

# THE MOSCOW TIMES

## The State of Auction Theory

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Returning to theory is often one of the ways people try to explain what went wrong in major auctions that have been held here in the past. The sale of the state's 75 percent stake in Slavneft in 2002, for example, was run in such a way that it maximized the opportunity for collusion between the most likely bidders. When the auction mechanism is based on open bidding -- so-called English auctions -- it is easy for participants who have reached an agreement on the outcome beforehand to track the bidding and make sure that no one deviates from the plan. The fact some of the firms participated were just fronts for unknown interests facilitated collusion even further. If one party to the plan noted that a bidder was acting outside the original agreement, he might activate a "sleeping" bidder to protect his interests.

In the 2004 auction for Yuganskneftegaz, formerly the largest production asset at Yukos, the whole process reached the absurd. It was unclear immediately following the auction which of the major parties interested, Rosneft or Gazprom, was behind the unknown company that came out the winner.

An example of how best to prevent collusion between bidders came in the auction for a blocking stake in state-owned telecoms giant Svyazinvest in 1997. As this case demonstrated, the risk of behind-the-scenes deals is minimized if the auction is conducted using sealed bids. The ultimate winners said themselves that they overpaid for the stake significantly, which had to be a positive result for those who organized the sale.

It appears that we may face the same issues again when Yukos' remaining assets go on the block over the next few weeks. In the first of these auctions, in which the now-bankrupt company's shares in state-controlled oil major Rosneft will be up for bid Tuesday, the outcome looks like a foregone conclusion. Even ignoring the likelihood of political interference, the main contender is Rosneft itself. It will be hard for TNK-BP, the other declared contender, to walk the fine line involved in losing the auction while still giving the impression that it is trying to win. As a result, it will likely be very careful in bidding. If the auction were "closed," meaning that it was based on the submission of sealed bids, the price fetched for the assets would be higher, as the favorite would have to insure itself against the risk of coming in too low.

The organizers have clearly not taken a best-theory approach in setting up another looming auction, scheduled for April 4. This will combine a 20 percent packet of shares in Gazprom Neft (the renamed Sibneft), ArcticGaz, Urengoil, and other Yukos assets. Pure theory would suggest that these assets should have been auctioned off separately. That way, bidders who didn't have deep enough pockets to vie for the entire package might have been interested in some of the individual assets. At the risk of sounding repetitive, this should have been designed as a closed auction as well. Bundling all of these assets into one package has made the auction absolutely uncompetitive. There is only one company in Russia that is interested and able to tackle something this big, and that is Gazprom. If the plan had been to auction the assets individually, Gazprom would have faced competition for at least some of these, a factor that would likely have driven prices higher. But the organizers apparently believed that organizing the auctions separately would allow the bidders to collude and that some assets would be scooped up on the cheap.

All of this theory aside, it is possible that political decisions about what should go to each of Rosneft and Gazprom and with only token competition have played the chief role in determining the auction mechanism here. If this is the case, then everything has been organized according to auction theories.

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