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Putin's Way Part 1

By **STEVEN LEE MYERS**, **JO BECKER** and **JIM YARDLEY** SEPT. 27, 2014

ST. PETERSBURG, Russia — Weeks after President Vladimir V. Putin annexed Crimea in March, an obscure regulatory board in Moscow known as the Market Council convened inside an office tower not far from the Kremlin to discuss the country's wholesale electricity market. It is a colossal business, worth 2 percent of Russia's gross domestic product, and a rich source of fees for the bank that had long held the exclusive right to service it.

With no advance notice or public debate, though, the board voted that day in April to shift that business to Bank Rossiya, a smaller institution that lacked the ability to immediately absorb the work. For Bank Rossiya, it was a tidy coup set to yield an estimated $100 million or more in annual commissions, yet it was hardly the only new business coming in. State corporations, local governments and even the Black Sea Fleet in Crimea were suddenly shifting their accounts to the bank, too.

In a matter of days, Bank Rossiya had received an enormous windfall, nearly all from different branches of the Russian state, which was delivering a pointed message. In late March, the United States had made Bank Rossiya a primary target of sanctions, effectively ostracizing it from the global financial system. Now the Kremlin was pushing back, steering lucrative accounts its way to reduce the pain.

The reason the Kremlin rushed to prop up Bank Rossiya is the same reason that the United States, and later its European allies, placed it on the sanctions list: its privileged status as what the Obama administration calls the "personal bank" of the Putin inner circle. Built and run by some of the president's closest friends and colleagues from his early days in St. Petersburg, Bank Rossiya is emblematic of the way Mr. Putin's brand of crony capitalism has turned loyalists into billionaires whose influence over strategic sectors of the economy has in turn helped him maintain his iron-fisted grip on power.

Now the sanctions are testing the resilience of his economic and political system. Even as President Obama argues that the measures aimed at Mr. Putin's inner circle are pinching Russia's economy and squeezing the tycoons who dominate it, many of them have mocked the sanctions as a mere nuisance, the economic equivalent of a shaving cut, while the Kremlin has moved rapidly to insulate them.

Woven deeply into the Putin system is Bank Rossiya. Founded as the tiniest of banks in the twilight of the Soviet era, Bank Rossiya, through staggering, stealthy expansion backed by the largess of the state, now has nearly $11 billion in assets. It controls a vast financial empire with tentacles across the economy, including a large stake in the country's most powerful private media conglomerate, a key instrument of the Kremlin's power to shape public opinion. How well the bank survives in a time of sanctions may ultimately be a barometer of whether economic pressure is enough to make Mr. Putin stand down at a time when neighboring countries, especially in the Baltics, are increasingly anxious about a newly aggressive Russia.

Mr. Putin came to power vowing to eliminate "as a class" the oligarchs who had amassed fortunes — and, to the new president's mind, a dangerous quotient of political sway — under his predecessor, Boris N. Yeltsin, in the post-Communist chaos of the 1990s. Instead, a new class of tycoons have emerged, men of humble Soviet origins who owe their vast wealth to Mr. Putin, and offer unquestioning political fealty to him in return.

"These guys emerged from scratch and became billionaires under Putin," Sergei Aleksashenko, a former deputy finance minister and central banker, said in a recent interview.

If the modern Russian state is Kremlin Inc., Mr. Putin is its chief executive officer, rewarding his friends with control of state-owned companies and doling out lucrative government contracts in deals that provoke accusations of corruption but have the veneer of legality under the Putin system.

"He has given and he has taken away," said Mikhail M. Kasyanov, who served as prime minister during Mr. Putin's first term. "They depend on him, and he depends on them."

This inner circle coalesced around Mr. Putin as he began his unobtrusive rise, from a middling career as a K.G.B. intelligence officer to a midlevel functionary in the office of St. Petersburg's mayor.

One of these loyalists is Bank Rossiya's chairman and largest shareholder, Yuri V. Kovalchuk, a physicist by training, sometimes called the Rupert Murdoch of Russia for his role as architect of the bank's media interests. Other Bank Rossiya shareholders include several of the country's wealthiest men, the son of Mr. Putin's cousin and even an old St. Petersburg friend of his, a cellist who was formerly first chair at the fabled Mariinsky Theater.

The Kremlin has long denied giving Mr. Putin's friends preferential treatment. But in acquiring many of its holdings, the privately held Bank Rossiya benefited from Kremlin directives that allowed it to purchase prize state-owned assets at what critics have called cut-rate prices. Meanwhile the true extent of its holdings is obscured by shadowy corporate shell structures that nest like matryoshka dolls, one inside the next.

Records show that the ownership of one powerful television advertising company linked to Bank Rossiya, for example, is buried in offshore companies in Panama, in the British Virgin Islands and even at a simple concrete house on Karpathou Street in Nicosia, the capital of Cyprus, whose owner had no idea of the company registered there.

In the early days of the conflict over Ukraine, several European leaders expressed deep ambivalence about alienating a Russia that under Mr. Putin's rule has become immeasurably wealthier than it ever was under the Soviet system. Russia has been a sought-after partner in the globalized economy, a source of cheap natural gas for Europe, where wealthy Russians have also purchased billions of dollars in real estate in places like the Cote d'Azur and the Belgravia district of London.

But that resistance has to some extent eroded, especially since the downing of a commercial airliner over eastern Ukraine in July that killed 298 people. This month, despite an edgy truce between pro-Russian separatists and government forces in Ukraine, the West announced a new round of sanctions aimed not just at Mr. Putin's powerful cronies but at the Russian economy more broadly. Some argue, however, that this punitive strategy fundamentally misunderstands the way the Putin system works.

Gennady N. Timchenko, an oil trader and Bank Rossiya investor whose own holding company is also under sanctions, admitted in a recent interview with Itar-Tass to a measure of annoyance. He was unhappy that his Learjet had been grounded because of sanctions, and that he could not vacation in France with his family and dog, Romi, which happens to be the offspring of Mr. Putin's beloved black Labrador, Koni.

And yet, he said, he would never presume to question the Russian president's policies in Ukraine, whatever the cost to companies like his. "That would be impossible," he said, going on to refer to Mr. Putin formally by his first name and patronymic. "Vladimir Vladimirovich acts in the interest of Russia in any situation, period. No compromises. It would not even enter our minds to discuss that."

'A Bouquet of Friends'

In the Kolomna district of St. Petersburg, near the shipyards, is a 19th-century palace that belonged to Grand Duke Aleksei Aleksandrovich, a son of Czar Aleksandr II. Lately its elegant halls — this one in Baroque style, this one English, this one Chinese — have been repurposed as the House of Music, a training academy for classical musicians.

The academy's artistic director, Sergei P. Roldugin, has his own singular back story. He is an accomplished cellist and musical director. He is certainly not a businessman, he explained at the palace the other day. "I don't have millions," he said. And yet, on paper at least, he has a fortune that could be worth $350 million. That is because, years ago, he said, he acquired shares in a small bank run by men close to his old friend Mr. Putin.

He had met Mr. Putin in the 1970s, and is godfather to his eldest daughter, Maria. He opened the House of Music with Mr. Putin's patronage. Last year, he recalled, the president asked him for a favor: would he organize a private concert?

So Mr. Roldugin traveled to the president's official residence west of Moscow, Novo-Ogaryovo, with three young musicians: a violinist, a pianist and a clarinetist. They played Mozart, Weber and Tchaikovsky — so well, he said, that Mr. Putin invited them to play again the next night for the same small group of friends who had gathered there.

They were "of course, very famous people," Mr. Roldugin said, without revealing any names. "Quite all," he said, "are under sanctions."

The concerts are a glimpse into the small, remarkably cohesive group of men who came together around Mr. Putin as the old order was crumbling and a new, post-Soviet Russia was taking form.

When the last Soviet leader, Mikhail S. Gorbachev, began to allow the first experiments in private enterprise in the 1980s, St. Petersburg was still Leningrad, an impoverished shadow of the czarist capital it had been.

An early adapter was Mr. Kovalchuk, a physicist at the Ioffe Physical Technical Institute, who founded an enterprise to turn its scientific work into commercially viable products. Another was Mr. Timchenko, a former Soviet trade official, who formed a cooperative to export products from an oil refinery on the Baltic Sea.

What brought Mr. Putin into their orbit was the fall of the Berlin Wall in 1989. After five years as a K.G.B. officer in East Germany, Mr. Putin was part of a wave of embittered military and intelligence officers who withdrew from the Soviet satellites and returned with few prospects to a changing homeland.

Still with the K.G.B., Mr. Putin came into contact with one of his former law professors: Anatoly A. Sobchak, a reformer who had just become chairman of the Leningrad legislature (and would later become mayor of the renamed St. Petersburg). He asked Mr. Putin to become an adviser, to smooth relations with the still-powerful security services. And when the Soviet Union collapsed, Mr. Putin joined Mr. Sobchak full time, overseeing a new committee on foreign economic relations.

The committee worked closely with Russia's emerging entrepreneurs, regulating imports and exports and distributing city contracts. Some of the deals became controversial, notably one during the hungry winter of 1991-92, of a deal to barter oil, metal and other products for food. Virtually none of the food ever materialized, and a City Council committee unsuccessfully sought to have Mr. Putin fired for incompetence.

For all that, Mr. Putin was considered an efficient, unprepossessing administrator, helping businessmen cut through the bureaucracy. His fluency in German was useful with the many Germans seeking a foothold in the city. Among them was Matthias Warnig, formerly of the East German secret police, the Stasi, who opened one of the city's first foreign banks, Dresdner.

Mr. Putin was, in short, both collecting new friends and laying the foundation for what would evolve into the system of personalized, state-sponsored capitalism now at the heart of his power.

"It was a favorable environment for such a bouquet of friends to appear," explained Mikhail I. Amosov, who served on the City Council at the time.
In many cases, contracts and property were distributed through insider deals, often without open or transparent bidding. "Everything was decided through personal connections," Mr. Amosov said. "We didn't like it."

One enterprise that received an infusion of municipal aid was Bank Rossiya.

The bank had been founded in 1990 at the initiative of the city's branch of the Communist Party, with party funds as capital. It was also believed to handle the banking needs of the K.G.B. But with the collapse of the Soviet Union, it was all but bust.

Mr. Kovalchuk stepped in. In December 1991, he and a group of friends secured a small loan from a local shoe manufacturer and bought the foundering bank. The investors included three other alumni of the Ioffe Technical Institute — the physicists Victor Y. Myachin and Andrei A. Fursenko, and Vladimir I. Yakunin, the institute's former head of international relations.

The reconstituted Bank Rossiya quickly became a favored city institution. At the mayor's instruction, according to news reports, the city opened several large accounts there, fattening the bank's coffers and setting it on its way.

Business connections became deeply personal connections.

In 1996, Mr. Putin joined seven businessmen, most of them Bank Rossiya shareholders, in forming a cooperative of summer homes, or dachas, called Ozero, or "lake," in the northeast of St. Petersburg. The group has come to have an outsize influence on Russia's political and economic life. The cooperative included the homes of Mr. Putin, Mr. Yakunin, Mr. Kovalchuk, Mr. Fursenko and his brother Sergei, Mr. Myachin, and Nikolai T. Shamalov, who headed the St. Petersburg office of the German manufacturer Siemens and would also acquire a major stake in Bank Rossiya. Vladimir A. Smirnov, a St. Petersburg businessman with an exclusive contract to supply the city's gasoline retailers, served as Ozero's director.

Mr. Timchenko, the oil trader, entered the Bank Rossiya circle as an investor; according to the bank, his stake is owned by a company he controls. Mr. Warnig, the German banker, would later join Bank Rossiya's board. (When Mr. Putin's wife was badly injured in a car accident, Mr. Warnig's bank arranged to pay for her medical care in Germany.)

And there was Mr. Roldugin, the cellist. "The issue was that I needed to have some money," he said, adding, "There was no money for art anywhere." His investment, he said, involved "a lot of manipulations" and required him to take out a loan. Today the bank lists him as owner of 3.2 percent of its shares.

Mr. Putin's stint in St. Petersburg ended in 1996, when his boss lost his bid for re-election. Soon Mr. Putin had a new boss, President Yeltsin. And after Mr. Yeltsin unexpectedly elevated him to prime minister and then acting president on New Year's Eve in 1999, the fortunes of many of his friends — and their little bank — began to be transformed.

'Bank Rossiya, That's It'

He had arrived in Moscow as a midlevel apparatchik in ill-fitting suits, had ascended to power as a thoroughly unexpected president and won his first presidential election in 2000 on the crest of war to suppress separatists in Chechnya. By 2004, Mr. Putin had become the paramount figure in Russia, winning a second term with 72 percent of the vote, in a race tainted by allegations of strong-arm tactics and vote rigging. Yet Mr. Putin probably would have won a fair election easily, too. The Russian economy, buoyed by high oil prices, was booming, creating huge fortunes and also lifting the middle class. The long era of post-Soviet gloom seemed done.

Not many people yet understood that in the middle of Russia's prosperity, the men in the tight circle close to Mr. Putin were becoming fabulously wealthy, and increasingly powerful, in what critics now consider a case study in legalized kleptocracy.

Bank Rossiya, which reported less than $1 million in profits the year before Mr. Putin became president, had grown steadily, but figures like Mr. Kovalchuk and Mr. Timchenko remained in the shadows.

"I didn't even know such names — Timchenko, Kovalchuk," said Mr. Kasyanov, whom Mr. Putin dismissed as prime minister shortly before the elections.

Putin's Inner Circle

During the 2004 campaign, one of Mr. Putin's quixotic challengers, Ivan P. Rybkin, did raise the issue of corruption, accusing Mr. Kovalchuk and Mr. Timchenko of acting as the president's "cashiers." But few people were listening. (Mr. Rybkin disappeared soon after making his accusation, re-emerging several days later, saying he had been kidnapped and drugged in Ukraine's capital, Kiev.)

In sanctioning Bank Rossiya, the Obama administration would resurface the "cashier" allegation, though it offered no evidence that Mr. Putin has personally profited from the bank. Mr. Kovalchuk, who through a spokeswoman did not respond to requests for comment, in the past has attributed his bank's success not to any special treatment but to sound investment and business decisions.

Either way, Bank Rossiya's holdings would increase tenfold during Mr. Putin's second term. Critical to this remarkable growth was the bank's ability to snap up assets, at knockdown prices, that had previously belonged to the state-owned energy company Gazprom.

Those deals were documented in a series of reports published at the end of Mr. Putin's second term by Boris Y. Nemtsov, a former deputy prime minister, Vladimir V. Milov, a former deputy energy minister, and others. "The total value of the assets exfiltrated from Gazprom," they estimated, was $60 billion.

An early deal involved one of the country's biggest insurers, Sogaz. Bank Rossiya bought a controlling stake in Sogaz by acquiring shares that had been held by Gazprom. The bank paid around $100 million, according to Mr. Nemtsov and Mr. Milov, who later valued Sogaz at $2 billion.

"Putin said, 'Bank Rossiya, that's it,' " Mr. Milov later told the Russian edition of Forbes.

Sogaz became the insurer of choice for major state companies like Russian Railways, headed by Mr. Yakunin, and the growing oil giant, Rosneft, by then led by Igor I. Sechin, who had been Mr. Putin's deputy in the St. Petersburg mayor's office. Sogaz also bought 75 percent of a company called Leader that managed Gazprom's $6 billion pension fund, Gazfond. The purchase price was $30 million, less than Leader's profits that year alone, according to Mr. Nemtsov and Mr. Milov.

It seemed to be a quintessential insider deal: The year before, Yuri Shamalov, son of the Bank Rossiya shareholder and Ozero member, had been appointed chairman of Gazfond. "Shamalov Jr., as head of Gazfond, sold shares in the company managing Russia's largest private pension fund at a fantastically low price to the bank owned by his father," Mr. Nemtsov asserted.

At the same time, Mr. Kovalchuk, the bank's chairman, began assembling a media empire that now controls some of Russia's largest television and radio stations and newspapers.

Bank Rossiya had already assumed management of the assets of Gazprombank, one of Russia's largest. Now, Gazprombank purchased Gazprom Media Group, which owns five television and several radio stations. The price: $166 million.

Two years later, Dmitri A. Medvedev, a Putin protégé and first deputy prime minister, put Gazprom Media's value at $7.5 billion, or 45 times the purchase price.

Not content merely to manage media assets, Bank Rossiya began buying up media companies of its own.

In 2005, a subsidiary of Bank Rossiya bought a stake in Channel 5, a local television network owned by the St. Petersburg government. The price was $25 million. There was no competition. Channel 5's value swelled in 2006, when regulators let it acquire frequencies in 30 regions across Russia.

Soon after, Mr. Putin designated it a national broadcaster, able to reach 91 cities and 53 million people. Today, it is the country's fifth-largest broadcaster.

A year later, a Bank Rossiya subsidiary bought a controlling stake in Ren TV, today the country's eighth-largest broadcaster.
Once known for investigating government corruption and airing opposition views that were never allowed on state television, Ren TV over time became noticeably less critical.

In August, amid the fervor over Ukraine, it canceled what was widely viewed as one of the last reasonably independent national political talk shows, "Nedelya," or "The Week."

"The first goal was political control of the media," said Roman Pivovarov, a leading analyst of the Russian media landscape. "But that was achieved relatively early on. So this was as much about money. The picture today is clear, in that the big media belongs to the small circle of people who control not only the politics but the economics of Russia."

By 2008, Mr. Putin's second term was ending and the Bank Rossiya media empire provided a supportive voice when, rather than recede from politics, he decided to serve as prime minister. Mr. Medvedev was elected president, while Mr. Putin largely retained control over the levers of government.

Two years later, Mr. Kovalchuk scored his biggest prize — a 25 percent stake in Channel 1, a state-controlled network with the largest audience in Russia. The stake cost only $150 million, "an amazingly low price," according to the newspaper Novaya Gazeta. The next year, Channel 1 reported profits of nearly $100 million.

Then, in 2012, Mr. Putin announced he would seek a third term as president. Democracy activists were deeply alarmed but powerless. No one doubted he would win, though the economy had slowed and Mr. Putin's men were targets of rising criticism, no longer hidden.

'My Friends Get Everything'

To grasp how Bank Rossiya's holdings extend around the globe — and how island tax havens and other tools of global finance may serve to obscure their true breadth — one place to visit is 13A Karpathou Street in Nicosia. This is the registered address of Med Media Network Limited, a company listed in a corporate flow chart connecting Bank Rossiya to a company called Video International.

In a peculiarity of the Russian marketplace, broadcasters do not sell advertising time directly. They act through middlemen like Video International, which buy airtime wholesale, then sell to those who wish to advertise.

Med Media is a major shareholder, holding a 20 percent stake. Except that Med Media's address in Cyprus is hardly a corporate headquarters at all. It is a simple concrete home with a large ficus shading a small garden. The owner, Agathi Zinonos, has never heard of Med Media or any of the other companies registered there.

She regularly receives legal documents in the mail from Russia, Bulgaria, Romania and other countries. "Every day, there is a whole packet coming," she said, noting that the documents are addressed to her son, who recently moved out. "Whatever comes, I take to him, because it is a lot of companies."

Attempting to unwind Video International's convoluted corporate structure requires going back to 2011. That is when Bank Rossiya and a couple of partners purchased the company, according to an interview given by Video International's chief executive in 2013.

Video International had controlled 70 percent of the advertising-placement market. But in the months before the sale, the government hastily enacted a new antimonopoly law, prohibiting national television networks from using advertising shops that controlled more than 35 percent of the market. Video International would have to abandon many of its contracts.

But what looked like a debacle for Video International turned out to be a boon for Bank Rossiya. The new law depressed the company's value — and thus its purchase price. And while Video International gave up many contracts, its new owners managed to profit from the "lost" business: Many of the networks simply brought the placement business in house — while continuing to pay Video International consulting and software-licensing fees.

Reflecting on the way the government's antimonopoly office has looked the other way, Mr. Aleksashenko, the former deputy finance minister, invoked the saying "my friends get everything, while my enemies get the law."

Among those taking part in the new arrangement was CTC Media, a company with several television channels that was partially owned by a subsidiary of Bank Rossiya. CTC continues to pay Video International around $80 million a year — but as a consultant.

Yet while the arrangement allowed Video International to maneuver around Russian law, it may actually have placed CTC at risk of violating American sanctions. For though CTC is a Russian broadcaster, its headquarters are in Delaware and it is traded on the Nasdaq. The sanctions prohibit American-headquartered companies like CTC from doing business with entities that are majority-owned by sanctioned companies like Bank Rossiya.

But whether Bank Rossiya retains a majority stake in Video International is impossible to ascertain. Records show that, on paper at least, its shares, held by a subsidiary, are down to 15 percent. Nearly all the rest of the shareholders are buried behind fronts like Med Media of Karpathou Street.

Cyprus is one of the world's busiest offshore financial-service centers, with one of Europe's lowest corporate tax rates and laws that enable foreigners to incorporate companies within days. Nearly 270,000 companies are registered there, and many are shells created to shelter income while obscuring the real owners.

Ms. Zinonos's son, Zinon, who is listed as a Med Media director, is an administrator at Scordis, Papapetrou & Co., a Nicosia law firm that not only represents Med Media but helped create it. A partner there, Makis Chrysomilas, said his firm typically uses its own address or those of employees when establishing residence for shell companies. "We are lawyers for 4,000 or 5,000 corporations," he said. Coming up with names for them can be a challenge, he explained. So he has taken names from a book listing the thoroughbred horses auctioned in the United States. He also has named companies after streets in London and other European cities.

Cypriot laws enable the true owners of shell companies to remain secret. Of the eight corporations with shares in Video International, at least five, with a combined stake of 69 percent, are incorporated in Cyprus: Med Media, Namiral Trading Limited, Devar Investments Limited, Reibruk Limited and Attalion Investments Limited. Delving into their ownership produces yet more corporate shells, headquartered in Panama and the British Virgin Islands, equally opaque jurisdictions.

Cari N. Stinebower, who advises clients on sanctions compliance at the law firm of Crowell & Moring, called the web of shell companies a "red flag." "The way the law works," she said, "it's incumbent on CTC to understand the beneficial ownership of the company they are doing business with" to ensure that there is not "some sanctioned entity at the end of the chain."

A Video International spokesman would not reveal who was behind the shell companies, and said only that they had not been sanctioned. "Why is the shareholder structure specifically like that?" he said. "Because the shareholders decided so." A CTC official declined to say what if any due diligence the company had done to determine if it was violating the sanctions. But he said CTC was working with the Treasury Department to ensure that it complied with the law.

'A Medium-Sized Bank'

The day after Mr. Obama blacklisted Bank Rossiya, Mr. Putin met with his national security council. Told that a total of 20 people had also been sanctioned — including three security council members, Putin compatriots from St. Petersburg — the president turned sarcastic. “We should distance ourselves from them,” he said, deadpan. “They compromise us.”

As for Bank Rossiya, he went on: “As far as I recall, this is a medium-sized bank. Personally, I did not have an account there, but I will definitely open one on Monday.” He later directed the presidential administration to begin depositing his official salary — roughly $7,500 a month — into a Bank Rossiya account.

Mr. Kovalchuk later gave a rare television interview with Dmitry K. Kiselyov, a prominent news anchor and ardent defender of Mr. Putin’s Russia. The president’s public gesture, Mr. Kovalchuk said, had prompted a flood of new customers, including an old, impoverished woman who wanted to deposit her life savings. For a bank with billions in assets, “this old woman means nothing financially, but the fact is that is worth more than any financial investments,” he said. “There is a Putin factor, and it is unconditional. The fact is that people intuitively feel which side of the barricades business stands on.”

Mr. Putin’s efforts to protect the bank were not just symbolic. He ordered the Central Bank to provide assistance if needed. State-owned energy companies transferred accounts to Bank Rossiya, and the governors of St. Petersburg and the surrounding Leningrad region told state institutions in their jurisdictions to do the same, according to Russian news reports. Additionally, in the lower house of Parliament, the main party loyal to Mr. Putin provided the margin needed to rescind the law effectively limiting Video International to just 35 percent of the advertising-placement market.

And on April 10, the Market Council stepped in. The council, which regulates Russia’s $35 billion wholesale electricity market, is a nonprofit organization with 22 members representing government ministries as well as major producers and suppliers of electricity. One of the council’s members is an executive at Inter RAO UES, a private enterprise spun off from the former state electricity monopoly. Its chief executive is Mr. Kovalchuk’s son, Boris; its board chairman is Mr. Sechin, the president of the state-owned oil giant Rosneft and one of Mr. Putin’s closest advisers.

The council met at its office in Moscow’s World Trade Center. A spokeswoman declined to discuss the vote, except to say that a quorum attended, explaining that she did not want to contribute to an “anti-Russian” article. The decision to shift the business to Bank Rossiya, she said, was one of several routine actions taken during a regular meeting that day. In remarks published on the council’s website in May, its director, Maksim S. Bystrov, said Bank Rossiya had “brought us” a proposal with lower commissions than those charged by the previous bank, Alfa. But he declined to provide details, and Alfa Bank declined to comment.

As the United States and Europe continue to ratchet up the economic pressure, it is an open question how long the government can continue to prop up the growing number of institutions faced with sanctions. Russia’s economy had been struggling even before the annexation of Crimea. The European Bank for Reconstruction and Development recently predicted that, with the added impact of Western sanctions and Mr. Putin’s retaliatory embargo on Western goods, the economy could contract next year.

Other companies are lining up behind Bank Rossiya, hoping for bailouts. The government recently announced that it would pump $6.6 billion into two state-controlled banks whose access to foreign capital has been cut. And Mr. Sechin's Rosneft has requested a $42 billion loan.

For his part, Mr. Putin has denounced the sanctions as unfairly targeting people with no influence over Russia's policies on Crimea or Ukraine. "Yes, these people are my friends and I'm proud to have such friends," he said at an economic forum in St. Petersburg in May. "They are true patriots and their business is oriented towards Russia. Have these sanctions done damage to them? Yes, they have. If I'm being honest, they have. But they are seasoned entrepreneurs and brought all their money back to Russia, so don't worry about them too much."

Steven Lee Myers reported from St. Petersburg and Moscow, Jo Becker from Washington and London, and Jim Yardley from Nicosia, Cyprus. Alexandra Odynova contributed reporting from Moscow, and Dimitris Bounias from Cyprus. Masha Goncharova contributed research from New York.

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Putin’s Friend Profits in Purge of Schoolbooks

By JO BECKER and STEVEN LEE MYERS NOV. 1, 2014
Putin’s Way Part 2
MOSCOW — The purge began in late winter. One by one, hundreds of textbooks that Russian schoolchildren had relied upon for years were deemed unsuitable for use in the country’s 43,000 schools. The reasons varied, but they shared a certain bureaucratic obstinacy.

One publisher saw all of his company’s English-language textbooks barred because he had failed to include their subtitles on the paperwork required for government approval. More than three dozen books that use a popular creative teaching style were dropped from a list of authorized titles because the publisher had submitted copies of supporting documents, rather than the originals.

Then there was the case of the colorful math textbooks published by a decorated educator, Lyudmila G. Peterson, cashiered for using characters from popular foreign children’s stories. Illustrating math problems with the likes of Snow White, Eeyore and Owl, in one expert’s decisive opinion, was “hardly designed to instill a sense of patriotism” in young Russian minds.

Putin’s Way

By the time the school year began this fall, the number of approved textbooks for Russia’s 14 million schoolchildren had been slashed by more than half. The summary winnowing by the Ministry of Education and Science upset lesson plans, threatened the livelihoods of nearly two-dozen small publishers and left principals, teachers and parents puzzled and angry.

There was, however, one standout winner: A publishing house whose newly appointed chairman was a member of President Vladimir V. Putin’s inner circle, Arkady R. Rotenberg, a judo sparring partner from Mr. Putin’s St. Petersburg youth.

The publisher, Enlightenment, survived the education ministry’s culling almost untouched.

“I have never seen such a level of cynicism and chaos before,” said Vladimir A. Peterson, who manages the publication of the math textbooks developed by his mother.

The purge was the latest in a string of government maneuvers that have positioned

Enlightenment, once the sole provider of school textbooks under Soviet rule, to dominate the textbook marketplace once again. Mr. Putin first directed that the state-owned company be sold into private hands, records show, in a deal that circumvented a requirement intended to ensure the highest prices for state assets. Then, having installed Mr. Rotenberg as chairman, Mr. Putin's government knocked out much of Enlightenment's competition.

The remaking of Russia's textbook industry features a murky trail of transactions that dead-ends in the opaque offshore tax haven of Cyprus, and a cast of characters including a federal lawmaker from the party loyal to Mr. Putin and the software giant Microsoft, which recently signed an agreement with Enlightenment to help it provide Windows-based tablets to Russian schools. That deal came after Mr. Rotenberg, though not Enlightenment specifically, had been targeted along with other close Putin friends by international sanctions stemming from Russia's annexation of Crimea.

Enlightenment's story also traces, in miniature, the arc of the Russian economy over the last quarter-century, from Soviet state ownership, to privatization, to what might be called the theater of state-sponsored private enterprise that flourishes today under Mr. Putin. In theory, market competition exists. In reality, the Kremlin and its functionaries have divvied up the nation's strategic industries among a small and malleable circle of allies. They command some of the nation's largest energy companies, control banks and much of the news media, and, increasingly, have a footprint in smaller sectors, like book publishing, that are nonetheless important to Mr. Putin's political control.

"The country is now run by a few families, or clans, close to Putin," said one publisher, who like many others spoke only on the condition of anonymity for fear of retribution. "They used to focus on the very biggest businesses: oil, gas, big infrastructure projects, the banks. But now that they have eaten all the food in that cupboard, they are eating the mice, and the mice's food, going after smaller and smaller markets."

A Soviet Legacy

Enlightenment is a legacy of the Soviet era, when the Kremlin sought to ensure the ideologically correct education of the country's youth through absolute control of the nation's curriculum. The publisher was an arm of the Education Ministry — which also went by the name Prosveshcheniye, Russian for Enlightenment — and schools had no choice but to use its textbooks.

The collapse of the Soviet Union freed the textbook industry, like publishing generally, from the state's ideology. Under President Boris N. Yeltsin, new publishers emerged, and schools could freely choose textbooks from a list approved by the government, based on expert opinions from the Russian Academy of Sciences and the Russian Academy of Education, certifying that the material was, among other criteria, factual and age appropriate. New textbooks — and new methods of teaching developed outside Russia — proliferated, creating diversity in what had been a rigid and rote educational system.

In 2011, after years of resisting, the government announced that the state-owned Enlightenment would be put up for sale as part of Russia's privatization plan. Competition had cost Enlightenment its monopoly, but with about 30 percent of the market, it remained a plum prize.

Russian law requires that state assets be auctioned off to the highest bidder, but a loophole allows the prime minister to issue a directive that effectively limits the competition to a select few. Mr. Putin, who had served two terms as president and would soon run for a third, held the post then, and for months industry rumors had been circulating that Enlightenment was about to be delivered into the hands of one of his oldest friends, Mr. Rotenberg.

During Mr. Putin's rule, Mr. Rotenberg, who declined repeated requests for an interview for this article, had gone from a modest trader specializing in Finnish goods to one of the most powerful businessmen in Russia, with an estimated worth of $3.1 billion. He is the guiding hand behind a vast banking and construction empire, and the recipient of tens of billions of dollars in government contracts, building everything from roads to gas pipelines to Sochi Olympic-related infrastructure projects and a new airport terminal in Moscow.

Eager to get in on the bidding for Enlightenment, textbook publishers hurriedly enlisted allies in the Russian Parliament to press for an open competition. They were right to be worried: Unbeknown to them, Mr. Putin had already signed a directive circumventing the open auction rule. The order, dated Sept. 27, 2011, designated Gazprombank to act as the government's agent in finding a qualified buyer for Enlightenment, for a price "not less than" market value.

The choice of the bank signaled the intimacy of the government's role in the sale. Its assets were managed by Bank Rossiya, an institution whose chairman and largest shareholder is Yuri V. Kovalchuk, another billionaire member of Mr. Putin's inner circle. Though Enlightenment's market value was to be determined by an "independent appraiser," the hiring of the appraiser fell to Gazprombank as well.

The entire process — from valuation to sale — took a matter of weeks.

"It happened very fast," the publisher who spoke on the condition of anonymity said, "and one thing to know about Russia is that when the bureaucracy moves fast, there's usually someone moving behind them."

The next thing anyone knew, the government announced in late December that Enlightenment had been sold to Olma Media Group, a publisher in Moscow specializing in fiction and art books. Records show Mr. Putin personally signed off on the sale.

Olma was a small player, with less than 1.8 percent of the Russian book market, according to the Federal Agency for Press and Mass Communication. But it was politically connected. One of its co-owners was Oleg P. Tkach, a legislator in the upper house of Parliament and member of United Russia, the political party loyal to Mr. Putin. And its authors included Mr. Putin himself, who in 2004 co-wrote a textbook called "Let's Learn Judo with Vladimir Putin," the royalties of which went to the black-belt Russian president.

Russian anticorruption law prohibits members of Parliament, like Mr. Tkach, from directly engaging in business activity, much less business activity involving the acquisition of a state-owned company. Olma's general director, Dmitri N. Ivanov, said Mr. Tkach complied with that law by leaving the running of the company to others.

Only two other publishers were allowed to bid for Enlightenment: a company called Eksmo and another called Drofa, which was subsequently purchased by Eksmo. The government did not disclose their bids, but maintained that the price Olma paid — $71.5 million — was actually higher than its appraised value.

The facts, however, cast doubt on that appraisal.

"It was very cheap," said one publisher who was shut out of the bidding. "We were all willing to pay more."

Enlightenment's business has been steady, with about half its revenue coming from government contracts. In 2012, the year after the sale, its annual revenue was close to three times the purchase price, records show, with net profits of nearly $41 million. The company's annual report estimated it would earn nearly $57 million for 2013, meaning that profits over just two years would exceed the price Olma had paid.

Mr. Ivanov said the company won the bid by offering the highest price. Justifying its profits since, he said: "We weren't exactly sitting on our feet. We were working so hard on the effectiveness of the company." He did, however, acknowledge that before acquiring Enlightenment, Olma Media Group was worth "tens of millions of dollars," while today the merged company's value is in the "hundreds of millions."

The sale price was hardly the only curious thing about the deal.

Just weeks after Olma Media Group bought Enlightenment, it sold it, for an unknown price, to a company registered in Cyprus. Then, in a final circular twist, the Cyprus-based Enlightenment turned around and bought 99 percent of Olma Media Group. Virtually overnight, the true owners of Russia's largest textbook publisher had become impossible to trace. That is because the merged operation was now registered offshore in Cyprus, a popular tax haven that does not require companies to disclose their shareholders.

It was at this point that Mr. Rotenberg, long rumored to be a beneficiary of the government's sale of Enlightenment, formally appeared on the scene.

Records show that the initial financing that made the entire transaction possible — a $54.2 million loan — came from SMP Bank, which is controlled by Mr. Rotenberg and his brother, Boris. That loan was then refinanced with a $77.1 million line of credit from Gazprombank, the bank that had appraised and then auctioned off Enlightenment for several million dollars less just weeks before.

Finally, on Oct. 31, 2013, nearly two years after the privatization, Mr. Rotenberg's role in Enlightenment became official: Following an internal shake-up, he joined the company's board as chairman.

Mr. Ivanov refused to explain the decision to move the company offshore; he referred questions to Mr. Tkach and his partner, Vladimir I. Uzun, neither of whom responded to written questions or requests for an interview. The move, Mr. Ivanov maintained, had not affected the ownership of the company; the shares, he said, are held by an international fund in trust for the families of Mr. Tkach and Mr. Uzun.

Mr. Rotenberg, he said, has no financial stake and receives no compensation.

But last week, Mr. Rotenberg himself appeared to contradict Mr. Ivanov. As The New York Times was preparing to publish this article, he discussed his role in Enlightenment as part of an interview with the Russian news agency Interfax.

“For me, this is a significant project, and in large part not financial, although it is business as well — there is profit there, there are dividends,” Mr. Rotenberg said. “This should in fact be a decent business.”

A Sudden Directive

The directive came out of nowhere. Henceforth, the Ministry of Education and Science declared late last year, the only textbooks eligible for purchase by Russia’s schools would be those that managed to meet stringent new federal guidelines.

Publishers had to resubmit all the previously required expert reports qualifying their textbooks, plus three new ones prepared by groups authorized by the government to assess the books’ “ethno-cultural” value. What’s more, the ministry would no longer simply rubber stamp experts’ recommendations; it was forming an internal council to assess textbooks itself.

The new requirements, argued the education minister, Dmitri V. Livanov, were needed to ensure quality. But Oleg N. Smolin, an opposition member of Parliament who chairs the education committee, wrote in a letter of protest that the goal was clearly to “artificially decrease the number of textbooks.”

Publishers had limited time to gather the necessary opinions, and a number of smaller publishing houses simply could not comply. Still, many managed to meet the February deadline, and that was when “they started doing all these crazy things to knock out more,” said one person knowledgeable about the industry.

Aleksei V. Konobeyev, editor in chief of Titul Publishers, said he received a phone call informing him that all 20 of the books his company submitted had been barred. Titul publishes English-language textbooks, including a line for grades 2 to 11 titled “Enjoy English.” The series is the most popular in the country; according to the publisher, about 70 percent of students taking English use the books.

Mr. Konobeyev knew that his company had submitted all the required expert opinions. So what, he asked, was the problem? The answer, he said in an interview, left him “incredulous.”

First the ministry contended that Titul’s submissions had been incomplete; then, when challenged, it declared that it had found a fatal “discrepancy” in the paperwork: Though the expert reports the company provided referred to the author and title of each textbook, the ministry stated that it could not be sure that the books submitted were in fact the ones reviewed — because the expert reports did not contain the subtitles from their inner pages.

Another publisher, Fyodorov, was told by a ministry official that it could submit photocopies of its documents, only to learn that 38 of 42 textbooks had been knocked out because it had done just that. Titul filed a lawsuit challenging the exclusions, so far to no avail; Fyodorov filed a similar suit, but a court dismissed it, and now the company is in talks to be acquired.

Other publishers, like Mr. Peterson and his mother, saw their textbooks disqualified as contrary to Russian values.

Ms. Peterson had created the concept behind her textbooks in the heady years after the Soviet collapse. The cartoon characters she used to illustrate math problems came not only from the West, but also included Russian characters and symbols. One, Karlsson-on-the-Roof, was the creation of the Swedish author Astrid Lindgren, but the portly hero was the subject of a beloved animated film produced in the Soviet Union.

Mr. Peterson said the rejections, the first in the company's history, were based entirely on the finding of only one of the nine reviewers. "If this expert was given a physics textbook, I am sure, she would see Newton's law and find it unpatriotic," he said.

Enlightenment, for its part, emerged with only a handful of its books — 6 percent — disqualified. It led the revamped list with 415 approved books; the runner-up, with 296, was its unsuccessful suitor, Eksmo.

In the first seven months of the year, Russia's schools spent $187 million on textbooks. Enlightenment won 60 percent to 70 percent of those contracts, according to Mikhail Morozovsky, editor in chief of the trade journal Book Business, who based his estimate on an analysis of government procurement records. In addition, Enlightenment is now providing around 80 percent of all the textbooks that Russia is sending to schools in the newly annexed Crimea.

"It's like what they say in 'Animal Farm,' " one competitor said. "All animals are equal, but some animals are more equal than others."

Thousands Protest

Changes in curriculum are not to be taken lightly. Sticking with a single line of textbooks ensures that students build upon the skills they learn from year to year. Additionally, different textbooks employ different teaching styles. Enlightenment, for instance, publishes Soviet-style texts that emphasize rote memorization. The textbooks produced by Fyodorov use a more progressive teaching method called the Zankov system, which is aimed at teaching children how to think. The Zankov textbooks are quite popular, and their exclusion prompted a rare public display of protest.

The books' authors gathered more than 25,000 signatures and petitioned the education minister, Mr. Livanov. "Thousands of teachers and parents from all regions of the Russian Federation who want to choose for their children a path to individual and optimal development of characters share in our concern," they wrote.

Yelena A. Ilinykh, a first-grade teacher in Moscow, is one. The very superiority of Fyodorov's textbooks is what led them to be barred, she said in an interview near her school, because they threatened the market share of its politically connected competitor.

"This whole list is a political order for Moscow, which is representing the interests of one publisher: Enlightenment," she said.

In a statement, the ministry defended its actions, saying the old list contained "outdated textbooks whose quality was under question" and was so large as to be unwieldy. "It was hard for teachers, parents and students to make a right and conscious choice," the statement said. In public remarks in March, Mr. Livanov said popularity was not a measure of quality. "You cannot say that because multiple schools use a textbook, then that means it is good," he said. "Many people drink Coca-Cola, but that does not mean it is good for you."

Tatyana G. Mitugina, an English teacher from Bryansk, scoffed at that reasoning. In an online education forum, she protested the decision to exclude Titul's English-language books. " 'Enjoy English' does not have anything in common with Coca-Cola," she wrote. "These are amazing Russian textbooks, confirmed by practice."

The ministry, in an apparent concession to the public anger, gave schools a few years to phase out the books that did not make the list, but made clear that only students who had started to use them could continue. (Of course, many schools, mindful of the ministry's power and fearful of losing accreditation, immediately switched over anyway.)

"We were told that all the schools will be undergoing inspections," Ms. Ilinykh, the teacher in Moscow, said. "And if they find out that teachers are using textbooks not on the list for more than just continuing students, then the school could get funds cut or layoffs, or I don't even know what else."

Mr. Konobeyev of Titul said the temporary reprieve simply underscored the arbitrariness of the government's decision.

"If the books are not good enough, why are you allowing them to be used for the next five years, and if they are as good as our experts say and the teachers say, why are they not on the list?" he asked. "I find the whole thing Kafkaesque."

Profit and Ideology

There may be multiple motives behind the reshuffling of Russia's textbook industry. Given Mr. Rotenberg's involvement, and with Russia increasingly at odds with the West, some see it as a sign of Mr. Putin's drive to ensure the loyalty and patriotism of Russia's youth.

"When my future partners at Enlightenment started to tell me about what is happening here in the area of educational literature, when I found out that we have dozens of textbooks not only on history, but also on physics or mathematics, I realized that everything was not really great here," Mr. Rotenberg said in the Interfax interview.

Now, the Kremlin appears to be going further. Last month, legislators introduced a bill to establish unified textbooks for all history, literature and Russian language classes — a proposal that has been debated for years but appears to have new life.

"The bacchanalia of textbooks until now has been destroying our youth," said one of the lawmakers involved, Frants A. Klintsevich, according to a transcript of the hearing.

Mr. Putin's critics see a corrupted system motivated as much by avarice as ideology. The government has in recent months come to the aid of Mr. Rotenberg, who was 14 when he first met Mr. Putin at a judo club in Leningrad and owns a palace outside Moscow that rivals Versailles in its opulence.

After the Obama administration sanctioned SMP Bank — in which Mr. Rotenberg and his brother own a 76 percent stake — Russia's Central Bank gave it a 10-year, $3 billion loan with a below-market interest rate, ostensibly to take over another struggling lender. When Italy seized $40 million of property Mr. Rotenberg owns there through offshore companies, including a luxury hotel in Rome and two villas in Sardinia, the lower house of Parliament quickly passed legislation allowing citizens whose property had been seized to seek compensation from the government. Though the tycoon has said he does not plan to take advantage of it, the bill was immediately called "the Rotenberg law."

Whatever Mr. Rotenberg's precise relationship to Enlightenment, his role as chairman offers the company the sort of protection — known as "krysha," or roof — that ensures a favored status in the bureaucracy. The publishing house is not only well positioned to take advantage of the unified textbook mandate, but also another new directive that mandates that all textbook publishers offer electronic versions of their books by January 2015.

According to Mr. Konobeyev, smaller publishers like Titul are still waiting for the ministry's electronic textbook guidelines. Enlightenment, however, is ready to go, according to Mr. Ivanov. The agreement the publisher signed with Microsoft in late September, to share research and development on a Windows-based tablet that could be provided to schools across the country, should only "strengthen our position in the market," he said.

The question for Microsoft, as with many American companies doing business in Mr. Putin's Russia, is whether the potential profits outweigh the risk. United States law forbids American companies from doing business with companies majority-owned or controlled by sanctioned people like Mr. Rotenberg.

His presence on the board, the opacity of the ownership structure and other elements of the sale should make an American company reluctant to do business with Enlightenment, said Katrina Carroll, a lawyer at WilmerHale who until last year was a senior officer in the Treasury Department's office of terrorist financing and financial crimes. "I'd never advise a client of mine to go forward under these circumstances," she said.

Last week, Microsoft decided to put off its plans, based on new information it had received from The Times.

"Microsoft signed a nonbinding agreement to provide, free of charge, to Prosveshcheniye, the same type of technical assistance that we provide at no cost to thousands of schools and publishers worldwide," the company said in a statement. "Although we conducted due diligence in both Russia and the U.S. — including consulting the U.S. government and engaging respected international law firms — and have not found evidence that Prosveshcheniye is subject to U.S. or E.U. sanctions, we'll follow up on the concerns by postponing work under the agreement and conducting an additional review."

Masha Goncharova, Nikolay Khalip and Alexandra Odynova contributed reporting.

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Even Loyalty No Guarantee Against Putin

By **STEVEN LEE MYERS** and **JO BECKER** DEC. 26, 2014

Putin's Way   Part 3

"Listen, I've done everything I can for you. Good luck." — **SERGEI V. PUGACHEV**, a self-exiled Russian banker, on what President Vladimir V. Putin told him as his financial empire crumbled. Credit Andrew Testa for The New York Times

MOSCOW — Vladimir P. Yevtushenkov, not long ago one of Russia's richest men, walked free on Dec. 17 after 92 days under house arrest. He was held by prosecutors on charges of laundering money from the purchase of an oil company in 2009 — charges that President Vladimir V. Putin ultimately acknowledged could not be substantiated.

By then, the legal case against him had stripped him of his shares of the oil company, Bashneft, and returned them to the property of the state. In a matter of months, his legal odyssey drained as much as 90 percent of Mr. Yevtushenkov's fortune, leaving him scrambling to salvage what he could of companies and subsidiaries that trade on the London and New York stock exchanges.

The swift, unexpected and still largely unexplained expropriation of Bashneft is the latest case to highlight the darker corners of the political and economic system that Mr. Putin has developed during his 15 years as Russia's paramount leader.

Even as he has wielded the virtually unchallenged power of government and legal bureaucracy to reward a new class of oligarchs, friends and allies from his years in St. Petersburg, he has also used the same instruments to punish those whose political or economic interests fall afoul of the Kremlin's. For each winner in Mr. Putin's system, there are inevitably losers.

Photo

A Bashneft refinery in the city of Ufa in 2013. Vladimir P. Yevtushenkov was stripped of his shares in the company. Credit Sergei Karpukhin/Reuters

Mr. Yevtushenkov has now joined a list that includes not only Putin critics like the exiled former oil executive Mikhail B. Khodorkovsky, who spent 10 years in prison before being freed by Mr. Putin, and Aleksei A. Navalny, the lawyer and businessman turned anticorruption crusader who, after final arguments in the latest criminal case against him, now faces the prospect of a similarly lengthy term behind bars. They also include others who, like Mr. Yevtushenkov, once expected that outward loyalty and close ties to the Kremlin afforded them a measure of protection.

A prominent businessman who knows Mr. Yevtushenkov said that Mr. Putin had eroded the very notion of property rights in Russia, even for those who displayed fealty. He said that Mr. Putin himself had described private ownership of strategic industries with the Russian word to roost. "A chicken can exercise ownership of eggs, and it can get fed while it's sitting on the egg," he said, "but it's not really their egg."

The case against Mr. Yevtushenkov and the oil company unfolded in the wake of the international furor over Russia’s annexation of Crimea in March. It continued despite the economic turmoil that has hit the country following the imposition of sanctions by the United States and its Western allies and the drop in the price of oil. According to analysts, investors, businessmen and employees of Mr. Yevtushenkov’s holding company, Sistema, the seizure of Bashneft was both a reaction to the economic tumult and a factor in worsening it.

They said that Bashneft fell victim to the rapacious ambitions of the state oil company, Rosneft, which is controlled by one of Mr. Putin’s oldest and closest aides, Igor I. Sechin. Mr. Sechin was instrumental in the legal assault against Mr. Khodorkovsky that began in 2003 and ended with Rosneft’s acquisition of the tycoon’s oil company, Yukos, and Mr. Khodorkovsky’s conviction on fraud and embezzlement charges in what were widely denounced as show trials.

Others attributed the case to an internal power struggle among Mr. Putin’s circle of advisers, while still others pointed to Mr. Yevtushenkov’s activities in Ukraine after the ouster of the president, Viktor F. Yanukovych. Mr. Yevtushenkov’s legal troubles served as an ominous warning to the country’s businessmen to remain loyal and pliant in what appears to be a new era of sanctions and economic hardship.

“It was definitely meant to be that public — to do it like that,” said Aleksandr Y. Lebedev, a banker and media mogul, referring to Mr. Yevtushenkov’s arrest in September. Mr. Lebedev faced a similar legal assault in 2012 that forced him to sell off a number of assets, including a minority share in the state airline, Aeroflot.

“The people in the Kremlin certainly would understand that it was going to hurt the stock market; that it’s going to add to the whole economic situation; that it was going to frighten the business community,” Mr. Lebedev said. They went ahead anyway, he added, because they wanted to deliver a message: “Behave yourself.”

The State Trumps Capitalism

The history of Bashneft since the collapse of the Soviet Union has reflected the uncertain and ultimately incomplete transition to a market economy, and its demise punctuated the steady accretion of state control in strategic industries that has become the most prominent feature of Mr. Putin’s rule.

Once part of the Soviet oil ministry, the company and its oil fields were transferred by the government of President Boris N. Yeltsin to the regional government where they were located in the Republic of Bashkortostan, an ethnically diverse region between the Volga River and the Urals. Mr. Yeltsin famously urged Russia’s regions and republics to “swallow” as much autonomy as they could.

Photo

Aleksandr Y. Lebedev was forced to sell assets, including a share in Aeroflot. Credit James Hill for The New York Times

Mr. Putin, though, has steadily eroded the independent authority of the regions. Bashkortostan was ruled as a fief by Murtaza G. Rakhimov, a powerful political ally of Mr. Yeltsin's whose relations with Mr. Putin would become increasingly strained. In 2002 and 2003, Mr. Rakhimov's government privatized Bashneft, with most of its shares ending up in the hands of a company called Bashkir Capital, which Russian prosecutors said was controlled by Mr. Rakhimov's son, Ural.

"It was privatized outside the law," said Mr. Navalny, whose Fund for the Fight Against Corruption has regularly highlighted shady transfers of property and wealth through government auctions and contracts. Even Russia's auditing chamber criticized the sale, but with the evident blessing of the Kremlin, the deal was upheld in court — until investigators, with no explanation, revisited the deal in April.

Mr. Yevtushenkov became involved in 2005 when his company acquired $600 million in shares in the newly privatized Bashneft; in 2009, he acquired a controlling share for another $2 billion, something that could not have happened, executives and analysts here said, without the tacit approval of the president at the time, Dmitri A. Medvedev, and the paramount leader, Mr. Putin, who was then prime minister.

Mr. Yevtushenkov, once a functionary in the office of Moscow's powerful former mayor, Yuri M. Luzhkov, founded Sistema in 1993 and built a business empire that included the telecommunications giant MTS, as well as real estate, media and retail investments. By the time of his arrest the company was worth an estimated $15 billion.

Despite his political ties to Mr. Luzhkov, whom Mr. Medvedev dismissed in 2010 after an internal power struggle, Mr. Yevtushenkov nurtured close ties with the Kremlin. He never spoke out in a way that would attract its ire. "He's a very commercially minded kind of person," Mr. Lebedev said, "but he's also by the book."

Under Sistema's ownership, production at Bashneft increased at a time when Rosneft struggled, despite a major expansion that included the takeover of another oil company, TNK-BP, for $55 billion. Since the annexation of Crimea, the company has come under the sanctions imposed by the United States, the European Union and other countries.

Two people who work for Mr. Yevtushenkov, who would speak only on the condition of anonymity, said they believed that Mr. Sechin personally was behind the takeover of Bashneft, pressing Mr. Putin to revisit the circumstances of the privatization as a pretense in hopes of increasing Rosneft's production and cash flow.

Rosneft had approached Mr. Yevtushenkov last year about the possibility of a merger or sale, according to news reports at the time, but Mr. Yevtushenkov resisted, and instead prepared a public offering of the company's shares in London.

The deterioration of relations with the West in the wake of the war in Ukraine appeared to make the sale of Bashneft's stocks abroad increasingly worrisome to the Kremlin. In the weeks that followed the annexation of Crimea in March, the powerful Investigative Committee — an investigative body often seen as pursuing political cases at the Kremlin's behest — quietly began a civil and criminal inquiry into Bashneft that exploded into public only in July.

Tellingly, in his annual news conference at the Kremlin on Dec. 19, Mr. Putin said that the case against Bashneft had nothing to do with the privatization of the company in the 2000s, but rather with the original transfer of the company from federal to regional authorities in the early 1990s. That raised the question of why Mr. Yevtushenkov had been arrested at all, since he was not involved until much later, and the company has argued it was a good-faith buyer of Bashneft.

Photo


Mr. Yevtushenkov at a court hearing in Moscow last month. He walked free on Dec. 17 after 92 days under house arrest, but he lost as much as 90 percent of his fortune. Credit Sergei Karpukhin/Reuters

Mr. Putin maintained that the Kremlin had no intention of reversing the notoriously murky privatizations of the past, but the result was the same anyway. Sergei V. Pugachev, a self-exiled banker who is now fighting Russia's attempts to freeze his assets, said the case highlighted Mr. Putin's longstanding strategy to subdue businessmen who would work independently of the Kremlin.

"He saw that there are people who have big businesses, companies and other assets," Mr. Pugachev said, referring to Mr. Putin's rise to power in 2000. "And from that moment on he felt himself a part of that system, and his goal became to get on top of that system. And that means he has to control everything."

What happened next followed a pattern that has become familiar. As happened in the case of Mr. Lebedev and Mr. Pugachev, a legal assault began from multiple directions, like a swarm unleashed by an informal signal from Mr. Putin. "Putin gives an order," Mr. Navalny said, "maybe 'act according to the law.' And the words 'act according to the law' means do whatever you want in the legal system."

On July 15, investigators arrested a prominent Armenian businessman and philanthropist, Levon Airapetyan, as he landed at Moscow's Domodedovo airport after arriving from France, accusing him of acting as a middleman in the sale of Bashneft, along with its former chief executive, Ural Rakhimov. The same day, a court ordered a freeze on Bashneft's shares. Mr. Yevtushenkov was summoned for questioning a week later.

Mr. Yevtushenkov appeared to presage his fate only days before the legal assault to capture Bashneft began in July. In an interview with the Russian edition of Forbes, he described the complex, informal and maddeningly opaque rules that govern business in the former republics of the Soviet Union, including Russia, especially when investing in crucial sectors like energy.

"Any government will always find a way to put you in your place, no matter how strong you are in the international arena, no matter what business you may have there," he said, describing transitional market economies that he said would take a generation to break free from state control. “And if suddenly it turns out that you declared one thing but did something else, then the punishment, directly or indirectly, will come soon enough.”

Mysterious Legal Assault

According to Mr. Pugachev, Mr. Yevtushenkov himself did not understand what he had done, if anything, to trigger the legal assault. He said they met in his London office only two weeks before Mr. Yevtushenkov was placed under house arrest on Sept. 17.

Mr. Pugachev was once close enough to the corridors of power that he was known as the “Kremlin’s banker,” but is now a fugitive from Russian justice. He once controlled a banking, real estate and shipbuilding empire, until the global financial crisis in 2008 and 2009 led to a flurry of difficulties with the government and accusations of fraud and embezzlement. A bank he founded, Mezhprombank, foundered under a crushing debt, some of which came from a bailout approved by the Central Bank in response to the crisis.

At the same time, the Kremlin suspended construction of a luxury hotel that he had overseen at a historic site on Red Square opposite the Kremlin known as the Middle Trading Rows. Mr. Putin had once been so involved in the construction, Mr. Pugachev said, that he offered advice on the hotel’s designs and the hiring of the hotel’s managing company. With the project only a year from completion, however, the presidential security service objected to the proximity of a hotel to the heavily guarded seat of power.

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Putin’s Way

Although Mr. Putin, then the prime minister, repeatedly promised that the government would compensate Mr. Pugachev for costs exceeding $1 billion, negotiations bogged down and he was never paid, he said.

When Mezhprombank collapsed in 2010, the government accused Mr. Pugachev of bankrupting the bank, though Mr. Pugachev claimed that the bank’s legal troubles were used as a pretext to seize two shipyards he owned in St. Petersburg and offered as collateral for the Central Bank loans.

Mr. Putin, he said, had urged him to sell the shipyards — which built, among other things, a nuclear-powered icebreaker at the center of Russia’s ambitions to exploit the Arctic’s natural resources — to the state company United Shipbuilding Corporation. At the time, the corporation was headed by Mr. Sechin, who also served as a deputy prime minister.

Mr. Pugachev said he began negotiations and had the two shipyards valued at $3.5 billion, but it became clear that he had lost the protection he once felt his relationship with Mr. Putin provided. With his financial empire crumbling, he made one last appeal. “Listen, I’ve done everything I can for you,” he recalled Mr. Putin telling him. “Good luck.” After a series of court appeals by the Central Bank, the two shipyards were sold in 2012 for less than $500 million, far below their estimated value. He said that he warned Mr. Yevtushenkov that he should not return to Moscow, citing his own troubled exile.

“Listen,” Mr. Pugachev said he told Mr. Yevtushenkov, “you must take one manly step in your life.” He said that he added: “You must spit on all this. Stay in London. You have enough money here. You won’t starve. You’re not poor. Then, I don’t know, maybe then you’ll go to court. You’ll figure it out. But if you go back there, I think you’ll have problems.”

Giving Up Without a Fight

After Mr. Yevtushenkov’s arrest in September, a court ordered the seizure of Bashneft’s frozen shares, then still worth about $4 billion. Mr. Yevtushenkov’s company issued a statement maintaining that the purchase of Bashneft had been “legal and transparent.” But with Mr. Yevtushenkov restricted to his home, able for a time to meet with only his lawyers, the company sought to contain the damage, including more than $3 billion in dividends that it had earned and distributed from Bashneft.

Instead of fighting the court’s seizure, the company abandoned its right to appeal a court ruling, citing the “best interest of the company,” essentially ceding one of its biggest assets without a fight. And in early December, the shares reverted to the state.

In the end, Mr. Yevtushenkov was never charged with any crime, though Mr. Airapetyan remains under house arrest, and Ural Rakhimov, who is reported to have fled to Austria, is also subject to an international warrant.

A day after Mr. Yevtushenkov’s release, Mr. Putin wished him and his businesses well. He even invited him to a meeting with other prominent businessmen in the Kremlin the following day. Shares of Sistema soared after his release, but the loss of Bashneft eliminated roughly half of the company’s revenues, according to one executive.

The ease with which the state reacquired Bashneft, one of the country’s most profitable oil companies, underscored the virtually uncontested power that Mr. Putin and his closest circle of advisers are able to wield over Russia’s economy and, especially, its natural resources.

For now, at least, the economic turmoil that has engulfed Russia after the conflict in Ukraine and the drop in oil prices have done little to curb Mr. Putin’s grip. Mr. Navalny said that the political and economic crisis had further tightened the circle of advisers around Mr. Putin, increasing the influence of hard-liners at the expense of those who once encouraged a more liberal economy. He said the Kremlin was now in a siege mentality. “The circle of decision makers has grown smaller,” he said in an interview in his tidy apartment in a Soviet-era block in southwestern Moscow, where he has been confined since February except for police escorts to his court appearances. “It’s harder to get to see Putin to resolve one’s own business problems.”

In his last court appearance, prosecutors asked the judge to sentence him to 10 years in prison on charges that he and his brother, Oleg, defrauded two companies, one of which is the Russian subsidiary of the French cosmetic company Yves Rocher, even though the company’s representative said the brothers had committed no crime against it. A judge is scheduled to deliver a verdict on Jan. 15.

“Earlier there were various groups,” Mr. Navalny said. “These groups had various levels of influence. These groups formally remain, but the center of decision making has moved in the direction of these people who can work under the rules of wartime.”

Correction: December 27, 2014
Because of an editing error, an earlier version of a picture caption with this article misspelled the surname of the former owner of Bashneft, a Russian oil company. As the article correctly noted, he is Vladimir P. Yevtushenkov, not Yevtushenkovfull.

Steven Lee Myers reported from Moscow, and Jo Becker from Paris and New York. Andrew Roth contributed reporting from Moscow, and Masha Goncharova from New York.

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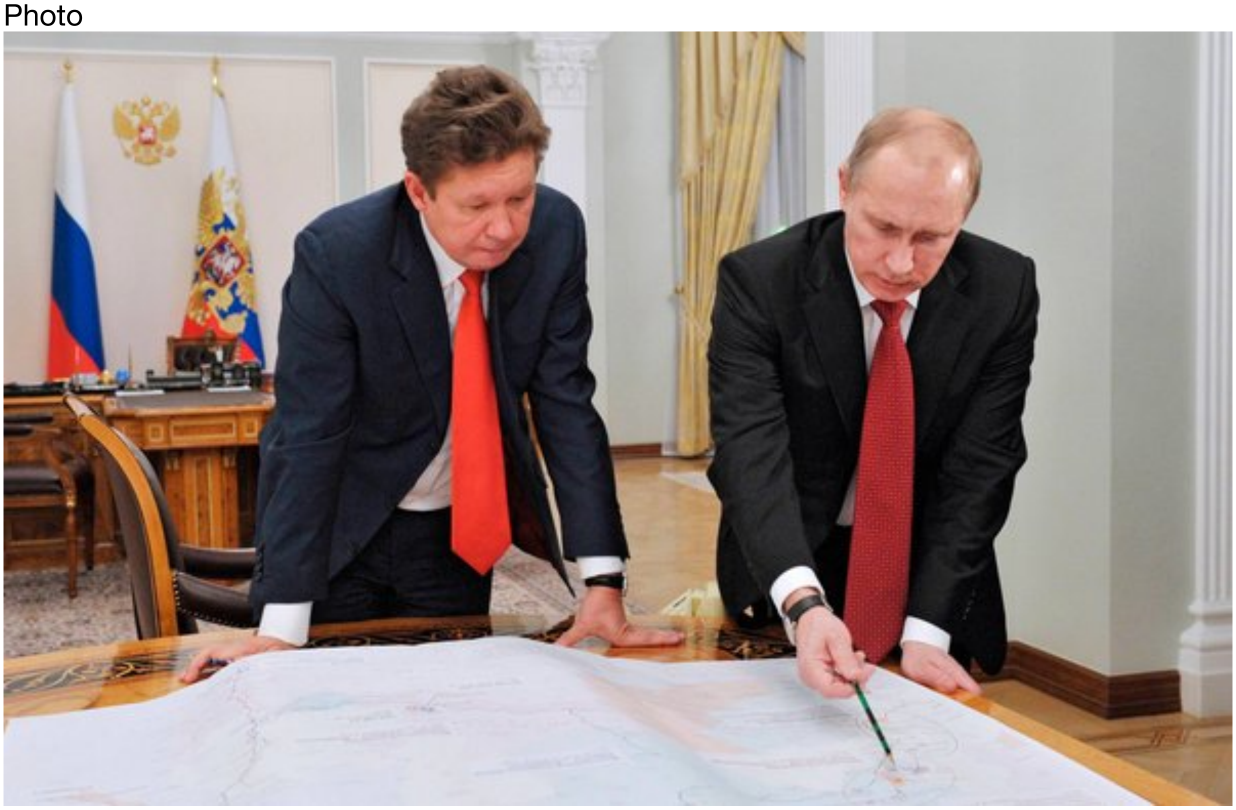
How Putin Forged a Pipeline Deal That Derailed - NYTimes.com

How Putin Forged a Pipeline Deal That Derailed

By JIM YARDLEY and JO BECKER DEC. 30, 2014
Putin's Way Part 4
Photo



President Vladimir V. Putin used Aleksei B. Miller, Gazprom's leader, left, to press Bulgaria for a pipeline. Credit Pool photo by Aleksey Nikolsky

SOFIA, Bulgaria — Barely two weeks after President Vladimir V. Putin annexed Crimea on one side of the Black Sea, he won a different prize on the other side. In Bulgaria's Parliament, lawmakers gave initial passage to a bill clearing the way for a mammoth gas pipeline from Russia.

The pipeline, known as South Stream, was Mr. Putin's most important European project, a tool of economic and geopolitical power critical to twin goals: keeping Europe hooked on

Russian gas, and further entrenching Russian influence in fragile former Soviet satellite states as part of a broader effort to undermine European unity.

The bill that Parliament took up on April 4 was arcane. But it swept aside a host of European regulations — rules that Mr. Putin did not want to abide by — for a pipeline that would deliver gas throughout southern Europe.

It was a dream bill for Mr. Putin, and with reason. While Bulgaria's Energy Ministry ostensibly wrote the legislation, documents reveal the hidden hand of the Kremlin: Not only did much of the language come from a subsidiary of Russia's state-owned energy giant, Gazprom, but Mr. Putin's energy minister was directly involved.

Putin's Way

"If this happens in the U.S., the whole government would resign," said Martin Dimitrov, a minister of Parliament from Bulgaria's Reformist Bloc. "Not in Bulgaria, apparently."

For years, Mr. Putin bullied and cajoled Bulgaria, one of the European Union's weakest nations, into doing Russia's bidding on South Stream. And he seemed poised to succeed, but for one fundamental miscalculation: He underestimated the West's response to his aggression in Ukraine. Faced with punishing sanctions, a petro-economy pushed to the brink by plunging oil prices and the wildly gyrating value of the ruble, Mr. Putin this month halted the project.

But if the story of South Stream shows how larger geopolitical concerns can, at least temporarily, limit Mr. Putin's ability to use his energy riches as a foreign-policy tool, it is also a case study of how he has operated in Europe, and will probably continue to do so.

He has won influence abroad by wielding the tools of crony capitalism that have made him so powerful at home. After a secret meeting between Bulgaria's prime minister and the head of Gazprom, pipeline contracts were given to a company controlled by a member of Mr. Putin's inner circle and politically connected Bulgarian companies.

In Russia, Mr. Putin has at times used Russia's state-owned banks for his own ends; they helped underwrite the Sochi Olympics, for instance. In Bulgaria, a subsidiary of one of those banks, VTB, showered the country with politically strategic investments as Mr. Putin pushed the government to move forward on South Stream.

As elsewhere in Europe, Mr. Putin courted Bulgaria's pro-Russian far right party, which promoted Russian interests by helping to beat back plans to explore for Bulgarian shale gas. Seeking to nail down support for South Stream, a member of the Russian Parliament, whose card identified him as a special emissary of Mr. Putin, even offered what one former Energy Ministry official understood to be a tacit bribe.

"It's not just South Stream, and it's not just Bulgaria," said the Bulgarian official, Bojan Stoyanov, who was deputy energy minister in 2013. "The Russians are promoting behavior where people are willing to dig the hole of a volcano in the middle of their country and not worry where the lava goes as long as they get paid."

Putin's Favorite Musicians

Vladimir Putin had a problem.

By 2011, his plan to build South Stream, estimated to cost more than $40 billion and four years in the making, had hit a stumbling block in Bulgaria, where the pipeline would make landfall after traversing the bed of the Black Sea. Geological surveys suggested that Bulgaria could be sitting atop an underground ocean of natural gas, enough to be self-sufficient for years, enough to eclipse the advantages of South Stream.

Bulgaria, once a staunch Soviet ally, and Russia share similarities in language, religion and culture, and Bulgaria still celebrates as a national holiday its 1878 liberation from the Ottoman Empire by the troops of the czar. Bulgarian leaders supported South Stream, declaring that the pipeline would provide not just transit fees but energy security: The country receives 90 percent of its gas from Russia, along a route through Ukraine that has left it vulnerable to periodic pricing disputes between Moscow and Kiev. In the winter of 2009, Bulgarians were left shivering for two weeks when Russia shut off the gas to teach Ukraine a lesson.

But in the middle of 2011, Bulgaria's prime minister, Boiko Borisov, also granted Chevron a permit to explore for shale gas. Almost immediately, a well-organized campaign emerged to kill shale exploration before it began, fueled in part by loyalists for Ataka, one of several far-right parties that Mr. Putin has cultivated in Europe. Parties like Jobbik in Hungary and the Northern League in Italy view Mr. Putin as a bulwark against a tide of Western liberalism. But the appeal is more than ideological. In France, the leader of the far-right National Front, Marine Le Pen, recently acknowledged that her party had received a loan for 9 million euros, or about $11 million, from a Kremlin-linked bank.

In Bulgaria, Volen Siderov, the chairman of Ataka, said his party received no direct funds from Moscow.

"I'll ask her how she managed to do it," he joked of Ms. Le Pen.

Still, Mr. Siderov has undeniably close ties to the Kremlin. He kicked off his most recent political campaign in Moscow, where he was receiving the Fatherland Star medal for promoting closer relations between Russia and Bulgaria. When he needed entertainment for a rally this fall, he landed singers described in Ataka promotional literature as "Putin's favorite musicians": Oleg Gazmanov, an aging Russian pop singer, and Iosif Kobzon, a lawmaker and singer who recently performed in Donetsk, a Russian separatist-held stronghold in eastern Ukraine, accompanied by the orchestra of Mr. Putin's Interior Ministry.

The anti-fracking movement became so broad that in January 2012, Parliament banned not only the extraction of shale gas, but even exploration that would quantify the country's reserves. Environmentalists praised the vote, but many Western officials were suspicious.

In Brussels, Anders Fogh Rasmussen, secretary general of NATO, later accused the Russian government of using "sophisticated information and disinformation operations" to help derail shale gas exploration in Bulgaria and other countries.

With the death of shale gas, South Stream's rationale was stronger than ever, especially as the Borisov government weakened. Mr. Borisov had signed preliminary pipeline agreements, even once presenting a puppy to Mr. Putin as a gift, but he was still considered pro-Western. Barely a year after the fracking demonstrations, Ataka members again took to the streets, joining protests over high electricity prices. In March 2013, Mr. Borisov resigned.

A caretaker government was appointed, pending new elections, and Mr. Putin's representatives quickly sought out the crucial figures involved in South Stream.

The Putin Steamroller

The meeting occurred after midnight at La Casa del Habano, a cigar bar in Sofia. Mr. Stoyanov, a New York-based corporate turnaround specialist who had returned to Bulgaria to serve as deputy energy minister in the interim government, had received several calls from an old acquaintance, insisting they meet for a drink.

But Mr. Stoyanov was surprised to find that his friend was not alone at the bar. With him was Aleksandr M. Babakov, a member of the Duma, the lower house of the Russian Parliament, whom Mr. Putin had appointed as a special envoy. (Mr. Babakov has been identified by the French news media as the middleman who arranged the Russian bank loan to the National Front in France.)

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The purpose of the meeting soon became clear. "He wanted to take my temperature on the South Stream," Mr. Stoyanov recalled in an interview.

Mr. Stoyanov said the project would not reduce Bulgaria's dependence on Russian gas and would bring marginal economic benefit, but Mr. Babakov had not come to debate the merits.

"In not so many words, he said he would make me very comfortable if I would participate and help," Mr. Stoyanov said, adding that he reported the encounter to Bulgarian intelligence. "I was not pleased by his presumption that I would just set aside and forget Bulgaria's national interests."

Mr. Babakov did not respond to requests for comment.

Mr. Stoyanov's skepticism about South Stream mirrored that of officials in Brussels and Washington. European Union rules forbid the same company that produces gas to monopolize the pipeline that delivers it. Europe insisted that South Stream allow access to other gas producers in order to safeguard against overreliance on Russia.

At one European summit meeting several years ago, Mr. Putin and the European Commission president, José Manuel Barroso, argued over those rules, according to C. Boyden Gray, an American diplomat who in 2008 served as special envoy for Eurasian energy. Two officials in the room told Mr. Gray that the Russian leader exploded.

“If I hear one more word about competition, I’m going to freeze your you-know-whats off,” Mr. Putin reportedly shouted.

Mr. Barroso, whose term expired in October, said he did not recall the specifics of the exchange but confirmed that he and Mr. Putin had clashed.

“His point was always: ‘This is against us! This is against Gazprom! This is against Russia!’ ” Mr. Barroso recalled.

By the time Bulgaria held elections in May 2013, Mr. Putin was in a stronger position. He had proposed South Stream as an alternative to a Western-backed proposal for a pipeline, called Nabucco, from Azerbaijan to southern Europe. Nabucco would have reduced Europe’s dependence on Russian gas, as well as Mr. Putin’s influence. But the project had died by 2013 because of political and economic obstacles as well as interference from Mr. Putin. Now only South Stream was left standing.

Moreover, the Russians had already invested heavily in Bulgaria. VTB Capital, the investment wing of Russia’s second-largest state-owned bank, had opened a Sofia office, placing Bulgaria’s former finance minister, his deputy and the minister’s brother in major positions. VTB Capital, which declined to comment for this article, then partnered to buy stakes in a host of companies with Corporate Commercial, known as the favored bank of Bulgaria’s energy oligarchs. VTB even took a 9.9 percent stake in the bank itself.

When Plamen Oresharski was Bulgaria’s prime minister, he had a secret meeting with Mr. Miller but will not discuss it. Credit Stoyan Nenov/Reuters

The Bulgarian elections also seemed to work to Mr. Putin’s advantage. They produced an awkward coalition government between two pro-Russia parties — the Socialists and the Turkish minority party. And since together they could not achieve a parliamentary majority, they relied on Ataka to achieve a quorum. Mr. Siderov, Ataka’s leader, was nicknamed the Golden Finger because he tipped the balance.

The new prime minister was a technocrat, Plamen Oresharski, who found himself caught between this Moscow-leaning coalition and growing pressure from the European Union. Aleksei B. Miller, the man Mr. Putin had chosen to lead Gazprom, was sent in July to bring the Bulgarians into line. He promised to finance the €3.1 billion construction of the Bulgarian leg of the pipeline and agreed to sponsor Levski Sofia, the capital’s top professional soccer team.

But Europe was pushing Mr. Oresharski, too. The European Commission had begun an investigation into Bulgarian Energy Holdings, the state corporation that was to be Gazprom’s partner in South Stream.

Three months later, Mr. Miller returned to Sofia, this time in secret, for another session with Mr. Oresharski. It was supposed to last only 40 minutes, one official said. Months later, prodded about the lack of transparency, Mr. Oresharski angrily responded that the “only nontransparent thing with South Stream is my five-hour conversation with the boss of Gazprom, the contents of which will never be revealed.”

Mr. Oresharski did not respond to requests for an interview. But Russian interests clearly won out. The next day, Mr. Oresharski and Mr. Miller watched by video link as workers welded the first two joints of the pipeline's Bulgarian leg.

A few months later, over the Christmas holidays and without public notice, the construction contracts were awarded: Bulgarian news outlets subsequently reported that the winners included companies with ties to a Bulgarian media mogul and member of Parliament, Delyan Peevski. In a statement, Mr. Peevski denied any ties to the project, calling the reports rumors "spread by the yellow press in Bulgaria." The acknowledged Russian construction partner was Gennady N. Timchenko, one of Mr. Putin's most powerful allies.

All seemed ready. The only obstacle was the European pipeline rules — unless they could be circumvented.

Pipeline That's Not a Pipeline

On April 4, 2014, soon after Mr. Putin annexed Crimea, Bulgaria's Parliament gave initial passage to a bill that effectively exempted South Stream from a number of European Union regulations, most important, the one that would have forced Gazprom to allow non-Russian gas to flow through the pipeline. Both parties in Mr. Oresharski's coalition supported the legislation, as did Ataka and its leader, Mr. Siderov.

The bill accomplished this with a linguistic sleight of hand: The initial Bulgarian section of South Stream was not actually a pipeline, but rather a "gas-sea" interconnector. The European Union challenged the proposed change, while opposition members filed a freedom of information request for documents linked to the bill. A month later, they announced that the documents — which have been obtained by The New York Times — proved that Gazprom and the Kremlin were directly involved.

"This was a unique breach of national security," Grozdan Karadzhov, a Reformist lawmaker, said in an interview. "It was also a unique amount of arrogance in how Russians see Bulgaria."

The documents included passages of draft legislation suggested by a Gazprom subsidiary and forwarded to Bulgarian energy officials.

In an interview, the energy minister at the time, Dragomir Stoynev, called Gazprom's suggestions a form of lobbying, insisting that "nobody dictated the terms; these were all our suggested changes."

But in a letter dated June 6, 2014, Mr. Stoynev acknowledged a direct Russian hand. In it, he updated his Russian counterpart, Mr. Putin's energy minister, on where things stood. The "law amendments proposed by the Russia side" were discussed in detail, he wrote, and a number of them were approved by Parliament.

It was audacious, but it would not be enough. The bill would never be brought up for a second, final vote, largely because of the escalating conflict between Russia and Ukraine. In early June, the European Commission told Bulgaria to stop work on South Stream, saying it was investigating whether the pipeline construction contracts violated European competitivebidding rules. When the Bulgarian government refused, the European Union cut off tens of millions of euros in regional development funds.

By this point, Ukrainian government forces were battling pro-Russian separatists in the east, and in the West there was talk of a new Cold War. On June 6, the American ambassador, Marcie B. Ries, warned Bulgarian companies against doing business with companies linked to Mr. Timchenko, who is on American sanctions lists. On June 8, a congressional delegation led by Senator John McCain, Republican of Arizona, met privately with Mr. Oresharski.

In desperate need of the European funds, the prime minister announced the next day that South Stream would be halted until it had full European Union approval.

At almost exactly the same moment, an unexpected panic swept through bank depositors in Sofia; a mysterious bank run had started at Corporate Commercial, the bank that had partnered with the Russian investment firm VTB Capital, and the financial institution of the state holding company overseeing Bulgarian involvement in South Stream.

Some speculated that VTB Capital, with its nearly 10 percent stake, would join other shareholders in riding to the bank's rescue. But after Mr. Oresharski's decision to halt the Bulgarian leg of South Stream, the Russian bank declined to participate in a bailout. Corporate Commercial collapsed, and in the ensuing crisis so did Mr. Oresharski's government.

The final, unexpected development came on Dec. 1 when Mr. Putin, on a state visit to Turkey, announced that South Stream was dead. He blamed Europe and, according to press reports in Turkey, said he was "fed up with Bulgarians."

Since then, Chancellor Angela Merkel of Germany, Europe's most powerful leader, has suggested that South Stream might yet be built. After meeting with her, the new Bulgarian prime minister said he was confident European Union objections could be overcome.

Even if they are not, some diplomats contend that Mr. Putin achieved many of his goals.

While "he overreached, and he underestimated the response" to his intervention in Ukraine, said Mr. Gray, the former American diplomat, the Russian leader has been "quite effective" in countries like Bulgaria.

"He won a great deal by getting Nabucco stopped," Mr. Gray said. "Ultimately, his goal is to keep as much control over the former parts of the Soviet empire as possible."

Correction: January 5, 2015

An article on Wednesday about tactics used by President Vladimir V. Putin of Russia to win Bulgarian approval for a natural gas pipeline under the Black Sea misidentified the professional Bulgarian soccer team that Gazprom, Russia's state-owned energy giant, agreed to sponsor to sweeten the deal. The team is Levski Sofia, not CSKA Sofia. (While the Bulgarian prime minister originally said Gazprom would sponsor CSKA Sofia, the company later changed its mind.)

Jim Yardley reported from Sofia, and Jo Becker from Budapest and New York. Georgi Kantchev contributed reporting from Sofia, and Masha Goncharova from New York.

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