁷⁸ By structuring the acquisition via the pension fund, Gazprom was only assuming OMZ’s debt in the loosest sense. It was not required to reflect OMZ’s liabilities in its own consolidated accounts, because it had no legal ownership over OMZ.

The FAS reacted to the official acknowledgement that Gazprombank had gained control of Atomstroieksport by writing to Gazprom in December 2004 requesting information regarding the acquisition, something Gazprom was required by law to provide in a timely fashion (“FAS zainteresovalas’ pokupkami ‘Gazproma,’” 2004). In January 2005 the FAS said that the information had not been provided within the required time-frame, and that it would soon be deciding on what action to take in response to this administrative violation (Grivach, 2005). But in March the FAS granted post-factum permission for the Atomstroieksport acquisition, saying that it had found no violations “either from the point of view of market dominance or from the point of view of the legal requirements to apply in advance of concluding the deal” (“FAS odobrila pokupku ‘Gazpromom’ kontrol’nogo paketa ‘Atomstroieksporta,’” 2005).

The main action taken by the FAS with respect to the two acquisitions followed the June 2006 application by Forpost-Management to increase its stake in Atomstroieksport to 49%, and its stake in OMZ to 95%. At the time, Forpost held a 19.9% stake (just below the threshold requiring approval) in both companies. The FAS delayed its decision on this application until May 2007. Unusually, its decision was to deny approval²⁷⁹. Contemporary press reports suggested that this decision reflected the FAS’s hostility towards Gazprom. But the FAS cited two apparently objective reasons for its rejection: firstly, Forpost had failed to provide the information requested on the identity of its ultimate beneficiaries, making it impossible to determine the impact the deals would have on competitiveness in the heavy engineering sector; secondly, Forpost had by the end of 2006 increased its stake in OMZ without waiting for a decision from the FAS. This second point meant that the information in Forpost’s application, on which the FAS was being asked to opine, was no longer accurate (Aliev, 2007; Belikov, 2007a; Malkova & Mazneva, 2007; Malkova, 2007a). For a year, Gazprombank abided by this ruling and held on to the 30% Atomstroieksport stake it had intended to sell to Forpost. But in June 2008, it went ahead and sold the stake in direct contravention of the FAS

²⁷⁹ In 2006, the FAS declined only 2.2% of the 6000 applications it received (Belikov, 2007a).

ruling, and notified the FAS of this after the fact. The FAS said that it was studying this notification to determine whether the transaction had been legal (Denisova, 2008). There is no record of the FAS having taken any legal action against Forpost²⁸⁰.

The FAS said that it intended to fine Forpost for its failure to gain prior approval to increase its OMZ stake, but the amount of the fine was a mere RUB 500,000 (approximately \$1,600). The antitrust body refused to be drawn on whether it intended to challenge the transaction in court (Belikov, 2007a). The evidence suggests that it elected not to do so²⁸¹. Forpost retained its OMZ stake at approximately the same level, rather than proceed as it had done at Atomstroiekспорт by increasing its stake despite the FAS ruling²⁸².

Growing - but limited - authority of the FAS

The above account shows that Gazprom's partial compliance with the law requiring prior FAS approval for deals was matched by an only partial willingness on the part of the FAS to sanction non-compliance. Although growing in independent authority, the regulatory body was still relatively powerless against the might of Gazprom and in any case had only limited sanctioning powers available.

Created in March 2004 as the successor to the Ministry for Antimonopoly Policy, the FAS was headed by Igor' Artem'yev, under whose leadership it "began to fight anti-competitive practices much more actively than in the previous 10 years" (Panov, 2005). This helps to explain why the FAS had played a less significant role in determining ownership outcomes in the 2002 takeovers of the previous chapter. Much of the work of the FAS focused on other anti-competitive practices (such as price-fixing or cartelisation) for which it was authorised to apply relatively severe penalties. Against companies that failed to comply with the law

²⁸⁰ Based on searches of press archives and the centralised database of *arbitrazh* court cases, which is maintained by the Supreme *Arbitrazh* Court and available at <http://kad.arbitr.ru>

²⁸¹ See fn. 280.

²⁸² As of the end of 2011, Forpost's stake in OMZ was 46.31%. This was down from 49.9% the year before, but was still enough to exercise voting control. Source: OMZ Consolidated Financial Statements, 31 December 2011, p. 28.

requiring prior approval for transactions, its powers were meagre. It could unilaterally impose a fine on such companies, but this was a token amount not exceeding RUB 500,000 (around \$1600) (Grivach, 2005; Malkova, 2008; Medvedeva, 2007c). In principle, it could apply to an *arbitrazh* court to have the transaction annulled. But in order to be successful, it needed to prove that the acquisition had been anti-competitive (Malkova & Mazneva, 2007). In a February 2007 interview, Artem'yev claimed that the agency was successful in 80% of the cases it brought to court (Corcoran, 2007). But the vast majority of these cases related to other types of anti-competitive activity.

In the same interview, Artem'yev made clear that the agency had a negative attitude to Gazprom's "growing monopolism". The two sides had just emerged from a bitter legal battle, which had begun two months before the OMZ acquisition, in September 2005. The FAS had approved Gazprom's acquisition of the gas producing company Nortgaz, but had imposed a highly significant condition on this approval: Gazprom group would not be permitted to buy any further controlling stakes in gas-producing companies in Russia. If it did so, the FAS would go to court to invalidate the transaction ("FAS razreshila vernut' 'Nortgaz' pod kontrol' 'Gazproma,'" 2005). Gazprom successfully challenged this condition in court, and by January 2007 the FAS had dropped its condition (Surzhenko, 2007). Artem'yev noted in the aforementioned interview that the FAS was successful against Gazprom in only 30% of cases (as opposed to an 80% overall success rate). But although he implied that the courts were biased in Gazprom's favour, he also claimed that "we normally launch about 20 suits against Gazprom a year and there have never been any complaints from the government or the Kremlin".

It appears that the FAS rarely exercised its right to take companies to court specifically for having failed to gain prior approval for a deal. Unsurprisingly, therefore, there have been occasions when Gazprom and Gazprombank have chosen to proceed without prior approval, if time was pressing. In the later acquisition of Sibneftegaz by Gazprombank, a source at the

bank made the calculation explicit by saying that, because the FAS fine was so small, “it will be easier to pay the fine now, rather than get together all the necessary documents and wait for the FAS decision on approval. All this bureaucracy takes a long time, which on this occasion we didn’t have” (Podobedova, 2007).

The FAS found two ways to make the most of the limited powers available to it. The conditional approval, as with the Nortgaz acquisition, was one tactic: failure to comply with the conditions imposed by the FAS gave the latter a sounder basis for challenging the original deal in court (Medvedeva, 2007c). The second tactic was to delay reaching a decision on an application, thus creating an aura of legal risk around the acquired asset because of the theoretical possibility that the transaction might be annulled in court. Delaying tactics were used when the independent gas producer Novatek announced in September 2004 that it would sell a blocking stake to French company Total. The FAS made it clear there would be no decision on approval until Novatek had carried out a planned IPO. Novatek’s owners then “got the message”, doing “virtually everything in their power to squirm out of the deal with Total without losing face” (Heinrich & Kuszniir, 2005, p. 24). On that occasion, Novatek no doubt understood that the stance taken by the FAS reflected a wider political opposition to the deal, which was in turn based on concern over a Western company taking a major stake in Russia’s second largest gas producer. Where that wider political opposition was absent, delaying tactics from the FAS were less likely to deter a state-backed company such as Gazprom. In his 2007 interview, Artemyev said that the FAS had ultimately succeeded only in delaying Gazprom’s acquisitions of Nortgaz and Mosenergo²⁸³, implying that to him such an outcome was better than nothing when the FAS had objections to a deal but did not have the power to block it.

²⁸³ In 2007, Gazprom sought FAS approval to bring its stake in Mosenergo up to controlling (Medvedeva, 2007b).

Conclusion

The evidence from the cases offers little support for the notion that the SLCTs had predatory motives. The decision to bring Atomstroiekспорт back into state hands was motivated by international pressure from its clients, who otherwise questioned the value of the Russian state guarantees underlying their orders, and by the belief that only a state-owned company would refrain from abusing its monopoly position as the gateway for exports of equipment for nuclear power stations. The state may, as Pappé and Galukhina (2009, p. 174) suggest, have been prompted by Bendukidze's takeover of Atomstroiekспорт to push out private capital at all nuclear-related enterprises including OMZ. But the particular importance of Izhorskie Zavody to the government's strategy for the nuclear industry, and concerns over Bendukidze's having joined the Georgian government, probably best explain why the state was demanding OMZ's return to state control.

There is also sufficient evidence to state with some confidence that the buyers' decision to become involved in these takeovers was not motivated only by naked self-interest. Granted, Gazprom's decision to buy OMZ was almost certainly influenced by the prospect of considerable profits from the supply of government orders for new reactors as part of the nuclear expansion programme. The successful realisation of this programme also promised additional revenues for Gazprom (and for the government) because it would free up more gas for export. Thus commercial incentives dovetailed with the wish to help implement government strategy. This is not the same as saying that they were simply opportunists battling with Rosatom for a share of the spoils from the nuclear expansion programme. They duly transferred Atomstroiekспорт to Rosatom's control, and apparently received no meaningful compensation for providing this service. At OMZ they backed up their talk of the need to preserve Russia's "technological sovereignty" with genuine efforts to revive this important part of the heavy engineering industry. Rather than being deliberately obstructive in order to maximise their profits from sales of reactors to Rosatom, they went through a number

of changes of senior management, in search of people who could mend fences with the government agency. Crucially, they also decided to keep OMZ alive with new credits after the hoped-for flood of orders from Rosatom failed to materialise and doubts arose as to whether it could otherwise survive as a going concern. This decision makes little sense from a purely commercial perspective and provides convincing evidence that the altruistic, patriotic rhetoric of the ‘silovarchs’ at Forpost and Gazprombank was not in this case a mere smokescreen for venal self-interest, as we would expect based on the remarks made by Murtazaev (2006) and Hanson (2007b, p. 33).

Nevertheless, the institutional self-interest of the buyers is an important part of the explanation for their subsequent failure to cooperate effectively with Rosatom, thereby endangering the same government programme they claimed to be intent on helping to fulfil. Williamson (1981) proved helpful in explaining why two sets of institutions which seem to have been genuinely interested in helping the government realise its strategy ended up undermining it. As a result, the distinctly mixed results of Gazprom group’s involvement in Russia’s nuclear engineering industry are explained in a way that is more nuanced and convincing than typical accounts based on rivalry between two sets of interest-maximising bureaucratic factions. From the state’s perspective, the failure to bring about the cooperation between the two sides can be attributed to a lack of coordination between the various state actors and institutions that had oversight of the nuclear and heavy engineering industries, and to overlapping responsibilities between them. This recalls the emphasis placed by Johnson (1982, p. 319) on the importance of a “pilot organisation” in successful state-led development. Indeed, the story of Rosatom’s and OMZ’s failure to cooperate provides an illustration of just how state-led developmental projects can founder in ways that do not require any of the state agents involved to be harbouring corrupt or predatory motives.

The examination of the way the Atomstroiekспорт and OMZ acquisitions were executed, and the precise way in which ownership was structured, has highlighted the extent to which these

were shaped by both domestic and international institutional constraints on the buyers. The use of multiple entities including Gazfond helped the buyers to delay the moment when they turned to the antitrust regulator for approval for the deals, so that they could expedite the deals in time-sensitive circumstances and avoid signalling their intentions to speculative investors who would drive up the price of the takeover. The peculiar legal status of Gazfond enabled the buyers to keep their identity secret and avoid problems with the European Union's antitrust body. Gazfond also provided a fresh source of 'off-the-books' funds for a group that was reaching the limits of its indebtedness.

That Gazprom's actions were shaped by institutional constraints at all is significant in itself, because in an ideal-typical kleptocracy one would expect a state-owned company to operate without regard to such constraints, especially when it is engaging in a takeover that has the government's full support. But in these two SLCTs, the state-backed buyers did not simply respond with meek compliance to the institutional constraints stemming from the FAS. Instead, their response was a mixture of compliance, "gaming of the rules", and direct breach, as follows:

- 1) using multiple entities including Gazfond, they delayed the moment when application was made for prior FAS approval for the acquisitions. They maximised the stakes that could be built up without the need for such approval (*compliance, but with some 'gaming of the rules' and possible breach through concealment of the amount of shares held by Gazfond*);
- 2) they duly applied for FAS approval (*compliance*), but at OMZ did not wait for this approval before building up the stake further (*breach*);
- 3) after the FAS declined the application, they halted the planned sale of the remaining 30% stake in Atomstroiekспорт to Forpost-Management, and abandoned the idea of increasing further Forpost's stake in OMZ (*compliance*);

4) but after a year, they proceeded with the Atomstroiekport sale in direct contravention of the FAS ruling (*breach*).

How to explain this particular mixture? North (1990, p. 4) writes that “an essential part of the functioning of institutions is the costliness of ascertaining violations and the severity of punishment”. The extent to which Gazprom’s actions were shaped by institutional constraints can no doubt largely be explained in terms of the possibility and severity of sanctions for non-compliance. As discussed above, the FAS was gaining real independent authority under its new leadership, and had begun taking companies including Gazprom to the *arbitrazh* courts. The FAS had a significantly below-average success rate in court cases it brought against Gazprom, and limited powers available to it without recourse to the courts. It may be that it chose not to pursue court action against the buyers of Atomstroiekport and OMZ (even when they directly contravened a FAS ruling) because it did not believe in the possibility of a fair trial against this powerful state-owned and state-backed company. But it is also possible that it decided that it could not prove either acquisition was anti-competitive, the only legal basis on which it could secure a court ruling to annul a transaction. The FAS may have realised that legal action would only prompt OMZ buyers’ to take defensive action by selling OMZ shares on to offshore companies and making it all but impossible to prove that those companies were part of a single group²⁸⁴.

Significantly, in these and other cases involving Gazprom, the FAS made substantial use of the powers available to it *without* going to court (delaying approval and/or making it subject to certain conditions). Its head, Igor’ Artem’yev, appeared to view successfully delaying deals of which the FAS did not approve as a worthy goal when blocking them was not practically possible. Thus, even when considerable doubts remain regarding the independence of the

²⁸⁴ This possibility was suggested by a lawyer cited in Belikov (2007a).

courts from the executive, institutions can still cause difficulties for state-backed companies, raising the costs of non-compliance with existing legislation²⁸⁵.

The buyers were apparently confident enough of their privileged position vis-à-vis the courts to ultimately go against a direct ruling from the FAS – and their confidence proved well-founded. But it is also significant that their behaviour showed an interest in complying with the relevant legislation: they did apply for FAS approval, even if this was after the fact; if the 20% threshold demanding prior FAS approval was an irrelevance to them, they would not have built up their stakes in Atomstroieksport and OMZ to 19.9% before applying for that approval; and the FAS ruling against the sale of the remaining 30% stake in Atomstroieksport made them pause for a year before proceeding nevertheless with the transaction. This limited interest in compliance might be explicable solely in terms of the distinctly inadequate (but greater than zero) capacity of the FAS to sanction non-compliance. But Gans-Morse (2011) may be right to suggest that another force was at work in moving Russian companies away from “force” to “law”: because of its exposure to external creditors and shareholders, Gazprom group was on balance interested in avoiding controversy and complying with the legislation. This limited effect was, however, only sufficient to constrain Gazprom’s actions when there was no overriding priority to expedite its takeovers.

²⁸⁵ Gazprombank’s sale of its remaining 30% stake in Atomstroieksport to Forpost-Management was aimed at helping the bank meet its capital adequacy requirements. By ruling against the transaction, the FAS at least delayed this sale for a few months, and thereby imposed a material penalty of sorts on the bank.

Chapter 5. State-led coercive takeovers, kleptocracy and the “developmental state”

Since Vladimir Putin first became Russia’s President in 2000, the state has played an increasingly active and interventionist role in the economy, and one important manifestation of this trend has been its involvement in a large number of coercive takeovers of privately-owned businesses. The best known case is the Yukos affair which began in 2003, but there have been many other, less prominent takeovers. It is no exaggeration to say that threats to property rights are an everyday concern for Russia’s private business actors, and that the state is now perceived as the greatest source of such threats (Gans-Morse, 2012; Rochlitz, 2013; Volkov, 2004).

Because coercive takeovers involving the state have become such a prominent feature of the political economy of modern Russia, it is important that they be correctly understood. While many analyses of the Yukos affair specifically have emphasized its political motivations, it is also explained as having been essentially an illegal act of predatory takeover by corrupt state officials who were motivated by the desire to enrich themselves or increase their power. Studies of the wider phenomenon of coercive takeovers involving the state, including the works cited above, have emphasized the latter interpretation by seeing them as cases of *reiderstvo* (defining features of which are the illegality of the takeover and the venal motives of those involved in bringing it about). Such analysis contributes to the perception that Russia under Putin is essentially a kleptocracy, with the state (or individual state actors) given free rein to engage in economically-destructive attacks on property rights.

This thesis is a study of a number of cases of state-led coercive takeover, including the Yukos affair. As the venn diagram in Figure 1 (Chapter 1) illustrated, it proceeds from a belief that some cases (perhaps a small fraction of the overall set, but including some takeovers of disproportionate political significance, including the Yukos affair) may be motivated by

considerations other than material gain. The cases were chosen for study in part because they appeared not to be explicable as examples of *reiderstvo*. The first central research question of the thesis therefore asked precisely what was motivating the state actors who were involved in instigating these takeovers.

The Yukos affair saw the company broken up and its assets effectively nationalised: the government sold them off at auction and controlled the process in a way that ensured that almost all of the assets were bought by state-owned Rosneft'. Yukos's fate has understandably been seen as part of (or as the beginning of) a broader trend of significant expansion of state ownership in Putin's Russia, not only in the oil sector, but in the economy as a whole. Various explanations have been offered for this trend, which generally fall under the same categories as those offered for the Yukos affair specifically: it has been seen as driven by the rent-seeking appetites of state officials, or as a response to their fear of the political threat posed by the 'oligarchs', or as an attempt at a state-led solution to developmental challenges. However, there is a puzzling feature to the state-led coercive takeovers studied in this thesis: some of them (i.e. the cases of Russneft' and Bashneft') resulted in the asset being sold to new private owners rather than being nationalised.

These differing "ownership outcomes" present a problem when attempting to explain the motivations behind the takeovers: if companies are forcibly nationalised so that venal state officials can enrich themselves, then what explains those coercive takeovers that do not result in nationalisation? If there were other good reasons for wanting to increase the amount of state ownership (as part of a state-led developmental push, or as a way to counter the growing political power of the 'oligarchs'), then why did the state not take the opportunity to nationalise *all* the targets of its coercive takeovers? The solution to this problem started with a recognition that state-led coercive takeover and expanding state ownership are two distinct phenomena from an analytical perspective: not only did some of the takeovers fail to have a nationalising outcome, but a significant proportion of the expansion of state ownership has

been the result of ‘voluntary’ acquisitions by state-owned companies rather than coercive takeover. The factors driving the expansion of state ownership might well be part of the explanation for the phenomenon of state-led coercive takeover, but they cannot account for the different forms of ownership that resulted, ranging from “state” to “private”. In order to gain an adequate understanding of state-led coercive takeovers, it was therefore necessary to address the latter point as a second central research question: what are the causal factors which determine the varying “ownership outcomes” of state-led coercive takeover?

Causes of the takeovers: sovereign development

To reiterate, this thesis does not set out to challenge the established notion that state-led coercive takeovers in Russia can be a form of *reiderstvo*, i.e. can be the work of state actors who are motivated by self-enrichment or self-aggrandisement. Instead it argues that this explanation does not hold for certain cases, including some that are highly significant. The same techniques that are used successfully by predatory state actors can be, and have been, used by the state to achieve political objectives.

The thesis has coined the term “sovereign development” in an attempt to encapsulate the sometimes conflicting political objectives that underlie the takeovers studied here. Contrary to the notion that Putin’s Russia is a kleptocracy, it has followed Barnes (2006a, 2006b) and Wengle (2012) in arguing that the regime pursued economic development and subscribed to the view that the state needed to play an activist role in achieving it.

However, economic development as a strategic goal occasionally conflicted with higher priorities. For reasons stemming from the way post-Soviet Russia had come into being in 1991, and the way market-based institutions including privatisation were introduced in the 1990s, Putin began his first presidency in 2000 facing threats to the supremacy of central state power. In other words, the concentrated political and economic power of certain ‘oligarchs’

and the refusal of certain regional leaders to accept the Kremlin's authority on their territory challenged what Krasner (1999) terms "domestic sovereignty". While economic development was in many ways helpful in consolidating state power, it also threatened to strengthen further the political power of the forces that were believed to be posing a threat to sovereignty. Thus "sovereign development" involves two vectors (the pursuit of development and the pursuit of increased sovereignty) which in Putin's Russia sometimes pointed in the same direction, but sometimes opposed each other. When they opposed each other, the perceived need to counter threats to sovereignty took precedence.

The oil industry takeovers examined in Chapter 2 are best understood as cases where concerns over sovereignty trumped developmental considerations. The existing owners of all three targeted companies were involved in political activity that the government identified as a threat. The political leadership undertook to neutralise that threat through forcing the business owners to give up their assets. Aside from the possibility that the takeover of Bashneft' was in part driven by the wish to see its petrochemicals assets opened up to the national and global economy, these were primarily politically-motivated takeovers that were undertaken despite the significant short-term economic damage they caused as demonstrative attacks on property rights. The primary objective in all three cases appears to have been to deprive the existing owners of their key assets as a way to neutralise them politically: precisely what form of ownership resulted and what happened to the assets subsequently was of secondary importance.

At the same time, it would be wrong to suggest that the owners of the targeted businesses posed a credible danger to the *incumbency* of the Putin regime: only Khodorkovsky could be viewed as having had any ambitions to overthrow the government, and his chances of success in such an undertaking have been vastly exaggerated. The political danger that Putin and his allies identified in these business owners lay instead exclusively in their perceived undermining of the state's sovereignty: Yukos and its owners were seen as exercising undue

influence over the workings of parliament and becoming involved in matters of foreign policy that were the government's prerogative; the owners of Russneft' and Bashneft' were blamed for the Kremlin's inability to exercise its authority over the Russian regions of Ingushetia and Bashkortostan, respectively.

In Chapters 3 and 4 the takeovers had different motivations. Underlying them was a decision that the assets involved should be taken into state ownership: the lost assets of *de facto* state-owned Gazprom should be returned to it; Atomstroieksport belonged in state hands because of the state guarantees to foreign buyers that formed the basis of its operations; OMZ's Izhorskie Zavody in particular needed to be re-nationalised so that it did not hold the nuclear expansion programme to ransom by exploiting its monopoly on Russian reactor production. In each case, developmental considerations loomed larger than in Chapter 2. State control of Gazprom was to be consolidated and the company itself built up as a tool of domestic and foreign policy. Restoring ownership of some of these lost assets was intended to solve economic problems such as supporting the petrochemicals industry which was seen as one step up the value chain from mere natural gas production (Sibur), or keeping alive an ailing infrastructure services company that for social reasons could not be allowed to fail (Zapsibgazprom). As Russia's last surviving enterprise that was capable of producing nuclear reactors, Izhorskie Zavody was particularly important to the ambitious developmental programme to expand the share of nuclear power in the country's overall energy mix.

However, in Chapters 3 and 4 there were related concerns over sovereignty and national security. The political leadership was undoubtedly concerned that it had only tentative control over Gazprom, its most strategically-important company, and that the company might fall into the hands of foreign or domestic 'enemies'. Even if state control could be consolidated by obtaining direct control over a majority of the company's voting shares, the fear remained that important Gazprom-owned assets might continue to go astray, thereby eroding the company's strategic value. There was similar alarm at the prospect of other strategic companies such as

Atomstroiekспорт (the sole gateway for construction of nuclear power plants abroad) and OMZ's Izhorskie Zavody becoming controlled not just by potentially uncooperative private business, but by hostile foreign powers. When OMZ's owner Kakha Bendukidze joined the government of Georgia, it looked as though these fears were being realised.

Causes of the takeovers: rival “rent-seeking” explanations

How do alternative explanations based on rent-seeking fare as rivals to the above “sovereign development” hypothesis? If in fact these takeovers were motivated by rent-seeking, then all the talk of sovereignty, national security and development was a mere fig-leaf aimed at justifying what was essentially predatory *reiderstvo*. The oil industry cases in Chapter 2 provide the most fertile ground for such an interpretation: they were lucrative takeover targets and (unlike in Chapters 3 and 4) there was no compelling or relatively self-evident reason for the state to want them to change ownership. The main challenge to the rent-seeking explanation for these cases lies in the contingent nature of their ownership outcomes. Rosneft's political patrons (who are widely held to be responsible for instigating the Yukos takeover) cannot have known from the outset that ‘their’ company would emerge as the owner of the majority of Yukos's assets, because, as Gustafson (2012, p. 314) puts it, that outcome was effectively a “fluke”. If they had embarked on the takeover in the hope of enriching themselves as the new owners of Yukos, they were therefore taking a surprisingly large risk that they might lose out to another set of state officials altogether (i.e. the patrons of whichever other company might have emerged instead as the new owner). Similarly, the private businessmen who took ownership of Russneft' and Bashneft' do not appear to have been involved in instigating the takeovers: rather, they were chosen by the existing owners as people who could protect them from attack. If the Russneft' and Bashneft' takeovers had been instigated by state officials with rent-seeking motives, then they were botched attempts at *reiderstvo*. It is possible to construct elaborate theories involving rent-seeking ties between the

buyers of these companies and whoever was behind the original takeovers. Alternatively, it can be argued that eventually those buyers will sell the companies on to their intended owners, at which point everything will fall into place. But years have passed and (as of this writing) the Russneft' takeover has been fully aborted with full ownership restored to its original owner. Meanwhile, Bashneft' has still not been sold to Rosneft' or Gazprom. As a result, attempts to explain these takeovers and their ownership outcomes through elaborate theories involving rent-seeking state officials have become increasingly difficult to sustain. By contrast, if the three oil industry takeovers were primarily aimed at neutralising the existing owners as a political threat by depriving them of their key assets, then it is no longer puzzling that their ownership outcomes were largely a matter of historical 'accident'.

In Gazprom's campaign to re-gather its 'lost' assets, which was the subject of Chapter 3, there were questions around how the existing owners came to control the assets. Accordingly it is not so easy to claim that they were the innocent parties attempting to defend their property rights from *reiderstvo* staged by venal state officials. There is undoubtedly widespread corruption at Gazprom, and therefore any attempt by the company to increase the size of its assets can be seen as increasing the theoretical potential for rent-seeking. However, the way that the company managed its newly-regained assets is particularly difficult to square with the claim that it took them back so that certain state officials could enrich themselves further. For example, the decision to take ownership of Stroitransgaz seems to have been a genuine attempt to control the inflated costs of its relationship with that supplier (and it is precisely the inflated costs of such relationships that are the most fertile ground for rent-seeking). The attempt to save Zapsibgazprom from collapse might not have been commercially prudent, but it is not the behaviour one would expect from rent-seekers faced with an unprofitable business.

In Chapter 4, the timing of the OMZ takeover shortly before the announcement of the government's nuclear expansion programme certainly gave rise to a suspicion that this was a

rent-seeking acquisition by people acting on insider information. There looked to be significant potential for OMZ's new owners to extract rents from Izhorskie Zavody's monopoly on reactor production. Additionally, the failure of cooperation between Izhorskie Zavody and Rosatom was explained in the Russian press as the result of a factional struggle over the windfall of state budget money that was to be spent on financing the nuclear expansion. However, close examination of the way OMZ was managed under its new owners found evidence that was difficult to square with the idea that they were essentially rent-seeking opportunists. Rather than using Izhorskie Zavody's monopoly to hold Rosatom to ransom, they repeatedly sacked the chief executives of OMZ as they searched for someone who could improve relations with Rosatom. And as the company got into increasing financial difficulty (not least because of its dispute with Rosatom), they continued to lend it money to keep it afloat, apparently far beyond the point where this was commercially prudent. This practice of throwing good money after bad (as at Zapsibgazprom) is more commonly associated with state-owned companies operating under political pressure. It is not the expected behaviour of opportunistic rent-seekers, who when faced with such a situation would normally engage instead in predatory asset-stripping.

In summary, the hypothesis that these state-led coercive takeovers were driven by the political leadership's pursuit of "sovereign development" provides a significantly better fit for the case evidence than do rival explanations based on rent-seeking. Even if the patriotic declarations of state actors regarding sovereignty and national security are dismissed as mere cover for their true, venal, motives, rent-seeking explanations still founder on the evidence from Chapters 3 and 4 regarding how the assets were subsequently managed by their new owners, and on the contingent nature of the ownership outcomes of Chapter 2.

Explaining the varying ownership outcomes

In cases of *reiderstvo* involving state officials, one expects the targeted business to be acquired by whichever company (state-owned or private) acts as the vehicle for rent-seeking by the state officials responsible. But if, as argued above, the state-led coercive takeovers studied in this thesis were undertaken in pursuit of “sovereign development” rather than rent-seeking, then the ownership outcomes of those takeovers are likely to have been determined by other factors.

Pappe and Galukhina (2009, pp. 161–5) and Radygin and Mal’ginov (2006) have provided a set of factors that might determine whether or not a particular takeover results in nationalisation. These can be summarised by saying that nationalisation can be the result for political reasons: as part of a plan to increase state ownership in the sector, or in order to save the company (and/or a wider set of companies on which it depends) from collapse. But it can also be the outcome when, for exclusively commercial reasons, a state-owned company happens to be best positioned among potential buyers, i.e. it has both the resources available to buy the targeted business and a compelling business case for doing so.

The above framework was intended to be applied when understanding the ownership outcome of *any* takeover. The evidence from the cases has indicated that for state-led coercive takeovers that are not cases of *reiderstvo*, the path to the ownership outcomes is altered substantially by the use of state coercion. Firstly, each takeover involved a two-way bargaining game between state and existing owner. In each case, the state applied a measure of coercion before presenting to the existing owner a “carrot-and-stick” offer, which, if accepted, would see the situation resolved peacefully. The evidence from the cases suggested that the offer typically entailed agreeing to sell the targeted business, but also undertaking to refrain from the activities that the state considered to be a threat. In some of the cases it also involved agreeing to leave the country. The owner could take some comfort from the fact that

he could expect to receive a substantial sum of money in exchange for the business – perhaps even approaching its market value.

Despite the use of coercion, the evidence from the cases indicated that the state prefers a “negotiated” outcome to the takeover, where the owner accepts the “carrot-and-stick” offer. Such was the “bargaining outcome” of all but one of the cases studied, the exception being the Yukos affair. The reason for the state’s preference—what prevented it from simply pursuing forcible seizure of the assets in every case—was that the latter was expensive in terms of the administrative resources required to undertake it effectively. Furthermore, there were defensive tactics available to the existing owners that could help increase this expense – for example, by structuring ownership offshore and otherwise ‘internationalising’ the business.

Chapter 1 noted that the process-tracing method adopted in this thesis should aim to provide causal explanations that are simple enough to be represented in an arrow-diagram – if this is not possible, then it is likely that the explanation itself is too “muddy” (Van Evera, 1997). Figure 10 builds on the game tree provided in Figure 2 (Chapter 1), by summarising how the “bargaining outcomes” of the takeovers (either the “negotiated” outcome involving the owner’s acceptance of the state’s “carrot-and-stick” offer, or “full-scale asset seizure” by the state) translate into their ownership outcomes.

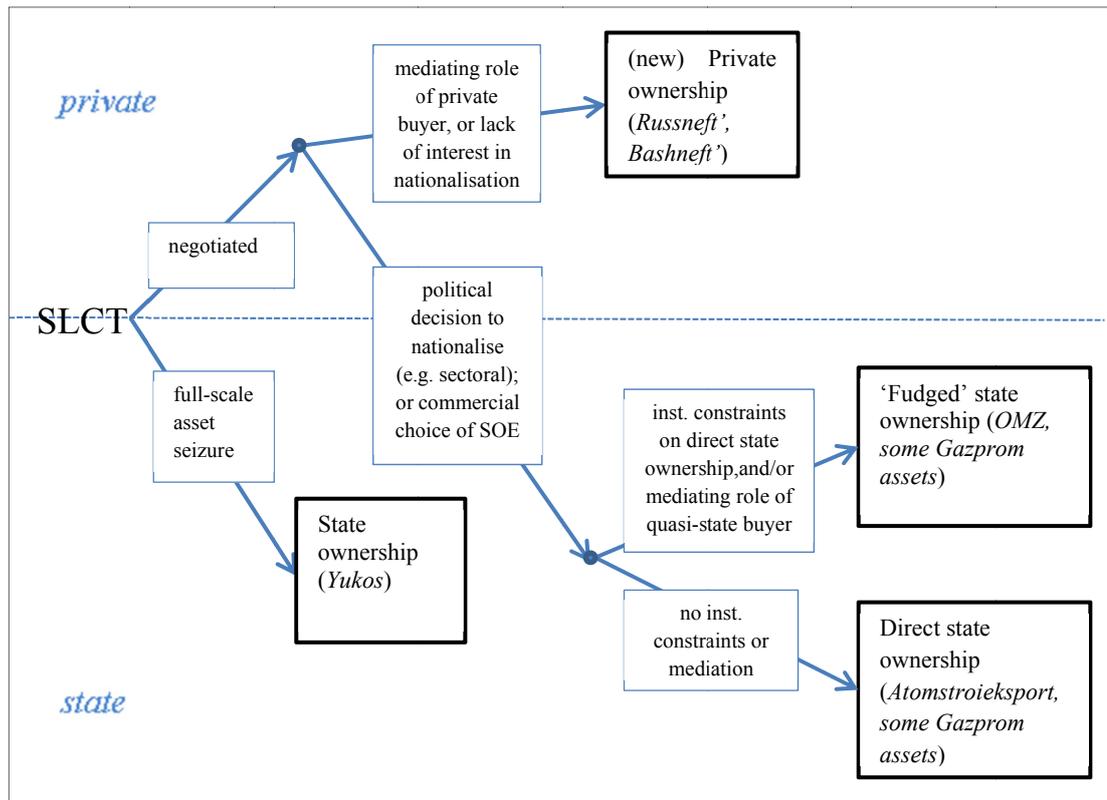


Figure 10. From bargaining outcomes to ownership outcomes

If the bargaining between state and existing owner fails to have a negotiated outcome, the state embarks on the full-scale coercive seizure of the assets of the targeted business, as happened in the Yukos case. The substantial deployment of state resources that is required to do this effectively makes a state ownership outcome most likely. Nationalisation strengthens the justification that the takeover, and the use of the state's resources, was in the public interest. It helps to protect the new owner from the reputational and (more importantly) legal fallout that ensues from the state's arbitrary actions, the effect of which is felt particularly acutely abroad.

In the event that the bargaining phase does have a negotiated outcome, either state or private ownership is possible. The aforementioned factors provided by Pappe, Galukhina, Mal'ginov and Radygin must play a causal role at this stage: has a political decision been taken to

nationalise the company, and what kind of company (state-owned or private) is best-placed from a commercial perspective to emerge as the buyer? However, the evidence from the cases has indicated that the use of state coercion increases the odds in favour of this “negotiated” bargaining outcome resulting in a private or quasi-state ownership outcome. This is because the state frequently uses an intermediary who promises to facilitate the negotiated outcome it prefers. In order to qualify as intermediary, the buyer needs to be at some remove from the forces identified by the existing owner as responsible for the coercion being used against him. The private business owners who emerged as buyers in the Russneft’ and Bashneft’ cases (Chapter 2) played such a role: they were not foisted by the state on the existing owners, but were approached and/or chosen by those owners as people who promised to be able to call off the Kremlin’s pressure. Similarly, in the Gazprom cases of Chapter Three, Usmanov was valuable to Gazprom as an intermediary because of his past dealings with its former management, with whom the existing owners had good relations, and because he was a private businessman in his own right as well as the hired manager of a *de facto* state-owned company (Gazprominvestholding). Remarks made by both the successful intermediaries (Usmanov and Yevtushenkov) and by some of the existing owners confirmed how resistant the latter were to the idea of being forced to sell to the same people who were responsible for the coercion being used against them. That these intermediaries would be involved in the ownership outcome as well as the negotiations is not entirely self-evident but also not surprising. It seems likely that Yevtushenkov helped Gutseriev on the condition (or at least on the understanding) that he would subsequently receive a 49% stake in Russneft’. Usmanov’s role as negotiator did not automatically translate into the selection of ‘his’ company Gazprominvestholding as the buyer, but it did favour that selection, because it increased his credibility as a negotiator independent from Gazprom and presumably gave him greater freedom to negotiate terms.

As the arrow-diagram indicates, once the decision has been made to take a company into state ownership, a final choice is made between a direct purchase by a state-owned company and an

indirect purchase via one of its subsidiaries or affiliates. The Gazprom cases suggest that this decision can be driven in part by whether or not the indirect route promises to facilitate a negotiated outcome. But what became abundantly clear from Chapters 3 and 4 was that Gazprom also faced *institutional* constraints on its taking direct ownership of new acquisitions. These constraints largely consisted of controls aimed at ensuring that the management of a state-owned company cannot make decisions on the buying and selling of major assets without appropriate sign-off from the state, and that any large company obtain prior approval from the antitrust regulator before making acquisitions that had the potential to undermine competition in the market. The problem was less that the relevant approvals might not be forthcoming (though Gazprom was driven to conceal its involvement in the OMZ acquisition because of fears it would be blocked by a European body, and its quasi-affiliate Forpost-Management had its application to the Federal Antimonopoly Service turned down), and more that they took time to obtain, thereby reducing the ability of the state-owned company to respond in a flexible and agile manner in time-sensitive situations. The coercive takeovers were particularly time-sensitive: either the existing owners were strategizing to place their assets offshore or otherwise hamper the state's ability to seize them, or (in the case of Atomstroiekспорт and OMZ) the same sovereignty-related reasons why the companies needed to be taken over also dictated that this be done as quickly as possible. Under the circumstances, the buyers felt they could not afford to wait for months for the appropriate sign-off from government and regulator. They discovered that by structuring the acquisitions via subsidiaries and other affiliates (or more specifically, via a pension fund whose legal status as an affiliate was usefully ambiguous), they were able to bypass these institutional constraints.

Kleptocracy and “coercion-constraining institutions”

The two key arguments summarised above, which form the answers to the project’s central research questions, present a challenge to the notion that Russia is a kleptocracy. The term implies (in the words of the Bill Browder epigraph to the thesis) a ruling elite that is interested only in “stealing money” rather than “the execution of public service”. The evidence from the cases indicates that the state actors involved did in fact have a significant interest in “public service”, though that service was arguably more to the state (as they conceived it) than to the public. But kleptocracy also requires an environment that offers no meaningful constraints on the thieving ways of the ruling elite. Granted, all of the cases involved the use of state coercion in ways that would not be possible in a country where property rights are adequately protected from attack by the state. Indeed, if they did not involve such coercion, they would not have qualified as cases. But constraints on this coercion were important in shaping the takeovers in a number of key ways:

- they meant that a negotiated outcome was favoured over full-scale asset seizure, therefore favouring private or quasi-state buyers and increasing the chances that the existing owner would walk away with substantial compensation for his assets;
- they gave the existing owners real options in terms of tactics they could use to improve their bargaining position or rescue some of their assets from seizure;
- they prompted state-owned companies to find indirect forms of ownership when acting as buyers in time-sensitive takeovers.

In an ideal-type kleptocracy, the takeovers would have proceeded quite differently. There would have been no bargaining, no chance for the owners to salvage any of their assets, and no need for innovative new ownership structures.

The cases have shed some light on the question of precisely what institutions act as constraints on the state's use of coercion to attack property rights. As noted in Chapter 1, Frye (2004) wrote that our understanding of this question was limited, but suggested that the key to tackling the "commitment problem" is a legal system and judiciary that is independent of the executive. Meanwhile, some scholars have argued that Russia's legal system is best characterised by "telephone justice", i.e. the ability of the executive to interfere arbitrarily in the workings of the courts, including by dictating verdicts (Ledeneva, 2008, 2011; Varese, 2005). "Telephone justice" is the antithesis of what Frye suggests is crucial to constraining state coercion. Since the state's actions are nevertheless being constrained somehow, we can conclude that either "telephone justice" does not extend to the whole of Russia's legal system, or that the constraints come from outside that system.

One constraint on state coercion that does indeed come from outside Russia's legal system stems from the fact that the Russian state and Russian business do not exist in isolation from the rest of the world. International exposure means occasionally being subject to legal constraints from outside Russia's jurisdiction. An excellent example is the US legal action brought by Yukos which forced Gazprom to abandon its plans to buy Yuganskneftgaz at auction. Rosneft', whose international exposure at the time was minimal, was able to step into the breach. Similarly, Russia encountered difficulties securing the extradition of Yukos associates who had fled the country and were the subject of criminal cases²⁸⁶, and persuading Western courts to freeze Yukos assets earmarked for the Russian bankruptcy proceedings. In other cases, Gazprom was reportedly reluctant to pursue full-scale asset seizure against Sibur because this would entail a large-scale legal campaign in various countries, thanks to the complex offshore ownership structure Goldovsky had put in place. Gazprom was apparently

²⁸⁶ Here "telephone justice" at home worked actively against Russia's purposes. Judges in Western countries turned down extradition requests on the grounds that there was no guarantee the individuals would receive a fair trial in Russia.

compelled to hide its beneficial ownership of OMZ because of fears the European Commission would not allow it to control OMZ's Czech assets.

However, it is also clear that the state and state-owned companies faced additional constraints that had no international dimension. For example, in Chapter 3 the existing owners of Gazprom's 'lost' assets used share dilutions to weaken Gazprom's ownership claims. At Zapsibgazprom, Gazprom was eventually able to have the share dilution annulled through the courts, but in the intervening period Zapsibgazprom had lost control of the South Russkoe oil field (the main asset of interest to Gazprom) through further share dilutions. At Sibur and Zapsibgazprom, Gazprom regretted its decision to begin bankruptcy proceedings because of a real danger that the assets could be lost to rival creditors. For all its access to "administrative resources", it was not able to ensure the bankruptcy proceedings went exactly as it wanted.

The existence of meaningful domestic constraints on state coercion, even in cases which had a clear political significance, lends weight to Hendley's (2006, 2009) view that "telephone justice" is only part of the story in Russia's legal system. In her view, it is better seen as "dualistic" and as an "equilibrium that somehow balances 'rule by law' and 'rule of law'". She sees the commercial *arbitrazh* courts as an area where particular progress has been made towards professionalism in recent years (Hendley, 2007). These courts are tasked with handling all economic disputes involving legal entities, and would have been the forum for legal action brought against the state-backed companies in chapters 3 and 4 if they had failed to comply with the antitrust and corporate governance laws. It is significant in this context that there has been a marked increase in firms' willingness to take their disputes with state authorities to the *arbitrazh* courts (Gans-Morse, 2011, p. 40; Hendley, 2006, p. 367).

However, as Hendley (2006, p. 361, 2007, p. 248 fn. 8) has pointed out, the *arbitrazh* courts have themselves been susceptible at times to "telephone justice". They were complicit in the legal travesty of the Yukos affair: the grossly inflated claims for back taxes, which formed the

basis for the seizure of Yukos's assets under the guise of bankruptcy, were given legal force by rulings from *arbitrazh* judges. Hendley's conclusion is that "telephone justice" interferes in the normal workings of the *arbitrazh* courts when the Kremlin takes a particular interest in the outcome of certain cases, while routine cases are resolved in accordance with the law.

It might be possible to conclude from this that the limited domestic institutional constraints on state coercion that we have observed in the case studies stem from the fact that "rule of law" operates outside of particular court cases in which the Kremlin takes a close interest. However, the Kremlin *did* take a close interest in all of the takeovers examined as case studies in the preceding chapters. Why did this interest not translate into complete freedom from domestic institutional constraints?

The answer lies in the fact that each state-led coercive takeover involved a great deal more than a single court verdict. It could involve multiple court cases brought by state *and* existing owner, as well as claims by third parties such as rival creditors. As Chapter 4 demonstrated, constraints could also come from regulatory institutions (in this case, the FAS) that had limited powers to sanction companies or hinder their actions without having to turn to the courts, for example by delaying approval for deals or imposing certain conditions on that approval²⁸⁷.

The number and complexity of interactions with the law and regulatory institutions is significant if the scope of "telephone justice" is limited by the Kremlin's lack of administrative resources to micro-manage outcomes on a wider scale. As Hendley (2009, p. 248 fn. 8) says, "it strains credulity to imagine that Kremlin officials are involved in resolving the hundreds of thousands of cases that are heard by the *arbitrazh* courts every year [...]". But at the same time, Hendley (2009) and Ledeneva (2008, p. 326 fn. 6) both suggest that judges

²⁸⁷ The FAS's record of success in challenging Gazprom both in and out of court was patchy at best, but it was certainly enough to make Gazprom interested in complying with the relevant laws when there was no overriding imperative to get deals done quickly.

operate to some extent under a form of “self-censorship”: without the need for a telephone call from the Kremlin, they understand which way a court case should go when (for example) one side is a state-owned company and the other a private business. Other institutions which enjoy no real autonomy from the executive are presumably similarly able to understand instinctively how they should behave vis-à-vis state-owned or state-backed companies. If this “self-censorship” were functioning perfectly, then the Kremlin’s attempt to micro-manage complex state-led coercive takeovers should not run up against any administrative constraints: all the judges and regulators involved should know how to behave without any direct guidance required. That is clearly not what was happening in the cases: in addition to the struggles of the FAS against Gazprom in Chapter 4, a good example is the way Alfa Group fought successfully against Gazprom to defend its interests as a Sibur creditor in Chapter 3.

In some instances, the apparent willingness of courts and regulators to take a stand against a company as powerful as Gazprom might be down to corrupt influence, or the fact that Gazprom’s rivals had an equally powerful source of patronage inside the Kremlin. However, it seems unlikely that this can explain all the moments where Gazprom felt the force of purely domestic institutional constraints. The evidence points instead to partial progress having been made towards the establishment of viable, independent market institutions. But this progress towards “rule of law” is at least as vulnerable as the pursuit of economic development to being trumped by higher priorities²⁸⁸.

Russia as flawed “developmental state”

In arguing that the state actors involved in the coercive takeovers were motivated in part by developmental motives, this thesis has subscribed to the view that Russia was during this period not just some distance from being an ideal-type kleptocracy, but was in fact a form of

²⁸⁸ At the time of writing, there appears to be a serious risk that the partial progress in this area (and many others) will be undone by Russia’s incursions into Crimea and Eastern Ukraine.

“developmental state”. When they were not aimed solely at countering perceived threats to sovereignty, the coercive takeovers were part of a wider set of *dirigiste* policies that had economic development as their goal.

However, the Russian variant of the “developmental state” was flawed in significant and instructive ways. The “developmental state” literature (e.g. Doner, Ritchie, & Slater, 2005; Leftwich, 1995) has pointed to the presence of an *external* security threat (e.g. the threat of invasion by a foreign power) as a factor that focuses the minds of state actors on the need to make a serious commitment to a state-led developmental push. The above discussion of “sovereign development” suggests that insecurity *within* a country’s borders (when state power has not been fully consolidated) can have the opposite effect of distracting state actors from developmental objectives²⁸⁹. In the Russian case this may have been enough to doom the state-led developmental project to partial success at best. The political elite’s apparently exaggerated, ideology-based sensitivity to threats to state security only compounded the difficulty.

However, even in those cases where the state was not distracted by sovereignty concerns from pursuing developmental objectives (such as the attempt to integrate Izhorskie Zavody’s reactor production effectively into the overall nuclear industry development programme) the results were still patchy at best. That particular case was one of poor implementation, and not because of predatory behaviour on the part of state officials. In the absence of any meaningful market signals to help them agree on appropriate prices for reactors supplied by Izhorskie Zavody, the apparently development-minded state actors at Forpost-Management and at Rosatom were unable to cooperate effectively across the institutional lines that divided them. This underlines the importance of getting the right institutional design inside government. The “developmental state” literature already offers a potential solution to this problem in the form

²⁸⁹ Similarly, Leftwich (1995) observes that successful developmental states typically start from a position where state power and autonomy vis-à-vis national and foreign capital have already been consolidated.

of the “pilot organisation”: a single institution within government that enjoys some autonomy from the rest of the bureaucracy, and that is tasked with devising developmental policies and coordinating their implementation across state agencies (Johnson, 1982). A pilot organisation would have been of considerable value for cooperation between Izhorskie Zavody and Rosatom through its simply ensuring that a single government body had both the power and the motivation to make two subordinate government agencies work together effectively.

The pilot organisation might also provide a solution to the drawbacks of the ‘directive’ system which is a central feature in the governance of Russia’s state-owned companies. As discussed in Chapter 3, this system requires sign-off from multiple state agencies before state representatives can vote at shareholder and board meetings. As Tompson (2008, p. 12) notes, this makes Russian state-owned companies inherently inefficient even when leaving aside their particular vulnerability (as he sees it) to corruption. It does so not solely because it is a piece of cumbersome ‘red tape’: it also exacerbates the historical problem noted by Vernon (1984) of state-owned companies being subject to poorly coordinated government control, and pursuing a multitude of sometimes conflicting political objectives. One solution to this problem, based on Hertog (2010), would be to allow state-owned companies to pursue profit-maximisation with a minimum of government interference. However, this is not viable in situations where an important part of the *raison d’être* of the state-owned company is to pursue political objectives besides profit-maximisation. Replacing the ‘directive’ with a single sign-off from a pilot organisation would maintain the channel of government influence and control, but make it possible to exercise this control according to a single, coordinated strategy. The varying agendas of interested government agencies would have to be taken into account when the pilot organisation was formulating its strategy, but this process would be separated from the issue of obtaining government sign-off for particular votes at the board and shareholder meetings of state-owned companies. It would therefore allow the government to

use state-owned companies for ‘political’ purposes besides profit-maximisation, without them becoming subject to ‘mission creep’ and bureaucratic paralysis²⁹⁰.

However, state-owned companies can be pulled in different directions by their masters in government not only because of flaws in their governance processes, but because the government has failed to devise an appropriate strategy for development. The Putin regime can perhaps be credited for having recognised the dangers of continuing to impose a neoliberal economic agenda, and for experimenting with forms of state intervention. In common with much of the rest of the world, Russia is feeling its way forward in terms of how best to bring the state back into economic strategy. But Putin’s policies have often been too *ad hoc* and impulsive to merit description as coherent strategy²⁹¹.

If the “developmental state” literature is correct, the economic challenge facing Russia requires a far more ambitious and coordinated response. The state will be required to settle on a few sectors that hold the potential to break the dependence on hydrocarbons and other primary natural resources, because it will not have sufficient administrative resources to spread its developmental efforts any wider. It will then need to devise and implement sophisticated policies aimed at fostering the growth of those sectors into serious contenders on the world market. As the apparent failure of Prime Minister Dmitry Medvedev’s nanotechnologies project indicates, these policies require long-term and institutional commitment rather than being associated too closely with the changing whims and fortunes of a particular politician or politicians.

²⁹⁰ Vernon notes that historically, various countries (including India) have attempted to solve the same problems through the creation of a special “ministry for state-owned enterprises, which was expected to act as both a buffer and an advocate for such enterprises within the ministerial structure”. The proposal made here is somewhat different, mainly because it places responsibility for strategic management of state-owned companies within the remit of a development-focused pilot organisation. This would eliminate the danger that a separate “ministry for state-owned enterprises” might begin pursuing its own self-interest (and that of the state-owned enterprises) at the expense of the wider developmental agenda.

²⁹¹ Granted, it may be that devising such a coherent strategy requires the creation and empowerment of a “pilot organisation” staffed with the best and brightest minds, sufficiently protected from political interference to prevent policy capture by vested interests, yet sufficiently “embedded” in society to ensure adequate policy implementation and feedback regarding successes and failures (Evans, 1995).

Making the decision to target only a small number of sectors for state support is bound to entail a more coherent strategy for dealing with the unprofitable sections of the Soviet industrial legacy. Autarchy is clearly a high priority for Russia's security-minded political elite, and it has its place in any country's economic strategy, but one suspects that Russia's development is being hindered by an excessive emphasis on maintaining domestic production capabilities in many areas of the economy, including some where the national security imperative is limited. There may be other good reasons (both in terms of the social impact and the knock-on effect for other areas of the economy) for not letting much of Russia's ailing industrial legacy go the way of creative destruction. But half-hearted and *ad hoc* attempts to keep alive failing enterprises such as Zapsibgazprom are surely not the answer.

The world is full of examples where states have been unsuccessful in their attempts to make economic interventions, and a cynic might question the value of adding new case studies to the pile. But in an era of growing realisation that states are integral to all economies, it is more important than ever to learn the correct lessons from failed interventions as well as seeking to explain the rare successes. This thesis has argued that states' economic interactions are too often explained away in terms of corruption and rent-seeking. The author hopes that it has made a small contribution towards correcting this imbalance, by providing an alternative account that allows for the possibility of state actors pursuing political objectives besides their own venal interest-maximising, and that focuses on institutional constraints on their efforts at economic intervention.

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