This case is prepared as a basis for class discussion rather than to illustrate either effective or ineffective handling of a business situation. Support for this case was provided by the U.S. Agency for International Development (USAID) through the Eurasia Foundation in Washington, D.C. for which we are very grateful. We would like to express our gratitude to Ms. Yulia Botvich, graduate student at Texas A&M University for her assistance in the analysis of the case.
Bankruptcy in Russia

I. Introduction

“Things are seldom what they seem, [s]kim milk masquerades as cream.” (H.M.S. Pinafore, 1878, Act. 2, Sir William Schwenck Gilbert). The famous above quote from the H.M.S. Pinafore in many ways aptly applies to the conduct of business in Russia during the past decade, and indeed in many respects even today. Perhaps in no area has this been more true than in the area of bankruptcy, and the operation of Russian bankruptcy law. When enacted in 1998, Russia’s New Bankruptcy Law was hailed as a major positive development in the field of business and corporate governance. But then, of course, “things are seldom what they seem . . . .”

II. Doing Business in Russia Today

Doing business in Russia today can be very risky indeed. The collapse of the Soviet Union in the early 1990’s led to a period of “crony capitalism” where a relative handful of individuals with close ties to the government were able to essentially take over a large number of newly “privatized” businesses (Sale of the Century). Indeed, recent surveys of world-wide U.S. dollar billionaires place a number of Russians (who had zero wealth not more than a decade ago) among the world’s wealthiest individuals today. (Forbes 400).

In terms of corruption, a recent 2001 “Corruption Perceptions Index” published by the Economist Magazine (July 21, 2001, A Survey of Russia, p. 11) placed Russia as one of the most perceived corrupt countries in the world, ranking far below even countries like Colombia and Mexico in this regard. Interestingly as the chart below illustrates, Russia’s next-door-neighbor, Finland, is perceived as the least corrupt country in the world!

In addition, Russia’s currency, the rouble, has been highly unstable. In 1990, 1000 Russian roubles were worth approximately $1000 U.S. dollars. In 2001, because of massive currency devaluations over the past decade, the same 1,000 roubles, was worth as the chart below illustrates, about only $30 U.S. dollars.

There are also considerable “corporate governance” risks to doing business in Russia today. A recent study by a leading Russian investment banking firm found there to be considerable problems among Russian companies when it comes to the use of accurate accounting standards, disclosure and transparency regarding true ownership structure, and director accountability. (Report on the Perception and Cost of Corporate Governance Risk, Troika Dialog, February, 2001, section 1(7).)

III. Bankruptcy Law in Transitional Economies

Sound bankruptcy laws and procedures are extremely important in economies such as Russia’s, which are transitional in nature. The case for sound laws and procedures of this kind was recently quite cogently articulated by Dr. Michael H. Moskow, President and CEO of the U.S. Federal Reserve Bank of Chicago. Dr. Moskow said:
Why are procedures so important? Property rights are generally clear when a firm is functioning well. But when the firm can no longer pay its bills, the enforcement of property rights becomes more critical. Different claimants are trying to divide up an inadequate pie. This is the role of bankruptcy law. And by overseeing the orderly dissolution of firms, bankruptcy law plays an essential part in the process of Schumpeterian creative destruction. Capital is recycled from less efficient to more efficient uses.

(Speeches, U.S. Federal Reserve Bank of Chicago, June 15, 2001, p. 3).

A key part of having a sound bankruptcy law structure is that it eliminates uncertainty. People getting involved in the bankruptcy process should clearly know what the “rules of the game” are and how the process operates. This has clearly not been the case, however, in all emerging markets and transitional economies. Moreover, a sound bankruptcy law structure also requires a system where laws are enforced consistently by a judiciary that commands public confidence.

Since the dissolution of the Soviet Union, Russia has had two bankruptcy laws. The first law was dated November 19, 1992. The second law, repealing the 1992 legislation, was signed by Russian President Boris Yeltsin on January 8, 1998 and became effective March 1, 1998 and is currently in force. What follows is a brief description of these laws.

**The 1992 Russian Bankruptcy Law**

Under the old Soviet system there obviously was little need for comprehensive bankruptcy regulation. In this system, state enterprises operated without formal profit and loss constraints, and focused primarily on reaching various production goals and quotas. (Reforming the Civil Code, pp. 2-3).

The original 1992 Russian Bankruptcy law did not represent much of an improvement over things during Soviet times, and was generally regarded as being extremely ineffective. Very few Russian companies went bankrupt during the period this law was in effect from November, 1992 to March, 1998. In general, this law was viewed as being too restricted in terms of scope of application, and too complicated in terms of procedure. (Mogilansky, Sonin & Zhuravskaya, p. 3 and note 3)

More specifically, the basic concept of this law did not, as one observer has put it, “accord with present-day commercial reality.” (Vitryansky, p. 412). Under the 1992 Russian law bankruptcy proceedings could be initiated against a company only if the total amount of company debt exceeded the total balance sheet value of company assets. Thus, a company could be “insolvent” in the sense of being truly unable to pay the bills it owed, but could not be thrust into bankruptcy unless it could be proven that the total value of its assets were less than its debts. Moreover, given the lack of clear accounting standards, as noted above, it was relatively easy for corporate managers to manipulate the balance sheet value of assets – and thus perpetually avoid bankruptcy under the 1992 law. (Mogilankky, Sonin, & Zhuravskaya, p. 3, note 3).
The extremely pro-corporate debtor approach of the 1992 Russian Bankruptcy law had a profound negative impact on the overall Russian economy. As the Deputy Chairman of the Higher Court of (Bankruptcy) Arbitration of the Russian Federation, Vassily V. Vitransky, has observed regarding the old 1992 law:

Such an approach allowed commercial actors who were unable to pay to continue in operation, thereby dragging their creditors into insolvency with them. The domino principle thereby took effect, stimulating the non-payment crisis affecting the Russian economy. . . . Such conditions allowed top managers of commercial organizations who had no reason to fear bankruptcy to withhold debt payment and use the available money as their own enterprise funds, ensuring only that the total amount of accounts payable did not exceed the asset value of the organization. (Vitryansky, p. 413)

Consequently, it became apparent that the 1992 law was protecting even bad-faith debtors and thus subverting the basic principles of commerce. Moreover, some creditors lacking any reasonable legal recourse resorted to “desperate measures to settle debts”, and it was not entirely unheard of for valuable assets to simply “disappear” from factories overnight. (Reforming the Civil Code, p. 3). It was clearly time for reform of the Russian Bankruptcy Code.

The 1998 Russian Bankruptcy Law

The serious problems associated with the 1992 law motivated the enactment of the new law which became effective in 1998. In marked contrast to the old law under which it was extremely difficult to initiate bankruptcy proceedings against a company, the new law made it extremely easy to initiate bankruptcy proceedings against a Russian company. Under the new law any creditor who holds even a small amount of outstanding debt (around $5000 U.S. dollars) which is at least three months overdue can file for bankruptcy of the firm. (Clifford Chance, p. 1)

Pursuant to the new Russian bankruptcy law, delinquent companies are generally initially put under a three to five month period of “supervision” or “observation”. The purpose of this observation period is to ensure the safety of the debtor’s assets while the bankruptcy/arbitration court investigates the situation and determines whether or not the company is technically “insolvent”. During this observation period the court usually appoints a “temporary manager” who works with ongoing company management and with company creditors. Indeed, the temporary manager will generally convene a meeting of the company’s creditors and seek recommendations regarding the future of the company including possible liquidation or possible appointment of full external management and adoption of a reorganization plan. (Vitryansky, pp. 420-21)

It is then up to the Russian arbitration/bankruptcy court to act on the recommendations of the creditors (and temporary managers). If the liquidation approach is taken, the court pursuant to Article 97 of the Bankruptcy Law will initiate a competitive procedure for the liquidation/disposal of company property within a one-year period (unless this period is extended

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by the court for an additional six months). If the external management approach is taken, the court, pursuant to Article 70 of the Bankruptcy Law, places the debtor under external administration for up to 18 months (an initial twelve month period, which can be extended by up to six additional months). During this period a new corporate plan is adopted and implemented aimed at restoring the debtor’s financial health. All corporate debts are frozen during the period of external management. (Burger, p.2). The external manager (who may be the temporary manager previously appointed by the court during the observation/supervision period) appointed by the court on the recommendation of the creditors has full authority during this new period to run the company and basically implement the reorganization plan. The original management of the debtor organization is formally removed once the court has officially appointed an external manager. (Vitryansky, p. 421)

**Operation of the New 1998 Russian Bankruptcy Law**

Not unexpectedly, the number of bankruptcy proceedings has soared since the new bankruptcy law became effective in March of 1998. Moreover, preliminary empirical analyses have revealed some interesting developments. While liquidation procedures have been initiated in large numbers of small enterprises, this is rarely the case with respect to larger, more politically important businesses. With respect to these larger enterprises, bankruptcy procedures primarily result in them being placed under “external management.” Perhaps most interestingly, while firms that end up in liquidation under the new law are almost uniformly extremely unprofitable and inefficient, empirical evidence shows this not generally to be the case with respect to larger firms ending up under “external management” under the new bankruptcy law. Indeed, many of the large firms are relatively efficient and profitable in their operations. They are “large and politically important firms in very profitable and efficient industries in politically and economically strong regions.” (Mogiliansky, Sonin & Zhuravskaya, pp. 5-7, p. 7)

How did this happen? We will explore the dynamics behind this development shortly examining of two cases. Remember, “things are seldom what they seem.”

**IV. United States Bankruptcy Law Comparison**

In general, bankruptcy laws in the United States are considerably more pro-debtor (the company in financial trouble) than the new 1998 Russian Bankruptcy Law. Under Untied State law, businesses in severe financial trouble will generally face one of two types of bankruptcy, Chapter 7 “liquidation bankruptcy” or Chapter 11 “reorganization bankruptcy”. Under Chapter 7 bankruptcy, the company’s assets are sold off or liquidated in an orderly fashion, while under chapter 11, the company is permitted to reorganize pursuant to a specific reorganization plan. In both types of bankruptcy, an “automatic stay” is issued by the bankruptcy court, which instantly suspends all collection activities etc. against the debtor. (Bagley, pp. 932-939).

In the United States, bankruptcy proceedings pursuant to Chapter 7 or Chapter 11 can be either “voluntary” or “involuntary”. In the corporate arena, “voluntary” bankruptcy is where the company itself seeks the protection of the bankruptcy court, while “involuntary” bankruptcy
involves situations where a creditor or creditors of the company file for the company’s bankruptcy. Interestingly, the vast majority of bankruptcies in the United States today are “voluntary” in nature. (The Bankruptcy Yearbook and Almanac, 1999, pp. 18-22) In the corporate sector, voluntary bankruptcies afford businesses the opportunity to keep creditors at bay while they restructure (or liquidate) their business.

It is significantly harder for a creditor to involuntarily force a United States company into bankruptcy, than it is for a creditor to do the same in Russia under the 1998 Russian bankruptcy law. For a creditor to force a United States company into bankruptcy, the creditor, under section 303(h)(1) of the U.S. Bankruptcy Code, must show a “general pattern of nonpayment of undisputed mature debts during the period immediately preceding the petition.” In determining whether such a “general pattern of nonpayment” exists, the United States bankruptcy courts look at a wide range of factors such as the percent of debts the company is in default on both in terms of number and value, the length of time the debts are overdue, and the extent to which the size of overdue debts has increased over time, etc. (Blum, pp. 176-179). While, as in Russia, the dollar amount of debts overdue which allows a creditor to petition for a debtor’s bankruptcy is not great (around U.S. $11,000 in the United States versus around U.S. $5,000 in Russia), the fact that a debtor is three months overdue on a debt of the requisite size does not in the United States automatically force the company (as it does in Russia) into involuntary bankruptcy.

Moreover, under U.S. bankruptcy law if a company has twelve or more creditors at least three of the creditors must join in the involuntary bankruptcy petition (if the company has eleven or less creditors it is sufficient for one creditor to file the petition). As Professor Brian A. Blum has noted, the purpose of the three-petitioner rule is to protect debtors from involuntary bankruptcy at the instance of a single creditor who can not muster other creditor support for the bankruptcy petition. (Blum, pp. 176-77) With respect to the three-creditor rule, courts also carefully scrutinize situations where the three creditors are closely related parties, or where a given claim has been split up and sold to other parties who then join the bankruptcy petition. (Ibid.) In contrast, in Russia it appears under the new bankruptcy law that it is sufficient for only one creditor to make a valid claim in order to involuntarily force a company into bankruptcy procedures.

Like in Russia, most large and important United States businesses face “reorganization” bankruptcy proceedings (pursuant to chapter 11) rather than “liquidation” (pursuant to Chapter 7). Indeed, it is fair to say that the United States Bankruptcy Code encourages rehabilitation and reorganization for such businesses rather than their liquidation. (Ibid, p. 99)

In contrast to Russia, however, where companies being reorganized in bankruptcy have new external management appointed to run the business, in the United States there is a very strong presumption in favor of the company’s present management retaining control of the company. The clear philosophy of chapter 11 of the United States law is to give the debtor a “second chance”, and consistent with this philosophy current management is generally permitted to identify and correct its past mistakes. (H.R. Rep. No. 595, 95th Cong., 1st Sess. 220 (1977). A new external manager/outside trustee is generally appointed to supplant existing management in U.S. Chapter 11 bankruptcy cases only where there are situations of fraud, dishonesty, or clear “gross” mismanagement on the part of the company’s current management (which is known as the debtor-in-possession or DIP). In contrast to the situation in Russia, the appointment of external management in a U.S. business bankruptcy reorganization case is viewed as an extraordinary remedy. (In re William A. Smith Construction Co., 77 Bankr. 124, 126 (Bankr.
V. Example 1: Leningrad Metal Works Corporation (LMZ)

Leningrad Metal Works (LMZ) is Russia’s largest and oldest maker of turbines for power stations. It was founded during the reign of Czar Alexander II in 1857 and started operations in 1875. In the beginning, the plant was engaged in the production of fabricated metal components for various purposes. After the great October Socialist Revolution of 1917 LMZ was requisitioned by the Bolsheviks in their efforts to electrify the entire nation and was re-oriented to manufacturing power generators. The first turbine was produced at the plant in 1924. The turbines produced by LMZ were used both to meet domestic demand and for export. It is noteworthy that within Russia and the former Soviet Union over 75 percent of the turbines in use come from LMZ. Furthermore, LMZ is well known throughout the world, having a global market share of around 10 percent with respect to various types of power turbines.

A joint-stock company “Leningrad Metal Zavod” (JSC LMZ) was founded in 1992 as a result of privatization of the state company, LMZ. The company initially had 441,266 shares which were registered on November 27, 1992. However, by the end of 1995 after a 25 for one stock split and the issuance some new shares, the company had a little over twelve million shares outstanding.

In 1993, “Energomash Corporation” (EMK) was created with the support of the Russian Government in an effort to consolidate over twenty five leading energy engineering companies of the Russian Federation. The Russian Government felt that such consolidated within one holding company was necessary if Russia was to be able compete internationally in this business against companies like General Electric, Siemens, and ABB. EMK’s code production division was comprised of three St. Petersburg operations in which it held controlling stakes:

1. Electrosila – this company which makes turbogenerators, hydrotreaters, and electric power machines was actually founded by the legendary German industrialist, Karl Siemens, in 1898. The company has over 9500 employees. Siemens Corporation continues to own about 20 percent of this company.

2. LMZ – this company, with over 10,000 employees primarily makes hydro, gas, and steam turbines.

3. Turbines Blade Factory (ZTL) – this company, with over 1800 employees, primarily makes blades for steam and gas turbines.

In the period prior to the new 1998 Russian Bankruptcy Law, Energomash/”EMK” and its off-shore subsidiary “Mardima” owned about 45 percent of LMZ, the German company Siemens owned 10 percent of LMZ, with the remainder of the company was owned by individual investors and investment firms.
At the beginning of 1998 EMK finished a major investment program aimed at technologically updating LMZ, as well as Electrosilia and ZTL (its three key St. Petersburg properties). The idea was clearly to try and modernize these manufacturing facilities so they could meet world production standards and thus effectively compete with General Electric, Siemens, and ABB. During this period EMK also began centralizing control over LMZ and the other companies, e.g., putting its representatives on the LMZ Board of Directors, coordinating pricing, investment, marketing and sales at the holding company (EMK) level.

Around this same time EMK also shuffled LMZ’s management, replacing LMZ’s long-time Director General Viktor Shevchenko (Shevchenko was moved “upstairs” to the post of EMK deputy director). In his stead, EMU named Valery Chernyshyov to the top spot at LMZ. Chernyshyov had previously held a top position at EMK subsidiary Electrosila. Chernyshyov immediately began to further streamline LMZ’s management structure and, to the extent deemed necessary, downsize the workplace.

On November 6, 1998, though, about eight months after the new Russian bankruptcy law came into effect, LMZ was sued in bankruptcy court for a relatively small amount of debt by it owed of its contractors, the construction firm “PAL”. It has been publicly speculated that this bankruptcy filing was “engineered” by enemies of EMK and Valery Chernyshyov as a way of possibly getting rid of EMK/Chernyshyov. (“Drama Escalates in battle over LMZ,” St. Petersburg Times, January 22, 1999, p. 1)

On March 10, 1999 the Russian Bankruptcy Arbitration Court of St. Petersburg and Leningrad Oblast established a Council of Creditors and appointed an external manager at LMZ pursuant to a plan of bankruptcy reorganization for the company. The Council of Creditors was initially headed by Siemens AG, the giant German engineering company which owned 10 percent of LMZ and held considerable LMZ debt. Viktor Shevchenko, who was ousted by EMK from his executive position at LMZ, was now appointed to be deputy director of the Council of Creditors. There was no representative from EMK on the LMZ Council of Creditors, even though EMK continued to be the largest shareholder in the company.

Despite the activity in bankruptcy court, core business prospects began to look quite positive for LMZ during mid-1999. On July 9, 1999 LMZ signed a $120 million U.S. dollar contract to build two 1000 megawatt turbines for the Lyan Yun Han atomic power station in China. Also around the same time, Russia’s RAO United Energy Systems (UES) power grid company, headed by former Russian deputy prime minister Anatoly Chubais, announced its intention to spend billions of U.S. dollars on new equipment over the next five years in order to update Russia’s power generation system.

In early 2000 “Interros”, one of Russia’s most powerful and diversified financial-industrial groups announced its intention to gain control over most of Russia’s leading engineering companies manufacturing equipment for the energy-producing sector. Interros is headed by Vladimir Potanin, one of Russia’s wealthiest individuals, and a former Russian deputy prime minister. Interros was particularly interested in LMZ because of its export contracts and thus its ability to earn “hard currency”. (LMZ Doubles Share Capital, Allows for Factory Takeover,” St. Petersburg Times, February 15, 2000, p. 1)

Given its interest, in January, 2000 Interros purchased Siemens’ 290 million rubles of debt in LMZ and became the new head of the LMZ Council of Creditors. Shortly thereafter, in conjunction with the LMZ external manager, Interros proposed a new share offering of 14
million LMZ common shares, more than doubling the company’s shares outstanding. Moreover, LMZ’s creditors would under this proposed plan have the first option to purchase these new shares. If executed as planned, the new share offering would give Interros now LMZ’s largest creditor, a 51 percent controlling interest in LMZ.

EMK, obviously, was not at all happy with this new share issuance proposal since the new issuance would dilute EMK’s holdings and the take away its control of LMZ. EMK’s lawyers immediately went to court to stop this new share issuance from going into effect. EMU’s lawyers argued that a decision for new share issuance is the prerogative of the company’s shareholders and not the company’s Council of Creditors and external manager. Moreover, EMK’s representatives argued that any new share issuances/emissions must first be offered/allocated to currently registered shareholders, i.e., existing shareholders have priority in purchasing shares in a new issuance.

In July, 2000 the Russian Federal Service for Financial Recovery (FSFR) declared LMZ to be an “object of social importance” – meaning that the Russian government considers LMZ vital to the Russian economy and that any actions taken by the company will be subject to very high government scrutiny/regulation. (“LMZ Director Ousted in Control Struggle” St. Petersburg Times, July 25, 2000, p. 1) A picture of the scene of the battle is set forth below.

Who do you think controls LMZ today, Energomash/EMK or Interros?
VI. **Example 2: Chernogorneft**

In November 1999 Tyumen Oil Co. (TNK) made headlines when it bought Chernogorneft, a key subsidiary of Sidanco, another large (and bankrupt) Russian oil company at a bankruptcy auction. TNK paid $175 million for the purchase. The move put TNK at loggerheads with BP Amoco, which in 1997 had paid $571 million for 10% of Sidanco. *The Economist; London; Dec 4, 1999.*

The major players in the situation are:

**Sidanco**

In 1999 Sidanco was the sixth largest oil company in Russia with an output of 420,000 barrels a day, mainly in West Siberia, and technically recoverable reserves of some 16 billion barrels of oil and gas. It also controlled refining subsidiaries with a total capacity of 770,000 barrels a day.

Sidanco was established in 1994 with the objective of supplying eastern Siberia and the Russian Far East and Far Northeast with oil, gas, and oil products. Sidanco comprised 28 subsidiaries, including Chernogorneft, which accounted for 30% of Sidanco’s total production.

Sidanco supplies oil to captive markets in the Russian Far East. However, because most of its production is originates in West Siberia, transportation costs are high. Sidanco also holds significant reserve potential in eastern Siberia and the Russian Far East, but developing these resources will require significant capital infusion.

In 1995, 51% of Sidanco was transferred to Onixembank – MFK run by Vladimir Potanin in the loans-for-shares auction for $130 million. In 1997, BP acquired a 10% stake in Sidanco for $571 million. The presence of a major Western oil company was expected to bring a positive element to Sidanco’s management.

Since the Oneximbank acquisition, Sidanco’s leadership has been struggling to gain control of its many subsidiaries. Sidanco’s “federalist” style of management, under which subsidiaries are allowed to run themselves as independent entities, has resulted in a weak organizational structure and poor performance.

**Chernogorneft**

Chernogorneft produces 126,000 barrels of crude oil per day and is estimated to be worth about $2 billion. Chernogorneft was somewhat of a pioneer in the contemporary Russian energy industry. In 1994, it became the first enterprise to invite foreigners to audit its reserves. In 1996, it became the first Russian independent company to receive an international loan.
Chernogorneft is the largest of the six subsidiaries which were brought under Sidanco's control on June 1997. Sidanco holding company assumed all management functions as well as functions relating to the sale of oil. Sidanco has control of the Chernogorneft voting shares.

**BP Amoco**

BP is the holding company of one of the world's largest petroleum and petrochemicals groups with approximately $182 billion in annual revenue. Its main activities are exploration and production of crude oil and natural gas; refining, marketing, supply and transportation; and manufacturing and marketing of petrochemicals. BP has well-established operations in Europe, North and South America, Australasia and Africa. It produces 1.9 million barrels of crude oil per day and has estimated reserves of 15.2 billion barrels of oil and gas.

In November 1997 BP made a major move into the Russian market by buying 10% of Sidanco for $571 million, which made BP the biggest foreign investor in Russia’s energy sector. Over the long run it was planned that the partnership would provide the two companies with a strategic base from which to develop a major joint exploration and production business in West and East Siberia. Under the terms of agreement, BP was given a 20 percent voting rights stake and a seat in the Sidanco board. BP would also make available advanced technology, western management processes and technical staff to Sidanco.

**TNK**

In 1999 TNK was the fifth largest oil company in Russia by reserves and production. As with many typical Russian oil companies, TNK was rich in potential and poor in performance. Part of the problem was that TNK’s huge reserves were so badly exploited in the Soviet era that they were now waterlogged. In 1999 TNK’s production was falling. What oil TNK did manage to produce, it sold for little profit to third parties. The task of Simon Kukes, boss of TNK, was to turn round a company. He concentrated on exports and retail sales. By mid-1999 the company had more than 220 retail gasoline stations, and TNK used its refinery for its own oil, rather than renting capacity cheaply to outsiders. Earnings before taxes were up more than eight-fold, to an estimated $587 m in 1999. (The Economist; Face Value: Oiling the wheels; London; Aug 21, 1999.) Tyumen is owned by a private group of investors led by Moscow-based Alfa Group. One of Mr. Kukes priorities was to increase TNK’s reserves, so he started looking at the other half of TNK’s main oilfield which belonged to Chernogorneft, owned by Sidanco.

**Timeline of Events**

**December 1998.** A bankruptcy claim is made against Chernogorneft by NPP PoliPlastic Company, a very small creditor. In oil circles, and later in the mass media, rumors appear asserting that the bankruptcy was actually indirectly initiated by the Tyumen Oil Company (TNK), which is interested in acquiring its oil fields. However, Alexander Kiryanov, a supporter
of the Khanty-Mansi Autonomous Area government, another entity claiming the same oil, is initially appointed as the external manager of Chernogorneft.

March 1999. Two of Chernogorneft's other creditors, Khantymansiyskgeofizika and Avtomagistral submit a petition questioning the credentials of the initially appointed external management at Chernogorneft. These creditors though, together account for less than 1% of Chernogorneft's total debts. Chernogorneft's external management team is, however, approved of by most of Chernogorneft's creditors, including the European Bank for Reconstruction and Development (EBRD) and Societe Generale. A court in the town of Khanty Mansyiysk, West Siberia, thus rejects the petition by Khantymansiyskgeofizika and Avtomagistral.

There is a widespread suspicion that the foiled attempt to oust external management from the company was the work of investors seeking to seize control of Chernogorneft. Tyumen Oil Co has made no secret of its desire to merge with Chernogorneft, which holds the license to sections of the giant Samotlor oilfield not controlled by TNK. Acquisition of Chernogorneft would allow TNK to lower production costs by 15 to 20%.

May 1999. The bankruptcy court, under strong pressure from District Governor Leonid Roketsky, approves the replacement of external manager Alexander Kiryanov with a TNK representative named Vasily Bikin (incidentally Roketsky is the Chairperson of TNK’s Board of Directors.) The EBRD and U. S. Export-Import Bank strongly protest the bankruptcy court’s decision and file a petition with the Russian Supreme Arbitration Court.

New external manager Vasily Bikin, declares his plans for Chernogorneft. According to Bikin, Chernogorneft should be sold in order to repay debts to its creditors. COMPLICATIONS OF SELLING CHERNOGORNEFT; SOURCE: Rossiyskaya Gazeta, July 29, 1999, p. 2

June 3, 1999. Vice Chairperson of TNK Herman Khan conducts a press conference at which he outlines the current strategic interests of that company. He asserts that Chernogorneft is among the strategic interests of TNK, because it, as well as Nizhnevartovskneftegaz, (a subsidiary of TNK) is working on the Samotlor oil field. Hence, their unification will facilitate Samotlor’s development.

Khan added that TNK is ready to participate in external management of Chernogorneft, and after restoration of its solvency is ready to purchase the company. However, TNK will act "exclusively within the framework of the law". TUMEN OIL COMPANY TO PURCHASE CHERNOGORNEFT; SOURCE: Vremya, June 04, 1999, p. 4

July 30, 1999. Chernogorneft holds a creditors meeting. Mysteriously, the day before, a court in Nizhnevartovsk, the company’s western Siberian base, rules to reduce the registered debt of the European Bank of Research and Development (EBRD) to $26 million from $35 million. That prompts a sharp EBRD protest and a threat to take legal action. The EBRD says it will “challenge the preference shown to certain creditors, the failure to treat all creditors equally, and the reduction in the voting power of major international creditors in the meeting.” Less debt means less voting power. Equally strange is the treatment of the U.S. Export-Import Bank whose debt is repaid in full ahead of the meeting. No debt means no votes to reject the external manager agreed on by the other creditors. The reduction of the voting rights of these parties leads to creditor approval of new external management by a 58% to 42% margin. No swift deal on restructuring Chernogorneft is seen.
Sept 10, 1999. Creditors in Chernogorneft approve a plan proposed by external management to sell off company assets to repay creditors. The starting price is set at $200 million, and the minimum bid level is $104 million.

October 20, 1999. BP spokesman Howard Chase says the sale of Chernogorneft's assets will be a serious violation of the rights of Sidanco and BP Amoco as shareholders and creditors of the company. BP Amoco will dispute the creditors committee decision to sell Chernogorneft's assets, as well as continue to dispute earlier decisions "through the court system and other channels."

October 1999. EBRD requests that Russian Prime Minister Vladimir Putin prevent the sale of the Chernogorneft.

November 5, 1999. BP Amoco says it might fold up its operations in Russia if Chernogorneft is sold. BP Amoco investments in Russia exceed $1 billion. Alongside its investment in Sidanco, the company is taking part in the Kovyktinskoye gas condensate field development project, the Sakhalin-5 project, and has a chain of retail gasoline stations in Moscow.

November 23, 1999. A total of five organizations register to make bids in the November 26 liquidation sale of Chernogorneft. The three companies previously reported as being registered - TNK- Nizhnevartovsk, ZAO Neftegaz, and Neftyanoi bank - have been joined by two others, oil company Bashneft and Kuedinskaya Oil Company.

November 25, 1999. A court in the United States in New York State issues an injunction suspending the sale of Chernogorneft company. The New York court injunction was sought by Harvard University and the Soros Foundation, which participate in the Sputnik Foundation, which owns 10% of Sidanco shares. Sputnik also appealed to the Nizhnevartovsk court against the actions of sale organizers. The next day, however, the Nizhnevartovsk Siberian court revokes all injunctions, clearing the way for the sale of Chernogorneft to take place.

November 26, 1999. TNK wins the auction with a bid of $175 million.

BP Amoco says that it considers the sale “invalid” and a violation of the rights of shareholders and creditors. The European Bank for Reconstruction and Development, (EBRD) describes the sale as a “sham” and “a perversion of justice.”

The dispute over Sidanco and Chernogorneft is likely to further damage investor confidence in Russia. BP Amoco has said that it is studying all its options – including a strategic withdrawal from Russia. BP Amoco has already written down its Sidnaco investment by over $200 million.

December 2, 1999. Tyumen Oil Co invites BP Amoco and other shareholders in Sidanco to cooperate in developing the 5-billion Samotlor oilfield in the Nizhnevartovsk region of West Siberia. Chernogorneft controls a northern section of Samotlor while Tyumen Oil's affiliate Nizhnevartovskneftegaz operates the rest of the field. Analysts doubt that the international oil grant (BP) will soften its strong resistance to doing business with Tyumen Oil.

December 16, 1999. Involved in an interview with the daily newspaper Vedomosty, Vladimir Putin says that the claim that the takeover of West Siberian producer Chernogorneft by Tyumen Oil Co was unlawful is being investigated by the government and may eventually be settled in court.
**December 22, 1999.** U.S. Secretary of State Madeleine Albright refuses to allow the U.S. Export-Import Bank to guarantee the loans of $480 million to TNK. She points out that Western oil companies were complaining that they have been cheated by Tyumen with respect to TNK’s purchase of Chernogorneft at a highly discounted price during a bankruptcy proceeding.

BP Amoco had lobbied the U.S. Congress for the loan guarantees to be blocked, saying Tyumen manipulated the Russian bankruptcy code in grabbing Chernogorneft. Tyumen, however, claims every action it took in acquiring Chernogorneft was "completely legal and in accordance with the Russian bankruptcy process." The loan guarantees to Tyumen, which would have been used to upgrade a refinery and refurbish the highly prized Samoltor Field in Western Siberia, are now blocked until the restriction is lifted.

**January 2000 – Fall, 2001.** Various tentative settlements regarding Chernogorneft are reached, but nothing is finalized. TNK signs a $200 million plus deal with the U.S. Halliburton Company (Richard Cheney, CEO) for Siberian oil development work and seeks U.S. Export-Import Bank guarantees for this work. TNK also continues to seek joint venture interaction with BP Amoco.

Who do you think controls Chernogorneft today? What do you think are the present relationships among the various parties!