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PANIC IN THE AQUARIUM

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Sometimes it makes sense to wait in order to understand the consequences of major events. The expansion of US sanctions is last Friday's news, and most importantly, the Russian market, let alone foreign markets, has practically not reacted to the news. Well, sanctions are sanctions. The papers that were signed by Andrea Gacki, acting director at OFAC, who is unknown in Russia, proved underestimated: On Monday morning, the Russian RTS-MICEX [the Moscow Interbank Currency Exchange] stock exchange plunged across the board.

It is more difficult to say what did not tumble: On Monday, the RTS index dived 11.44%; Russian stock market capitalization dropped by about 0.8% of gross domestic product. The ruble crossed 60 per \$1 and 75 per €1. And it looks like this is not the limit. All of this turmoil is being accompanied by heavy trading on the stock exchange: Russian stocks are being actively dumped, which gives reason to believe that now that you are reading this text, the situation is approximately the same on MICEX.

There are three most important names on the updated SDN List - a list of specially designated nationals [and blocked persons] (of other states) that was presented by OFAC: Vladimir Bogdanov, the head of Surgutneftegaz [Surgut Petroleum and Gas], which is already under US sanctions; and [his] two partners in the aluminum and energy sectors: Viktor Vekselberg and Oleg Deripaska: These three names on the new sanctions list were most likely the reason for the RTS crash on Monday.

The "corporate" section of the OFAC list is represented by holding companies belonging to businessmen subject to sanctions: All of them are listed in OFAC General License No. 12. General License No. 13 lists only three companies: Rusal, En+ and GAZ Group. General License No. 12 limits all transactions and activities involving the

companies on the* list: They are authorized through June 5. General License No. 13 authorizes transactions that are necessary to transfer debt, equity, or other holdings in Rusal, En+ and GAZ Group to a non-US person through May 7. After this date any transactions are prohibited. Essentially, this is a ban on any US persons or entities to own stakes in the equity or debt of the companies belonging to Oleg Deripaska and Viktor Vekselberg: They must sell them within a month (notably, according to the logic of the license, the buy-out of shares, for instance, by Rusal is prohibited: these should be non-US persons who are not affiliated with Deripaska or Vekselberg) and file a report of each transaction, including the names of parties involved and the amount paid, with the US Department of the Treasury.

Finally, OFAC describes in detail what transactions between non-US persons and companies under General License No. 12 it would consider as supporting these companies' business. OFAC explains that "significant" transactions in other jurisdictions would also violate CAATSA [Countering America's Adversaries Through Sanctions Act] - and become a possible reason for including parties involved in such transactions on SDN lists if the US Department of the Treasury decides that they are de facto made in the interest of persons and companies from Russia under sanctions. This is an important clarification: As a matter of fact, nobody in the US directly prohibits, for instance, a company from China or Malaysia from buying Gazelle [minivans] from GAZ for their subsequent importation into the United States if someone decides to do so. However, if it becomes known that this is the continuation of GAZ's business in the US, then the intermediary would also be subject to sanctions.

De facto, this is the Iranian model of sanctions that was used in the US in 1981 - 1983 on a rather limited scale. As for Oleg Deripaska, Viktor Vekselberg and possibly Vladimir Bogdanov, they are a subject of a practical experiment by the US authorities: What would happen if a multibillionaire from Russia is prohibited from making any significant transactions with his assets and is declared to be outside the world economic community? In practice, this is simply the "soft forced nationalization" of Rusal, En+ and GAZ.

For understandable reasons, market reaction focused on Rusal, which is among the world's largest aluminum suppliers, and on Oleg Deripaska, the de-facto owner of this holding. Rusal sells 17% of its products to the US and taking into account Rusal aluminum processing in third countries with subsequent supplies to the United States, the company is about 33% dependent on the US market. Given the super stiff competition on the world aluminum market, the simplest and most understandable idea of the Donald Trump administration is obvious: Throwing Rusal out of the US means to provide American companies, above all Alcoa, an opportunity to increase their aluminum production by the same share. Considering that the expected trade war between the US and China would, among other things, most likely affect aluminum, it's quite clear why Oleg Deripaska is unwelcome.

Granted, in such a situation, Rusal's foreign buyers are Chinese companies for which such an asset would be more than useful in a future trade dispute with the US, and a sinicized Rusal is a good argument in this dispute. That the Chinese authorities are unprepared for such a course of events was demonstrated by the Hong Kong Stock Exchange on the Sunday/Monday night: The Russian aluminum company's shares plunged 40% within hours, evidently showing that China would not become involved in a "sanctions/aluminum war" right now.

And then the Russian market started wondering who Oleg Deripaska is and what would happen with his partners. After all, he is not working in a vacuum? Predictably, Rusal shares shed 20% of their value (50% since Friday) - but that would be a local event.

Thus, Oleg Deripaska is co-owner of Norilsk Nickel and is in conflict with Vladimir Potanin on the issue of control over the world's largest nickel producer. In the current situation, Deripaska is sure to include Norilsk Nickel in the new "trade-off" scheme, making it possible to sell off Rusal assets. Considering how such deals are usually made in Russia, how fair they are and under what political pressure they are made, Norilsk Nickel's capitalization dropped 14.5% on a single trading day.

Rusal's most recent creditors would be potentially affected by the company's default. Rusal has already announced a "technical default," i.e., the inability to pay due to settlement restrictions because of problems not

with money but with settlements as such. Granted, the market is confident that the aluminum holding, which has been actively credited both at home and abroad, is a de facto bankrupt: The loss of one-fifth of its sales and the impossibility of getting credits outside Russia would inevitably violate covenants on Rusal's credits; banks would call in debts later this week because of Rusal's plummeting capitalization; under the current circumstances, neither Deripaska nor Viktor Vekselberg can borrow anywhere. What happens next is insolvency, and the worst hit would be the [company's] biggest creditor, specifically Sberbank: capitalization down 17% in one day.

However, these are only the main domestic Russian problems. Commodities trader Glencore is a large shareholder of En+ (8.75%) and its CEO Ivan Glasenberg is a frequent guest in Moscow (on Tuesday, it became known that Glasenberg had resigned from the board of Rusal). Glencore can well afford not to pull out of En+. After all, it is an international holding, headquartered in Switzerland. But there are big question marks over trade in aluminum from Russia and Glencore's associated operations related to Russia. Meanwhile, Glencore, previously Glencore Xstrata and Marc Rich & Co. (companies that were founded in their time by the famous March Rich, who died in 2013, generally have an amazing ability to become involved in all Russian scrapes), based its global strategy on its partnership with Deripaska and Vekselberg, and even broader, with Russia as a whole. Readers will recall that the "privatization" of Rosneft by the Qatar Investment Authority and Glencore has not been closed yet, and Glasenberg, the Chinese authorities, VTB head Andrei Kostin, Rosneft CEO Igor Sechin, as well as a certain number of unknown but very influential persons, still remain in this virtual space: This is just the right time to leave this space, and in the current situation, Glencore is unlikely to get the better end of the deal. Considering that Glencore is a high-risk and heavily indebted company, Ivan Glasenberg and his partners - Swiss national Willy Strothotte and Greek Telis Mistakidis - are in for hard times: There are plenty of people in the world who are ready right now to tear off the juiciest pieces of the trading business that has a very bad reputation in the world. Incidentally, Glencore shares in London also fell almost 5% on expectations alone; as a result, on April 9, the company's capitalization was down 3.4%.

In short, if OFAC, the US Department of the Treasury and Donald Trump looked for a "sore spot" of Russian business, they have successfully found it. However, the thing is that it's unlikely they looked for it: The long-term consequences of expanding the sanctions list are far more unpleasant than a stock market crash - a grand event, but one that is not so significant.

What will Vladimir Putin - and there is no doubt that he is the one who will deal with Oleg Deripaska's problems - do with Rusal? Nobody has an answer to this question. Essentially, there are three options, and none of them is painless.

Option No. 1: de-facto nationalization of Rusal, En+ and apparently GAZ (in and of itself, this business is of little interest to anyone - at any rate, at present it is impossible to imagine its quick acquisition by a Russian, European or even South Korean company). This would make it possible to include Rusal on what is already a very long list of companies nationalized via the banking system, and it would be quite easy to do so: Sberbank CEO German Gref, who handles a considerable portion of Russian investors' money, together with Andrei Kostin, who controls a comparable share, can easily divvy up the huge industrial business with completely uncertain prospects on their balance sheets. With support from the Central Bank - unless Central Bank chief Elvira Nabiullina manages to prove to Vladimir Putin that this would go nowhere. In this case it would be make sense to appoint German Gref as the head of the reinstated Gosplan [Soviet-era State Planning Committee] because with further sanctions, in a year, he would become one automatically.

Option No. 2: granting Rusal emergency loans or a restructuring program, leaving Oleg Deripaska and Viktor Vekselberg the owners of their assets. In principle, this approach does not differ greatly from the previous one; in addition, in this case, Elvira Nabiullina would clearly have to support Sberbank and VTB (how's that for inflation targeting). This is a very costly and also generally dead-end method of addressing the problem that has come up: Tomorrow, oligarch Suleiman Kerimov and even Sergei Fursenko [a member of the board of directors of Gazprom

Neft, a subsidiary of state-owned Gazprom; president of the football club Zenit, St. Petersburg] will come asking for emergency loans: Who said that FC Zenit is not a national asset?

Option No. 3 - the most natural one: letting Rusal go bankrupt and selling off Deripaska's assets - surely, there would be those willing to buy some of them and perhaps they would even manage to come to terms with the US about the new rules of the game. This option potentially hurts national pride and involves the uncontrolled process of breaking up a business so large that the Russian authorities simply cannot accept. Because everything must be under control.

So, assuming that sanctions may expand, Option No. 4 is more likely: a forthright discussion within the Russian business elite about a new asset ownership configuration. In this context, the appearance of the all but forgotten Vladimir Bogdanov on the SDN list is very symptomatic. Surgutneftegaz [Surgut Petroleum and Gas] is traditionally a key piece of property for the Russian market: This is a company that prevents Rosneft from becoming a de facto monopolist in the Russian oil and gas sector. Surgut, together with Lukoil, is essentially the last hope of the Russian market that it will remain a market in the future, and any "big redivision," in which Rosneft, Gazprom, Norilsk Nickel, state-owned banks, the Kovalchuks, the Rottenbergs and Novatek [the largest independent producer of natural gas] (and this is not a complete list) would be bound to participate, may affect Surgutneftegaz. It differs from all other Russian companies in: (a) the volume of financial resources on its balance: about 2 trillion rubles or about \$35 billion (neither Deripaska nor Vekselberg is worth that much even if they are put together, and what is characteristic, they have never been worth that much before), and (b) the completely nontransparent ownership structure that is presumably controlled personally by Vladimir Bogdanov. His inclusion on the sanctions list is the obvious recognition of his role in the lineup that was evident from the stock market situation on Monday: Actually, all [companies] were falling, from Aeroflot to Mechel [steel and coal company] - and most likely, in expectation of a "war of all against all" in an attempt to re-divide all markets in the summer of 2018. After all, "consolidating around Putin" does not mean "abandoning the attempt to devour one's neighbor," does it? How many applicants for any asset on the Russian market are lining up in high offices the day after new sanctions lists were made public? And how many would be lining up there by May 7, the day before a new Russian government begins to be formed - a process that, in light of the new circumstances, would be extremely tense? Clearly, OFAC consulted some people who have a good grasp of Russian politics and economics.

However, would the picture be any different if Steven Mnuchin's team decided to experiment with new "targeted" sanctions in relation not to Deripaska and Vekselberg, but, say, in relation to Interros President Potanin or Volga Group head Timchenko or billionaire Roman Abramovich or head of Russia's Severstal Mordashov? It would be exactly the same. Big business in Russia is so integrated into the ruling establishment that there is no reason to talk about "oligarchs." Quite the contrary, there is reason to talk about "oligarchy" as a single ruling/entrepreneurial large conglomerate where - no matter what Vladimir Putin might think about this - with very rare exceptions, there are essentially no senior or junior or permanent partners or opponents or officials or businessmen, but there is a tight artificial ecosystem with almost biological rules of the game. And Vladimir Putin is inside, not outside this aquarium.

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