"Waves" of the Russia's Presidential Reforms Break About Premier's "Energy-Rocks"

By Dr. Zurab Garakanidze*

Story about the Russian President Dmitry Medvedev's initiative to change the make-up of the boards of state-owned firms, especially energy companies.

In late March of this year, Russian President Dmitry Medvedev demanded that high-ranking officials – namely, deputy prime ministers and cabinet-level ministers that co-ordinate state policy in the same sectors in which those companies are active – step down from their seats on the boards of state-run energy companies by July 1. He also said that October 1 would be the deadline for replacing these civil servants with independent directors.

The deadline has now passed, but Medvedev's bid to diminish the government's influence in the energy sector has run into roadblocks. Most of the high-level government officials who have stepped down are being replaced not by independent managers, but by directors from other state companies in the same sector. Russia's state-owned oil and gas companies have not been quick to replace directors who also hold high-ranking government posts, despite orders from President Dmitry Medvedev. High-ranking Russian officials have made a show of following President Medvedev's order to leave the boards of state-run energy companies, but government influence over the sector remains strong.

This indicates that the political will needed for the presidential administration to push economic reforms forward may be inadequate.

At the end of March in Magnitogorsk, Russian President Dmitry Medvedev announced plans for removing high-level civil servants from the boards of state-owned energy-companies. So far, though, the government has not fully executed this order, particularly with respect to companies active in the energy sector.

Medvedev has justified his decision by pointing out that government officials who are responsible for setting policy in a certain area – for example, energy – are serving as directors of competitive companies active in that same area. This causes conflicts of interest, he said, and leads to discord between the government, with its reformist agenda, and members of parliament, who are influenced by energy lobbyists.

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The president has officially charged the government with executing his initiative in several stages. By July 1, state-owned companies must discharge all deputy prime ministers and cabinet-level ministers that co-ordinate state policy in the same sectors in which those companies are active and replace them with independent directors at their shareholder meetings.

By October 1, state-owned companies involved in the energy sector, as well as some state-run military-industrial firms, must elect supervisory board chairmen who are not civil servants.

October 1 has also been designated as the deadline for finalising the replacement of all high-level civil servants with independent directors. (Board seats will still be open to officials at the level of deputy minister and departmental director, as these are not considered to have independent political influence.)

State involvement

The high number of government representatives on the boards of state-run companies stems from the fact that the Russian state has a high level of direct involvement in many sectors of the economy.

In other words, the Russian economy has yet to be extensively liberalised. Although more than a decade has passed since the so-called “Chubais” wave of post-Soviet privatisation (a reference to former First Deputy Prime Minister Anatoly Chubais), Russia is still home to many state-owned enterprises, not least in the oil and gas sectors.

After a period of consolidation of state interests under former President Vladimir Putin, now serving as prime minister, the push for reform took on renewed urgency because of the world economic slowdown that erupted in 2008.

In 2009-2010, the government of the Russian Federation again began actively considering serious reforms. However, the tortuous recovery from the crisis and the return of high oil prices have stymied Moscow’s efforts to move in this direction.

Moreover, the state has even raised its stake in some companies. This year, for example, the government has upped its interest in the Russian oil pipeline monopoly Transneft by 3.5%.

Sechin’s moves

Now, though, Medvedev is pushing for a change. He won his first victory in April, when Deputy Prime Minister Igor Sechin agreed to leave his post as chairman of the board of directors of Rosneft, the state-owned oil company.It should be noted that Sechin is still in a position to influence Rosneft, as his departure coincided with the promotion of another board member who is completely loyal to him – Sergei Shishin, the vice president of state-owned VTB Bank. According to a source close to the oil company’s board, Shishin has “good relations with both Igor Sechin and with the directorate of the FSB [Russia’s Federal Security Service, the successor to the KGB] – in particular, with [FSB director] Alexander Bortnikov. [1]”

Sechin had intended that Shishin would succeed him as chairman, but his hopes were not realised. Rather, an independent director – Alexander Nekipelov, the vice president of the Russian Academy of Sciences – has been appointed acting chairman.

However, this move is widely viewed as problematic in light of Sechin's history as a strong advocate of Rosneft's interests within the government. Even Nekipelov, who had been Medvedev's preferred candidate, said at Rosneft's shareholders meeting on June 10 that the deputy premier's departure posed "certain risks. [2]"

Nepotism

Sechin's bid to raise Shishin's profile within Rosneft has found echoes at other companies. In recent months, some of the officials who serve on the boards of state-owned companies have tried to appoint their own children to take their places.

In early May, for example, the presidential administration spoke out in opposition to the proposed appointment of the son of Deputy Premier Sergei Ivanov as the board chairman of Rosselkhozbank. (The younger Ivanov, also named Sergei, is already serving as the general director of the energy-insurance company SoGaz.) As a source in the Kremlin noted, Ivanov would have replaced another fortunate son – namely, the son of Dmitry Patrushev, the secretary of Russia's Security Council, who has headed Rosselkhozbank since May 2010. Movement in the direction of reducing the influence of government officials, most of them Putin's favourites, from company boards is seen by some as positive and as evidence of reform [3].

Since February 1, moreover, Denis Bortnikov, the son of FSB chief Alexander Bortnikov, has been appointed as chairman of the board at VTB Bank-Northwest. Meanwhile, the new vice president of Vnesheconombank, Russia's foreign trade and investment bank, is Pyotr Fradkov, the son of Mikhail Fradkov, the director Russia's Foreign Intelligence Service (SVR) [4].

Gazprom's board

This is not the only type of horse-trading to have occurred. On June 2, for example, it became known that Gazprom, the state-run natural gas monopoly, would no longer count Economic Development Minister Elvira Nabiullina or Energy Minister Sergei Shmatko as members of its board of directors. However, First Deputy Premier Victor Zubkov, who already serves as chairman of the board, will keep his seat.

According to the Russian press, the Kremlin has yet to find a replacement that satisfies both the government and Gazprom. As such, it is not beyond the realm of possibility that Zubkov will keep his post as chairman, at least until October, 1.

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Gazprom shareholders are due to elect board members at an extraordinary general meeting (EGM) on June 30, immediately following the regular annual general meeting (AGM). In total, the Russian government has nominated six candidates for seats on the board. Besides Zubkov, it has put forward the names of Alexei Miller, Gazprom's executive director; Vladimir Mau, the rector of the Russian academy of national economy and civil service; current board members Igor Yusufov and Farit Gazizullin, and also Andrei Akimov, the head of Gazprombank. The list of candidates has already presented to shareholders for approval.

The gas giant's board may also include Timur Kulibayev, the chairman of the Kazakhstan's state welfare fund Samruk-Kazyna. Kulibayev has held a number of high-ranking posts at Kazakhstan's state-owned oil and gas companies – Kazakhoil, Kaztransoil and KazMunaiGaz. He is also the son-in-law of Kazakhstani President Nursultan Nazarbayev and one of the richest businessmen in the Central Asian contry. (Forbes has estimated his assets at US$1.3 billion) [5].

Meanwhile, the Russian government is reportedly talking about inviting former German chancellor Gerhard Schroeder to join Gazprom's board as a replacement for Shmatko or Nabiullina. According to media reports, no final decision on this plan has been made yet. Schroeder is currently serving as the head of the committee of shareholders at Nord Stream AG, the consortium set up to build and operate the Nord Stream gas pipeline [6].

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As for other state-owned companies, it was announced in early June that Transneft President Nikolai Tokarev would head the board at Zarubezhneft, a Russian state-owned firm that carries out foreign oil projects. RusHydro will be headed by Vladimir Tatsy, the first vice president of Gazprombank, while Ilya Yuzhanov, the former anti-monopoly policy minister, will take over at Svyazinvest. Prince Alexander Trubetskoi, the co-manager of a Russian-French trading company, is to become the board chairman of Alrosa.

Doubts

These changes have had a mixed reception. On one hand, movement in the direction of reducing the influence of government officials, most of them Putin's favourites, from company boards is seen by some as positive and as evidence of reform.

On the other hand, some have pointed out that state-owned energy companies' boards will continue to include civil servants (again, many of them Putin appointees), even if they hold lower ranks, as independent directors. These board members, they say, still represent interests closely connected with the government.

This lays the groundwork for future disputes, and there are already signs of movement in that direction.

Arkady Dvorkovich, the top economic advisor to President Medvedev, recently declared that the Kremlin had "serious doubts" about a number of board nominees who were due to be confirmed by July 1. He said that the presidential administration probably would not approve the candidates who are believed to be on "Sechin's list. [7]"

The deputy premier had earlier suggested the appointment of Sergei Chemezov at Inter RAO UES, an electricity trading company, and Andrei Akimov at Rosneftegaz, the parent company of Rosneft. He also put forward the names of Tokarev, the head of Transneft, and Mathias Warnig, a German national, for board seats at Transneft and Rosneft. (Warnig, who served in the East German state security agency, known as the Stasi, is one of Putin's old colleagues; he now serves as managing director at Nord Stream AG.) In early June, it was reported that Akimov and Chemezov had been accepted as nominees.

According to the Russian media, eliminating Chemezov and Tokarev could pose certain problems for President Medvedev. Specifically, some observers view the dismissal of experienced government officials from state-run companies' boards as negative for the investment climate.

Some have also pointed out that efforts to diminish the influence of Putin and his circle, which includes Sechin and Chemezov, may have deleterious economic effects

Political ties

Under Medvedev's decree, the main changes envisioned have to do with the formal mechanisms of state control over so-called strategic assets.

Since 1999, the current president's predecessor – Vladimir Putin, now serving as prime minister – has appointed loyal government officials to the boards of large state-owned companies active in the energy, transport, military-industrial and air transport sectors.

Many of these appointees were close allies of Putin, who of course got his start in the KGB. However, even liberal members of the government fall into this category.

For example, Finance Minister Alexei Kudrin has served as chairman of Alrosa, Russia's national diamond-mining company, and VTB Bank, the state-owned foreign trade bank. Medvedev himself, when serving as first deputy prime minister before the presidential election in 2008, was chairman of the board of directors at Gazprom, the biggest state-owned company in Russia.

Following instructions

On the surface, high-level officials have been fairly quick to follow the president's instructions. For example, Deputy Prime Minister Igor Sechin, who oversees the fuel and energy complex, didn't wait for the July 1 deadline. Rather, he stepped down as chairman of the board at Rosneft on April 11, setting an example to other officials.

Additionally, Sechin, along with Energy Minister Sergei Shmatko, has said he will leave the boards of several other state-owned companies – Rosneftegaz (the largest shareholder in Rosneft), RusHydro (the national hydropower concern) and Inter RAO UES (an electricity trader) – by August 31.

The deputy premier and the energy minister announced plans to step down from their board seats at Inter RAO UES in June. It is worth noting, however, that while Sechin left his post as chairman on June 24, the electricity trader's majority shareholder is Rosatom, the state nuclear concern. The latter company, which is 100% owned by the government, holds a 57.3% stake in Inter RAO UES.

The trader's supervisory board includes many high-level officials, including Shmatko as well as three presidential advisors (Larisa Brycheva, Anatoly Dvorkovich and Sergei Prikhodko). Its chairman is Igor Shuvalov, a first deputy prime minister.

As such, even though two high-ranking civil servants are stepping down at Inter RAO UES, the government will still retain strong influence at the company through its control of Rosatom. Moreover, Shmatko's seat on the Rosatom board indicates that very little change is likely.

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Holding off

There are other signs that Moscow is losing the political will needed for pushing ahead with economic reforms.

For example, the Russian Ministry of Economic Development had earlier announced plans to sell an 8% stake in RusHydro, 50% minus one share in Rosagroleasing and 100% of Rosinteragroservice (RIAS), the state grain company, by 2013. The ministry also said that between 2013 and 2015, the state share in Sovkomflot, the shipping company that has teamed up with Transneft for the second Baltic Pipeline System (BPS-2) project, would be decreased to 50% plus 1 share and that a stake in Russian Railways (RZhD) of 25% minus one share would be sold. The Russian government also actively discussed proposals for the privatisation of the Sheremetyevo international airport, which is, like the other companies listed above, fully state-owned.

However, the Kremlin has backtracked, apparently as a result of an influx of oil revenues – that is, petrodollars – into the economy in 2010-2011. The size of the stakes being offered in some state-owned companies has gone down; for example, Moscow now intends to sell 7.6% of Sberbank, the state savings bank, rather than 9.3% as previously announced.

Meanwhile, plans for the sale of the Sheremetyevo airport have simply been postponed. (They may be shelved altogether, given that the government is now talking about consolidating it with Vnukovo, another airport near Moscow, and then possibly joining both to Domodedovo, the third airport serving the capital.)

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Meanwhile, Aeroflot – the country's biggest airline, which is 51.17% state-owned – has not even been considered for privatisation. Nor have Svyazinvest, the national telecommunications company, or the Agency of Housing and Mortgage Lending (AIZhK).

As for Transneft, the state oil pipeline operator, and Zarubezhneft, a state-owned company that is mostly active in foreign projects, no plans have been made to sell major stakes that might give an outsider investor significant control. The same path is being followed with respect to Rosneft, Rosselkhozbank (the national agricultural bank), VTB and RusHydro.

Moreover, Moscow appears to be putting off making decisions on the fate of state-owned companies for as long as possible. For example, it was decided at a government meeting led by Putin in October 2010 to wait until 2014-2015 to sell part of the state's stake in VTB, and until 2016 for Rosneft. The officials also decided to defer a decision on the RusHydro stake, saying that a sale was only possible if a "reliable investor" came forward beforehand.

These moves were endorsed by Putin, who has not always seen eye to eye with Medvedev on matters of economic reform. By contrast, Dvorkovich, who serves as the top economic advisor to the president, has said that Moscow may revise its plans for the sale of a stake in Rosneft.

Conflicts

Following these delays, a commission set up by Medvedev approached the Russian government with a proposal for completely eliminating state ownership of several companies – namely, VTB, Rosneft, Rosselkhozbank and RusHydro. The president has responded positively, and his administration has said it will not rule out a full exit from VTB and Rosneft.

This, along with the push to remove high-ranking civil servants from the boards of state-run firms, indicates that liberalisation and privatisation remain among the president's top priorities. However, officials who would see their influence dwindle as a result of these campaigns are likely to fight back. If they do, the boards of these state-run companies may become battlefields between the Kremlin and the White House.

For example, in mid-June, it became known that Medvedev had blocked the government's move to nominate Yuri Kudimov, the general director of VEB Capital, to the board of Sheremetyevo airport. Instead, the president put forward Yuri Medvedev, the deputy director of the Gazoturbinconstruction Salute company.

According to press reports, this was at odds with the government's plan, which called for Kudimov to be replaced by Anatoly Tikhonov, the first vice president of Vnesheconombank, VEB Capital's parent organisation.

The presidential administration apparently did not co-ordinate its choice of nominees with the government because it feared that this would allow VEB to play a more prominent role in the process of amalgamating the airport's terminals.

The presidential administration explained its decision to nominate the Gazoturbinconstruction Salute chief by describing the nominee as "a skilled manager with a very good reputation." It also noted that Yuri Medvedev, as the deputy director of Rosimushchestvo (Russia's State Property fund), had never been involved up in any scandals or conflicts.

However, there may have been horse-trading involved here too.

The decision to nominate Yuri Medvedev was made by Dvorkovich, the president's top economic advisor. Meanwhile, Dvorkovich's wife, Zumrud Rustamova, is a member of the Sheremetyevo airport's board of directors. In the past, Rustamova was also one of Yuri Medvedev's colleagues at Rosimushchestvo.

So once again, board members at a state-owned company are being replaced by directors with ties to the government. The difference is that this time, state-owned companies are not swapping one high-level civil servant for another but for the directors of another state-owned company active in the same sector of the economy.

These trends are not conducive to improving the image of the Russian economy in the eyes of foreign investors, as they increase the likelihood of clashes between the different factions represented on company boards. Disputes of this type, especially in Russia's regions, have already made many investors skittish in the past.
President Dmitry Medvedev is confronting a difficult situation in some regions of the Russian Federation with respect to his push to reduce the government's influence over the boards of public sector energy firms. In the republics of Tatarstan and Chechnya, for example, the president's decree calling for high-level officials to leave their board posts has not been accepted.

The presidential order was issued in late March of this year. The following month, though, the president of Tatarstan, Rustam Minnikhanov, declared that high-ranking officials would not have to step down from their seats on the boards of state-owned companies in Tatarstan [8].

As for Chechnya, high-level officials continue to hold prominent posts in local energy companies. For example, Ramzan Kadyrov, Chechnya's president, serves as chairman at Grozneftegaz.

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Tatarstan

In late May, the Tatneftekhiminvest holding convened its annual general meeting (AGM) under the chairmanship of Minnikhanov.

The shareholders present at the gathering elected a new board of directors nearly identical to the one already in place – with the Tatarstani president staying on as chairman, in violation of Medvedev's order. In total, shareholders appointed 22 persons to Tatneftekhiminvest's board. (Previously, the board had 21 members.) Along with President Minnikhanov, several other high-ranking republican officials kept their places on the board: Prime Minister Ildar Halikov; First Deputy Prime Minister Ravil Muratov; Industry and Trade Minister Ravil Zaripov; Renat Sabirov, an assistant to the president, and Renat Muslimov, the president's advisor on oil and gas issues.

Meanwhile, new board members included the republic's minister of energy, Ilshat Fardiyev (who is, incidentally, the nephew of Tatarstan's former President Mintimer Shaimiyev); Economy Minister Midhat Shagiakhmetov, and the prime minister's assistant for energy, natural gas and chemical issues, Almaz Galeyev. Overall, almost all members of the holding's board are politicians.

The matter does not end there. Tatneftekhiminvest is the main shareholder in Tatneft, the republic's oil company. Immediately after its AGM in Almetyevsk on June 23, Tatneft's board met in its new configuration and elected Minnikhanov as its chairman, even

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though he was already serving in the same capacity at the oil company's parent organisation.

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Chechnya

The presidential decree will also be difficult to execute in other regions of the Russian Federation. In Chechnya, for example, republican officials are still determined to maintain control over the revenue streams coming in from the oil and gas sector.

The republic's main fuel and energy enterprises are Grozneftegaz and Chechenneftekhimprom. Both were registered in 2001.

The first company is involved in the extraction and transportation of Chechnya's oil resources. A minority 49% share in the company belongs to the government of the Chechen republic, while the remaining 51% is in the hands of Rosneft, a company owned by the Russian government.

In 2001, Akhmad Kadyrov, then serving as Chechnya's president, was appointed chairman of Grozneftegaz's board of directors. Currently, his son, Ramzan Kadyrov, who has succeeded his father as president, is serving as chairman. Musa Eskerkhanov, the company's general director, is a close relative of President Kadyrov.

The second company was originally founded as an affiliate of Grozneft, which was established during the Soviet period. It was included in the privatisation programme of 2004, but so far it remains under the control of Russia's federal government. In 2004, Chechenneftekhimprom's general director was arrested and replaced by a member of Kadyrov's inner circle.

At present, Grozneftegaz has no title to any energy production and transportation facilities in Chechnya, while Chechenneftekhimprom's property rights exist only on paper. All licences and titles are under the control of the company's majority shareholder, Rosneft.

More than six years ago, Chechenneftekhimprom's oil-producing assets were transferred to Rosneft on the basis of a lease agreement. Since then, the leaders of the Chechen republic have sought repeatedly to regain control over this oil. In fact, the first attempts to revise the lease agreement were made by Akhmad Kadyrov, the father of the current president, who informed his inner circle one week before his murder that he intended to hold serious talks on the matter with Vladimir Putin, then serving as Russia's president.

Money matters

The Chechen leadership is motivated by money. According to official data from Rosneft, Grozneftegaz extracted around 1.9 million tonnes (38,000 barrels per day) of oil in 2008 and 1.6 million tonnes (32,000 bpd) in 2009. Assuming a price of US$90 per barrel, this oil is worth around US$1.1-1.2 billion per year.

Officials in Grozny have complained that all of the crude is exported and that none of the proceeds remain in the republic. These complaints are likely to be renewed if, as predicted, oil prices continue to rise – even though Chechnya receives more than US$1 billion per year in direct subsidies from the Russian government.

The true disposition of Chechen oil revenues is not so clear-cut, however, and official Russian statistics offer no clarity.

Crude is currently exported from the republic by pipeline and rail and loaded onto tankers for delivery, with much of it being sold to offshore companies registered in Cyprus, the Seychelles or elsewhere. These buyers use offshore accounts in other countries such as Liechtenstein to make their payments, with some of the money going to Russia's state treasury and the rest going into a special account held by the Russian Energy Ministry.

However, the price for Chechen oil set by the Energy Ministry does not take account of the volumes used for blending with lower-quality Russian and Central Asian crude in Transneft's pipelines. In fact, the amount of Chechen oil blended in this fashion and exported via the Novorossiisk and Tuapse terminals is classified as a state secret.

In practice, this allows the owners of the companies involved in the business to collect even larger profits, while none of these firms' board members asks about the transparency of money transfers.

Who benefits?

According to the Russian media, those in position to benefit include Chechnya's president, Ramzan Kadyrov. As noted above, Kadyrov serves as chairman of Grozneftegaz. He has frequently clashed with Russian Deputy Prime Minister Igor Sechin, who served as chairman of Rosneft before Medvedev launched his initiative, over the matter of management of oil revenues.

Another player is Vakha Agayev, the founder and board chairman of the Yugnefteproduct holding, which was previously controlled by offshore companies. The firm had strong links to Tuapsenefteproduct and the Tuapse refinery before they came under Rosneft's control. Agayev is considered to be a close friend to Ramzan Kadyrov. His son has served as chairman of the Krasnodar refinery, formerly state -owned but now under the management of Russ-Neft, a private company. Another prominent name is that of Nikolai Bukhantsov, a former Russian Energy

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Ministry official who was involved in the founding of Naftatrans, one of the main players in Chechen oil exports. In 2002-2003, Bukhantsov served in the departments of the Energy Ministry where all data on quotas, export transactions, shipments and production are collected. During the same period, he also acted as an advisor to former Energy Minister Igor Yusufov, who then headed the board of Rosneft. Bukhantsov and Yusufov both lost their positions in 2004, when Sechin took up his position.

Meanwhile, the Magomadov brothers, the scions of an influential family in the Chechen republic, are holding the reins at Chechenneftekhimprom. The elder brothers, Lema and Abdul-Khamid Magomadov, are members of Kadyrov's government, one serving as a deputy premier and the other as the minister of economic development and trade.

The younger brothers, Yunus and Yusup Magomadov, worked at the Ministry of Internal Affairs in 2003-

2004. They held posts in the department charged with ensuring the security of the republic's oil pipelines – that is, with protecting the infrastructure of Chechenneftekhimprom.

For his part, Adlan Magomadov served as plenipotentiary representative of the Chechen republic in Moscow until July 2004, and after personnel shifts, he became the head of the Impexproduct company. This firm, which had a central office in Moscow and branches in Kazakhstan and Ukraine, was until recently the main oil trading concern of RussNeft – which was, incidentally, founded by Mikhail Gutseriyev, a businessman from Ingushetia.

Another name in the mix is that of Pyotr Suslov, a former officer in Russia's Foreign Intelligence Service (SVR), who has been an active participant in Russian oil, energy and construction projects. Suslov has at various times crossed paths with Sechin.

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Family ties

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Dead end

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The president's campaign has not led to any appreciable growth in foreign investments and has not made these companies more transparent. Rather, government control over the companies mentioned in this series has not been reduced. PR

Notes:

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