Analyses OSW

CENTRE FOR EASTERN STUDIES 11.04.2018 **www.osw.waw.pl**

The Magomedov brothers under arrest: growing rivalry inside the Russian elite

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The Russian oligarchs Ziyavudin and Magomed Magomedov, who control the Summa holding and own assets in the energy, transport, agricultural and telecommunication sectors, were arrested on 31 March. In 2017, Forbes assessed that their joint fortune was worth US$1.75 billion. The brothers are suspected of fraud, the misappropriation of public funds worth a total of 2.5 billion roubles (around US$40 million) and forming an organised criminal group. This means that the Magomedov brothers may face a sentence of even 20 years in prison, and charges may also be brought against other people.

The Magomedov brothers' case, which has been given a great deal of publicity in Russia, is another spectacular manifestation of the increasingly bitter struggle for influence and assets within the Russian political and business elite. This is an effect of the shrinking sources of income and corruption benefits due to the economic stagnation and the Western sanctions. It seems that the reasons behind the attack on the Magomedov brothers are of both a business and political nature. It is most likely aimed at taking over attractive assets by the state-controlled oil company Rosneft and its CEO, Igor Sechin. The latter is striving to strengthen his influence in energy policy as a result of the weakening of the present deputy prime minister Arkady Dvorkovich (who is in charge of the energy sector) and Prime Minister Dmitry Medvedev both of whom until recently backed the development of the Magomedov brothers' business. This case also fits in with the Kremlin's efforts to force Russian businessmen to repatriate their capital to Russia – the example of the Magomedov brothers would thus be intended at intimidating and disciplining others.

The suspicions towards the Magomedov brothers

The case against the Magomedov brothers is conducted by the Economic Security Service of the Ministry of Internal Affairs which coordinated action of an operational nature with Directorate 'K' of the FSB (economic counterintelligence). The Ministry of Internal Affairs has not yet brought any charges (it has 45 days to do this). The media, referring to individuals who have contact with the investigation, have reported that the Magomedov brothers are suspected above all of the embezzlement of public funds through companies they control, for example, during the construction of the football stadiums in Kaliningrad and Saint Petersburg, and of causing financial losses in the state-controlled United Grain Company in which Summa holds 50%-1 shares. The investigation into the irregularities during the preparation of the site for the construction of the football stadium in Kaliningrad for which Globalelectroservice, a company controlled by Summa, was responsible, was launched in 2014 but it gained momentum only in the middle of 2017.

The case concerning the formation of an organised criminal group was launched on 29 March 2018, right before the arrest of the Magomedov brothers. The seriousness of the possible charges (they may be sentenced for up to 20 years in prison for this crime) and the fact that two ministries whose prerogatives include economic security have been engaged in investigating the Magomedov case suggest that the Kremlin is treating the investigation as a matter of significance for the state. It wants to demonstrate to the public that the government is determined to continue the struggle with oligarchs who cheat the state. A representative of the prosecution authorities has emphasised that the intention of the investigation will be to prove the charge that they embezzled funds from the state budget in conspiracy with a number of individuals and corporate entities (including state officials). This may mean that this case will in the future extend to other areas of the Magomedov brothers' activity, and that further arrests of businessmen or public servants should be expected.

The Kremlin's motives

The criminal behaviour the Magomedov brothers have been suspected of fits in with the typical systemic practices of the Russian political and business elite who have been building their fortunes for years partly through the embezzlement of funds from public procurement. The economic crisis in Russia followed by continuing stagnation and Western economic sanctions has, however, made the Kremlin inclined to gradually narrow the circle of beneficiaries of these practices and to apply pressure on selected representatives of big business to transfer their assets to Russia. One of the tools used to achieve these goals and to force the Russian elite to be loyal to the Kremlin, regardless of financial losses, is the campaign employing the slogans of combating corruption. The victims of this so far have been officials from federal ministries (including the former economy minister, Alexey Ulyukaev) and a large group of high-ranking regional officials. It appears that the decision to arrest the Magomedov brothers might have been influenced by a few factors simultaneously – the political and economic interests of the Kremlin and the political and economic interests of the CEO of the state-controlled oil company Rosneft, Igor Sechin, intersected in this case.

By arresting the Magomedov brothers, the Kremlin delivered another warning sign to the business elite aimed at forcing it to become fully loyal to the government. The brothers who, like most Russian oligarchs, control their assets in Russia via companies registered in tax havens (mainly Cyprus) might have fallen foul of the government's disfavour for two reasons. Firstly, the Russian media began speculating recently that they were making attempts to withdraw from their business activity in Russia, and thus they might become independent from the Kremlin. Ziyavudin Magomedov was arrested immediately before his planned trip to the USA with his family. It cannot be ruled out that he was arrested because the government was concerned that he might intend to escape the country. Had he escaped, the Kremlin would have had limited possibilities of influencing him and accessing his capital abroad. Another reason for the disfavour might be the misappropriations of funds committed in connection with the construction of sports facilities for the 2018 World Cup, Putin's flagship project intended at improving the international image of Russia. The embezzlements of funds and the poor quality of work carried out by the companies linked to Summa not only posed the risk that the entire project might not be finished on time but were also proof of disrespect for the special significance the Kremlin attaches to hosting the event. Nor can it be ruled out that the pretext was provided by the brothers' links with Dagestan (their ethnic background – they are Avars from Dagestan, extensive interests in the republic and influence on local officials), a region where massive anti-corruption cleansing among the local elite has been seen over the past few months.

Sechin's motives

It is probable that Igor Sechin, who has informal influence on the directions of operation of the FSB's economic counterintelligence section, was directly interested in forwarding certain information to the Kremlin on Summa's abuses. Ivan Tkachev, who is believed to have close links with Sechin, was put in charge of the FSB's operational actions in the Magomedov brothers' case. Sechin was likely actively lobbying for striking the blow against the Magomedov brothers and, indirectly, their business partner, the state-controlled company Transneft.

Sechin's motives may be two-edged. Firstly, economic. He is interested in taking control of the joint-stock company Novorossiysk Commercial Sea Port (NMTP) owned by Transneft and Summa which has shares in export terminals in Novorossiysk (50.1% stake) and Primorsk. Rosneft has the largest share among Russian producers on crude oil exports via these terminals (33% and 35%, respectively).

The arrest of the Magomedov brothers resulted in a transaction being withheld between Summa and Transneft which was almost finalised. Transneft was to buy in April 25% of shares in NMTP owned by Summa and thus become the company's majority stockholder (see Appendix for more details). It cannot be ruled out that the part of NMTP owned by Summa will finally be acquired by Rosneft. This would weaken Transneft's position in the company and might be an introduction to taking over further stakes, firstly a further 20% of the stocks in NMTP owned by the Treasury, which Sechin has been attempting to take over, though without visible effects so far. This would fit in with the broader game with Transneft. Sechin has been engaged in disputes for many years with its CEO, Nikolai Tokarev, attempting to undermine Transneft's monopoly on oil pipeline transport. The Russian media have even speculated that Rosneft would like to take over Transneft. This would mean that Rosneft would take control of oil transport in Russia which would enable it to regulate export tariffs and decide on the direction of transport infrastructure development, thus significantly strengthening its position in the Russian oil sector.

Secondly, Sechin's motives might be political. The attack on the Magomedov brothers might be an element in a long-term game Sechin is playing. Namely another attempt (after the trial of the former minister of economic development, Alexey Ulyukaev, who was sentenced for an alleged attempt to force Sechin to offer a bribe) to neutralise the government's resistance or even take control of its decisions in issues concerning the energy sector, which are of key importance for Rosneft. The Magomedov scandal is most likely aimed at discrediting deputy prime minister Arkady Dvorkovich who supervises this sector and who has maintained close contacts with the brothers since university and also, indirectly, Prime

Minister Dmitry Medvedev. They both have extended patronage over the business career of the Magomedov brothers for years, proof of which include several lucrative transactions which the latter managed to finalise during Medvedev's presidency (see Appendix for more details). Sechin's goal is most likely to weaken the prime minister as much as possible and to gain influence over the makeup of the new Russian government which will be formed after Vladimir Putin is sworn in for his fourth term as president on 7 May and, above all, to ensure that the 'energy section' of the new cabinet is staffed with his trusted people.

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Appendix

The Magomedov brothers' business

Summa, controlled by the Magomedov brothers, has been reluctant to release information about its business. It has not published its financial results or stockholding structure.

The Magomedov brothers started their business activity in the 1990s from trade in electronics and operations on the currency market. In the mid-1990s, they bought the Diamant bank. Even though the bank lost its licence in 2001, it enabled them to become active in the oil business. The bank took over around 5.5% of the shares in Nizhnevartovskneftegaz (currently part of Rosneft) as a lien for an unpaid loan, and the Magomedov brothers became engaged in the oil trade. In the early 2000s, they established co-operation with Transneft and its then CEO Semyon Vaynshtok. They implemented numerous infrastructural projects for Transneft, earning most of all on the Baltic Pipeline System (BPS), ending in an export terminal in Primorsk by the Baltic Sea. The brothers managed to buy part of the land on which the future port was to be built. As a consequence, Transneft leased the land from them for the construction of BPS-1 and entrusted the construction of the second branch of the system to the Magomedov brothers. They continued their co-operation with Transneft also after Nikolai Tokarev was nominated its CEO in 2007; for example, they were engaged as a sub-contractor for the construction of the East Siberia-Pacific Ocean (ESPO) oil pipeline, and in 2010 jointly with Transneft they bought a 50.1% stake (part of it was bought from Arkady Rotenberg, a businessman linked to Putin) in Novorossiysk Commercial Sea Port (NMTP), a company which holds shares in export terminals in Novorossiysk and Primorsk. The two companies control their stake via the joint venture Novoport Holding Ltd. The estimated value of the transaction was US$2 billion. A further 10.5% in NMTP is controlled by Transneft via its subsidiary, ZAO Transneft Servis, 2.75% of the shares are held directly by Summa, 20% by the Treasury (the federal agency Rosimushchestvo) and 5.3% by Russian Railways. NMTP also owns shares in the Baltiysk port (Kaliningrad Oblast).

In 2009-2014 two companies controlled by Ziyavudin Magomedov, Souz Petrolium and Star Oil FZE, were among the main exporters of Russian oil to Lithuania, Poland and the Czech Republic.

Since 2014, Transneft and Summa have been unable to reach a compromise as regards the NMTP's management and have been considering splitting their assets. At the beginning of

2018, the companies agreed that Summa would sell Transneft its stake in the NMTP (for 1.8 billion roubles, which was reportedly double the true value of these assets). The transaction was approved by the anti-trust service, and it was planned to be finalised on 9 April 2018. However, the CEO of Transneft met with President Putin on 30 March, and Ziyavudin Magomedov was detained the same evening. As a consequence, Transneft announced on 3 April that it was suspending the talks with Summa.

As regards assets in the energy sector, Summa has owned the Yakut Fuel and Energy Company, a large regional gas firm, since 2007. In 2016, this firm extracted 1.7 billion m^3 of natural gas and might increase its output but has been prevented from this due to the low demand for natural gas in the region and the lack of access to a transport network. Therefore, in autumn 2017, Summa decided to build a methanol processing complex. In January this year, Summa announced that China's CEFC would be its partner in this investment.

Outside the energy sector, Summa is an important player on the Russian transport market. It holds shares in the transport company Fesco whose assets include: the Far Eastern Shipping Company (32% controlled by Summa); the port in Vladivostok, 19 ships, 5 terminals and a container and carriage park. Furthermore, Fesco manages a 25.07% stake in TransContainer, a large container shipping company.

Summa is also present on Russia's agricultural market as it holds 50%-1 shares in the United Grain Company (OZK), which was established as a result of a merger of around 30 different companies from the food and agricultural sector, including Novorossiysk Grain Plant, which controls Russia's largest grain reloading terminal (a third of Russian exports). OZK also acts as a manager of the state grain intervention fund (on 2 April 2018, it stored 4 million tonnes of grain worth 36.4 billion roubles). Summa acquired these shares as a result of the privatisation process (the privatisation decision was signed in 2011 by President Medvedev). A few months before this, the Magomedov brothers directly acquired a 30% stake in Novorossiysk Grain Plant. The position of the Magomedov brothers in Russia began its decline already in 2014, visible proof of which was the loss of access to public procurement (the Magomedov brothers were last listed in the Forbes 'Public Procurement Kings' ranking in 2015, according to which public firms in 2014 bought goods and services from them worth a total of over 49 million roubles, i.e. around US$0.84 million). Several investigations have also been launched against firms linked to them.