

## PRIVATIZATION REGULAR PRIVATIZATION NEWSLETTER

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To Our Clients and Friends:

The mass privatization of state-owned property in Russia continues.

### FEDERAL DEVELOPMENTS

As reported previously, on November 27, 2010, the Russian Government endorsed a privatization program for 2011-2013 (the “Privatization Program”) that included such major Russian companies as Rosneft, VTB Bank, RusHydro, Russian Railways, Sberbank, Federal Grid Company, Sovcomflot and Russian Agricultural Bank. The Privatization Program is continually updated to take into account of the economic and political needs of the country and the companies included in the Privatization Program. For example, in July 2011 the Russian Government included 25.1% of the shares of JSC Territorial Generating Company No. 5 (TGK-5) in the Privatization Program.

At the St. Petersburg Economic Forum, the President of Russia laid out the task of expanding the privatization plan. The Russian Government prepared and the President approved a report on an expanded privatization plan providing for an extension of privatization through 2017. The projected revenue of the drive to expand privatization of Russia’s largest companies and banks through 2017 is 6 trillion rubles (approximately \$20 billion).

There are proposals to include other companies, such as Aeroflot (Russia’s largest airline with a market capitalization of approximately \$2.7 billion), Transneft (an oil transportation monopoly operating trunk pipelines), Rosnano (a company investing in the development of nanotechnologies in Russia), Zarubezhneft (an oil and gas company involved in international oil production and trade) and Inter RAO (one of the largest power companies in Russia). It is also expected that the Privatization Program for 2012-2014 may include the removal of 50 companies from the list of strategic companies, but this is not yet included in the Privatization Program.

The current Privatization Program covers three years (2011-2013) and provides for the possible sale of RusHydro, Sovcomflot and Russian Agricultural Bank by 2015. Since the Privatization Law<sup>1</sup> allows for a Projected Privatization Plan/Program to be adopted for a period of no more than three years, expansion of the privatization program to 2017 will require either that the Privatization Law be amended (although no draft amendments have been drawn up) or that a separate three-year privatization program be approved.

#### CITY OF MOSCOW INITIATIVES

Together with the sale of the shares of companies partly owned by the federal government, privatization is also being planned for companies partly owned by the city of Moscow. On September 14, 2010 the Moscow City Government adopted a Privatization Program for 2011-2013.<sup>2</sup> The Privatization Program contains a list of city-owned shareholdings/participation interests due to be privatized by 2013, with an indication of the size of the shareholding to be privatized. The Privatization Program was amended on a number of occasions following the appointment of Sergey Sobyenin as the new Mayor of Moscow.

In 2011-2013 the City plans to sell its stakes in the companies Vnukovo Airport (one of the largest international airports in Russia) – 74.3%, Metropolitan Insurance Group (one of Russia's leading insurance companies) – 25% plus one share, Moszhilcomplex (a Moscow residential real estate developer) – 100%, and others.

As with privatization at the federal level, the Moscow City Government is planning to engage investment banks for the sale of the assets, since the sale of assets through public tender has in many cases proved inefficient.

Moscow-controlled companies will be privatized in accordance with federal law. The primary law in this area is currently the Privatization Law, which, *inter alia*, defines the procedure for privatizing state and municipal property, privatization methods and procedures for effecting payment for privatized property. There are certain additional specific features of

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<sup>1</sup> Federal Law No. 178-FZ on Privatization of State and Municipal Property dated December 21, 2001 (as amended July 18, 2011).

<sup>2</sup> Decree No. 816-PP on a Mid-Term Privatization Program for Moscow State Property for 2011-2013.

privatization in Moscow that are dealt with in special legislation enacted by the city of Moscow.<sup>3</sup>

#### PRIVATIZATION PRICE

Pursuant to Article 12 of the Privatization Law, the starting price of state or municipal property due for privatization is set in accordance with Russian legislation on valuation activities. The Federal Law on Valuation in the Russian Federation provides that it is mandatory to perform an official valuation in determining the value of property belonging to the Russian Federation, constituent entities of the Russian Federation or municipalities for the purpose of privatizing it. It is worth noting that despite the existence of federal valuation standards approved by the Ministry of Economic Development, assessors are not limited by strict requirements as to the valuation methods applied (in particular, there are no special requirements for valuation of state or municipal property being privatized), and may take various approaches.

In accordance with the Privatization Law, the starting price of federal property being privatized must be indicated in the decision approving the privatization terms, unless otherwise provided for by the Government of the Russian Federation.

The procedure for determining the ultimate price of the property being privatized will depend on the specific method of privatization used. Thus, in the event of the sale of property being privatized at auction or by competitive tender, the property is sold at the highest price offered. At specialized auctions the shares to be sold are alienated in favor of all winning bidders taking part in the specialized auction at a single price per share. When state or municipal property is sold by public tender, the announcement of the sale must state the initial bid price, the amount by which the initial bid price may be reduced (“reduction increment”), the amount by which it may be increased (“bid increment”) and the minimum bid price at which the property being privatized may be sold (the cut-off price constituting 50% of the tender starting price). For the sale of state or municipal property without publication of a price, the starting price is not set. The ultimate price will be the highest price bid by a participant.

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<sup>3</sup> E.g., *Law of the City of Moscow No. 66 on Privatization of Moscow State Property dated December 17, 2008.*

In the recent privatization of a 10% stake in VTB Bank, the sale shares were valued by an independent assessor in accordance with an agreement between the agent and the independent assessor (the Government of the Russian Federation appointed OOO Merrill Lynch Securities as managing agent on behalf of the Russian Federation for the alienation of the shares of VTB Bank held by the federal government).

Another example is the appointment of one of the Big Four international accounting firms (KPMG) by Russian Railways (RZhD) for valuation of the shares of Freight One. The auction for the sale of 75% minus two shares of Freight One took place at the end of October 2011, with a starting price for the stake of RUB 125.375 billion (approximately \$4 billion).

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We would be happy to answer any questions you may have regarding the above, as well as any other questions on privatization.

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