

# **The Selective Use of State Capacity in Russia's Economy Property Disputes and Enterprise Takeovers After 2000**

## **PONARS Policy Memo No. 273**

*Vadim Volkov*

*European University at St. Petersburg*

*October 2002*

Throughout the 1990s, the role of the Russian state in governing the private economy was negligible. Private organizations of various kinds, such as organized criminal groups, private security agencies, and informal groups of state police and security officers, were key to resolving property disputes, enforcing contracts, and processing security-related business information. After Vladimir Putin came to power, the central authority's major concern became the reassertion of state capacity. To what extent has the policy of strengthening the state and of increasing its role in economic governance been successful? What are the main achievements of this policy and what are its side effects? How did property transfers and patterns of resolving property disputes change after 2000?

This memo looks at a new form of violent property disputes—so-called enterprise takeovers—and argues that although the Russian state became stronger and managed to bring more order and security into the economic domain, it still remains internally incoherent and segmented, failing to provide a space governed by efficient, homogeneous rule. If in the 1990s, rising business groups used bandits and private security companies to advance their economic interests, after 2000 the major instruments of aggressive enterprise takeovers are corrupt state organizations that have judicial and coercive power. The first step in reconstructing the state has been made: the bandit has gone; the state employee has taken his place. The second step—making him act as a state employee rather than a bandit—is still a problem.

### **Enterprise Takeover**

Enterprise takeover (*zakhvat predpriatiia*) is a forced change of ownership and management practiced by influential business groups in relation to large- or medium-sized enterprises. The objects of takeovers have most frequently been either profitable export-oriented enterprises (e.g. aluminum or cellulose production), oil-mining facilities, or ore-processing plants (vanadium, strontium, etc.) that supplied vital ingredients to metallurgical enterprises and were therefore crucial to creating vertically integrated business groups. The hallmark of enterprise takeovers is the instrumental use of court decisions, of special police forces, and extensive media campaigns to help new management occupy and control the target enterprise. In many cases, in order to suppress resistance the attacking side initiated criminal prosecution against the old managers and owners. A court decision may soon be repealed and criminal charges proven unfounded, but once the armed takeover has brought new management into the head office, it would be very hard and costly to return the enterprise to its previous owners. From 1999–2002, there were over 25 cases

of large enterprise takeovers (18 successful), most of which involved coercion and included episodes of violent clashes between state and private police forces.

## **Scheme 1**

Before the Law on Bankruptcy was finally amended in 2002, even a small debt was sufficient to initiate a bankruptcy procedure. This allowed those who initiated the procedure to introduce external management to take control of sales and financial flows and to force the previous owner to part with its shares, or to amend the ownership register of the enterprise and change the list of owners. The key trick in such a scheme was to ensure a quick and favorable court decision and to contract a formidable armed police force to overpower the enterprise security service in order to occupy its headquarters. Such a scheme was used in 2000 by Russian Aluminum (*Rusal*) in acquiring control over the Novokuznetsk Aluminum Plant (NKAZ) in the Kemerovo region. Rusal belonged to the so-called aluminum oligarchs Oleg Deripaska and Mikhail Tchernoi and was supported by the copper oligarch Makhmud Iskanderov. First, the energy company Kuzbassenergo (subordinated to the state-owned United Energy System headed by Anatolii Chubais) initiated the bankruptcy procedure against NKAZ to introduce external management consisting of Rusal representatives. The latter swiftly linked the enterprise to their own trading companies and redirected its financial flows, demanding that brothers Mikhail and Yuri Zhivilo (whose company Mikom owned the controlling interest of NKAZ) sell it to Rusal. When the Zhivilo refused, the Procuracy of Kemerovo Oblast initiated a criminal investigation against Mikhail Zhivilo, accusing him of preparing an assassination against the governor, Aman Tuleev. To avoid arrest, Zhivilo had to leave the country. All of Mikom's assets (NKAZ and a number of coal mines) were then transferred to the companies of Deripaska and Makhmudov.

The same scheme—bankruptcy procedure, media campaign, armed takeover, external management, criminal prosecution, transfer of ownership—was used in several other cases by the so-called aluminum-copper oligarchic group to take over the ore-mining and processing enterprise Vanadium in the Urals and the Ust'-Ilim Cellulose Plant in Irkutsk Oblast (although with limited success). The Alpha group applied the same scheme (except for criminal prosecution) to acquire a number of oil-processing companies.

## **Scheme 2**

The second basic option of enterprise takeover is to initiate a lawsuit by a minority stockholder, in most cases by a trusted person owning just one or two shares, in order to acquire from some small provincial court a decision that would either formally allow a change in the board of directors or to arrest and manipulate the stocks of the target enterprise. Once such decision is produced (and the judge normally resigns after delivering the desired verdict), the attacking side hires bailiffs and up to one hundred armed special police troops to storm the enterprise headquarters to install the new managerial team. By the time that first court decision is repealed, due to the procedural mistakes and falsifications, the new managerial team would either have taken control of the financial flows of the enterprise or manipulated the stocks to increase its share.

In 2001–2002, Scheme 2 (or a combination of Schemes 1 and 2) was applied, again, by Rusal, which had renamed itself by then, “The Basic Element,” to take control of the Bratsk Cellulose Plant in Irkutsk Oblast in December 2002 and of the Kotlass Cellulose Plant in

Arkhangelsk Oblast in June–July 2002. In the latter case, a court decision was used to legitimate a covert sale of stocks, the formation of a new management team, and the mobilization of a special police force to storm the enterprise. But the scenario did not work, because in anticipation of the takeover the old management (Ilim Pulp Enterprise) fortified the plant and used the local militia and workers' brigades to strengthen its security. This deterred the takeover and resulted in a stalemate. Consequently, the interference of the president and the procuracy general ended the armed opposition, channeling the conflict into a series of endless lawsuits and appeals. A similar outcome occurred in April 2002 in the Rostov Oblast where the Moscow business group Alfa-eko, backed by OMON special police, attempted the takeover of the Taganrog metallurgical plant. The management of the plant, supported by the workers' militia, organized an armed defense; a violent clash and then a stalemate followed. Consequently, only the interference of the representative of the president in the southern *okrug* compelled the sides to return to court.

## Halfway to the Rule of Law

The practice of enterprise takeovers reflects the new condition whereby some basic elements of the state infrastructure are in place; yet, the poor coordination and lack of regularity within the state allow powerful business groups to use them to pursue private interests. In fact, state resources on the regional and local level are rented to powerful and expanding business groups. In all cases, business groups mobilize local courts, police detachments, anti-criminal police, the Procuracy and, in some cases, regional governors to exercise their respective powers to achieve the transfer of lucrative economic assets or to resolve a conflict between different owners. State officials and organizations did become much more active and powerful after 2000; new laws were adopted and legal procedures were used much more frequently and efficiently. But the strengthening of the state has not yet resulted in the same degree of strengthening of the rule of law. Rather, it brought about the practice of selective application on a commercial basis by business groups, some of which still maintain close connections with officials in the Kremlin.

Another symptom of the growing role of state representatives in economic governance is, sadly enough, the mounting rate of assassination of state officials. It is no longer criminal leaders and their business partners who fall victims of contract killings. In 2001–2002, state officials ranking from vice mayors of Russian cities to regional governors, from Interior Ministry officials to the chief of the regional Borderline Service dominate the list of victims. Many such killings were in response to attempts by state officials to regulate certain segments of the shadow economy (city markets, gambling, offshore fishing, alcohol production, etc.). This, again, reflects the ambivalence of the current stage in state formation. On the one hand, we do see clear symptoms of the growing presence of the state. On the other hand, this presence and, accordingly, the resistance to it, are expressed in personified form. Since state organizations and individuals act as autonomous interest groups and not as agents of the state acting on behalf of the general laws, the killing of such individuals would be the logical way of resisting their influence.

## Conclusions

At the current stage, the source of risk and insecurity in Russian business is not criminal groups (the so-called mafia), as it used to be in the past, but the arbitrary and commercially driven

actions of poorly controlled segments of the state. Accordingly, the success of certain business groups depends on the availability of administrative and coercive resources of the state. This situation continues to produce incentives for enrichment by means of redistributing economic assets and accumulating rents rather than by the productive employment of these assets.

Ideological commitments and the goodwill of the central authority aside, the major incentives and possibilities for increasing the degree of order and regularity within the state and for more consistent application of laws derive from two new sets of circumstances. The first is the increasingly frequent stalemates in interest group conflicts, which lead to the interference of central authorities and compel the opponents to turn to a more fair and consistent legal settlement. The second is the increasing physical risk emanating from sharp conflicts caused by the arbitrary policies of state officials (even if they pursue public interests). One way of mitigating such conflicts and changing the mode of their resolution is, clearly, a more impersonal and rule-governed politics. Those state officials who wish to increase their life expectancy will eventually take this path.

© 2002