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The NC ECU Takes Charge

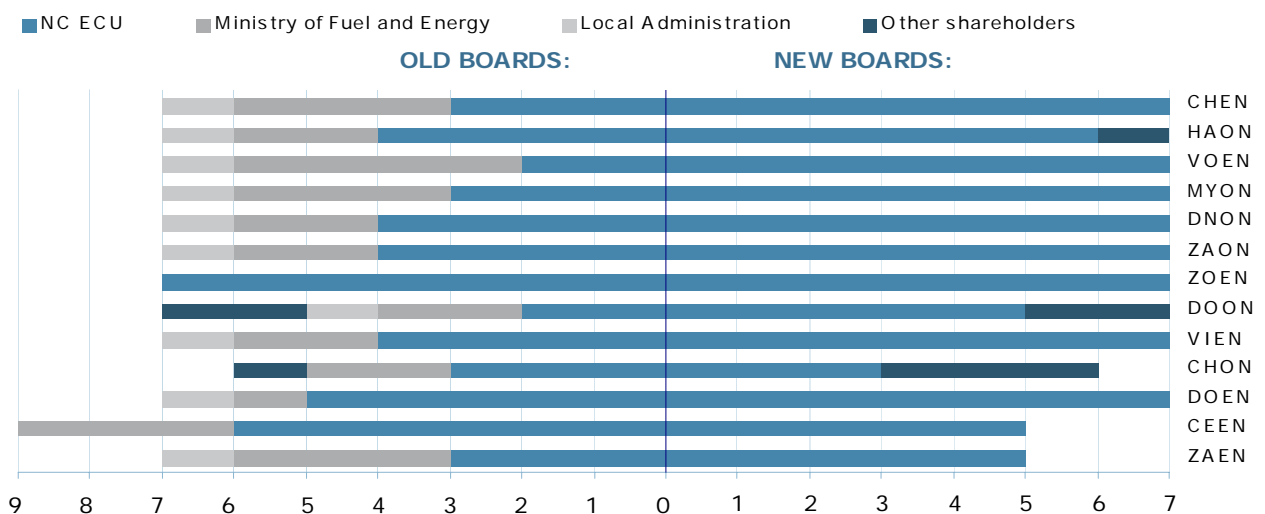
EGMs that took place in 13 energy companies during November-December 2006 resulted in the replacement of each supervisory board, which is vitally important because in most GenCos and Oblenergos the board has the power to replace top-management.

Eighty out of 86 positions in the supervisory boards (93%) are now occupied by representatives from the NC ECU. The previous boards had representatives of local administrations (where the companies are registered: one person on each board), the Ministry of Fuel and Energy (one to four people) and the NC ECU (two to six people).

From a corporate governance point of view, the implications are mixed:

- Improvements due to the absence of regulators and local lobbyists, which leaves the boards filled with shareholders and their representatives that will play to the interests of the company without any political influence; and
- A potentially worrying concentration of power in the hands of one corporate entity, the NC ECU, and no representation by independent members.

Supervisory board representation, number of places



Source: Company data

We believe that, in general, the positives outweigh the negatives because the supervisory boards are now more flexible to react quickly to sector changes.

From a political point of view, these replacements mean the Minister of Fuel and Energy delegated management of energy companies to the NC ECU.

Grigorishyn Wins Favor, VS Energy Left Out in the Cold

Minority shareholders retained their positions on the supervisory boards of only three electricity companies (DOON, CHON and HAON). This actually indicates slight progress - in the past only two energy companies (out of the 13 described here) had representatives from minority holders on their supervisory boards.

It is logical that SCM-related companies obtained places at DOON (the NC ECU's top managers came from SCM energy companies) and UkrEsCo obtained places in CHON (as UkrEsCo is a state entity with 25% ownership in CHON).

However, it is beyond logic that representatives of offshore company Grayham obtained places at CHON and HAON (one place in each company), while it owns only 15%-16% of stakes there. This is especially strange given that VS Energy, which owns 22%-24% in MYON and CHEN, did not get any places on those boards.

We connect Grayham with the Energy Standard Group of Konstantin Grigoryshyn and we believe that he has established relationships with current NC ECU managers. It also looks like VS Energy is not considered by NC ECU a competent player on the Ukrainian energy market, despite the fact that it controls five Oblenergos.

One interpretation of the continued exclusion of VS Energy on the boards at MYON and CHEN is that the NC ECU believes it to be too aggressive and thus is moving to prevent it from influencing Oblenergos' activities. Another interpretation is that SCM is targeting MYON and CHEN for a takeover and, hoping to prevent competition from VSE, is trying to isolate it through the NC ECU.

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