ARBITRATIONS PURSUANT TO THE RULES OF
THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

PCA CASES NOS. AA 226, AA 227, AA 228

HULLEY ENTERPRISES LIMITED

YUKOS UNIVERSAL LIMITED

VETERAN PETROLEUM LIMITED

Claimants,

—v.—

THE RUSSIAN FEDERATION

Respondent.

RESPONDENT'S COUNTER-MEMORIAL

(Resubmitted on July 29, 2011)

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I. INTRODUCTION

1. Relying principally on popular accounts that owe their origins to Claimants' own public relations efforts, Claimants portray Yukos Oil Company ("Yukos") as the "victim" of a concerted conspiracy, organized and implemented at all levels of the Russian Government, to punish the Oligarchs who owned and ran Yukos, Mr. Khodorkovsky in particular, for their political activities and to restore Russian oil assets to Government ownership.[1] Claimants' repeated reliance on public misperceptions and on assertions they attribute to those notoriously unreliable sources -- "it was widely believed," "it is to be assumed," "it was reported" -- is testament both to the success of Yukos' well-financed public relations campaign and to Claimants' failure to support their allegations with competent evidence or non-speculative explanations.

2. The reality of these cases is very different. In this Counter-Memorial, the Russian Federation demonstrates that in the mid-1990s the Oligarchs used rigged sham auctions and subverted Russia's loans-for-shares program to acquire control of Yukos; that they later illegally squeezed out the company's minority shareholders; that beginning in the late 1990s Yukos brazenly engaged in serial tax fraud; that Yukos' principal owners and managers were well aware that the company's core tax evasion scheme was subject to challenge by the Russian authorities and, if challenged, could result in very substantial liabilities for Yukos and criminal prosecution for the individuals involved; and that these same individuals actively sought to conceal Yukos' tax scheme both from the Russian Government and from the company's own accountants, and then, when the tax scheme was finally uncovered, organized a scorched-earth defense of Yukos' illegal wrongdoing that only increased the company's taxes, fines, and penalties. Rather than pay Yukos' overdue taxes, Yukos' principal owners and managers caused Yukos to transfer abroad to Claimants and to vehicles controlled by the Oligarchs billions of dollars that

[1] In this Counter-Memorial, "Oligarchs" refers to Mikhail Khodorkovsky, Platon Lebedev, Leonid Nevzlin, Vladimir Dubov, Mikhail Brudno, Vasily Shakhnovsky, and Alexei Golubovitch, the individual owners standing behind Claimants, as discussed more fully below.

could otherwise have been used to discharge Yukos' tax liabilities, leading ultimately to the company's self-inflicted demise.

3. This Counter-Memorial also demonstrates that any other country's tax authorities would have responded in much the same way as the Russian authorities did – both to Yukos' initial tax fraud and to the company's and its controlling shareholders' subsequent attempts to obstruct and resist the collection and enforcement of Yukos' overdue taxes.

4. Claimants' case is built on misleading anecdotes and sound bites wrenched from their context. For example, Claimants represent to the Tribunal that the Russian tax authorities allowed Yukos "less than one day" to "sell or leverage any of its assets" to pay its 2000 tax assessment,[2] when in fact Yukos had 109 days, nearly one-third of a year, to set aside the necessary cash following receipt of the company's 2000 tax audit report. Rather than supporting Claimants' due process allegation, this incident when viewed in context shows that responsibility for Yukos' failure to pay its 2000 taxes lies solely with Yukos and its controlling shareholders, including Claimants. Claimants also fail to provide the context relevant to their claim that Yukos lacked the resources to pay its 2000 tax assessment, and was "was prevented from discharging"[3] its tax liabilities for 2000. The relevant facts omitted here by Claimants include that Yukos paid an unprecedented US$ 2 billion giga-dividend to its shareholders, including Claimants, knowing full well that the company would almost certainly soon face a very substantial tax bill. This Counter-Memorial methodically presents the facts and context Claimants omit, both in an initial exposition of the facts, largely in chronological order, and elsewhere throughout this Counter-Memorial where necessary to supplement Claimants' partial account. This has inevitably led to a lengthy Counter-Memorial.

5. The Russian Federation's tax assessments were not, in any event, the "bolt from the blue" Claimants would have the world believe. To the

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2 Claimants' Memorial on the Merits, ¶ 338.

3 *Ibid.*

contrary, the evidence is clear that the owners and managers of Yukos realized full well, from the very beginning (in the late 1990s), that their "tax optimization" plan was fraught with legal risks. At that time, it was already evident to anyone familiar with Russian tax law and practice that if the Russian tax authorities and courts ever became aware of Yukos' "tax optimization" scheme, they would condemn it -- as a flagrant abuse of the Russian law providing federal tax incentives for investments made in Russia's low-tax regions -- on the basis of anti-abuse doctrines that had already been accepted by Russian courts and are mirrored in similar doctrines and rules in the tax systems of virtually every other country. It is for this reason that, from the beginning, Yukos took extreme precautions to cloak its program in secrecy, concealing its ownership and control of the empty-shell "trading companies" it established to take improper advantage (including by not making meaningful local investments) of the available tax incentives. The illegality of Yukos' scheme was confirmed as early as 1999, when tax authorities in the Lesnoy area began to investigate some of Yukos' local trading shells. That multi-year investigation culminated in the condemnation of the trading shells' participation in Yukos' "tax optimization" program, and the assessment of back taxes and penalties. The company's response to that experience is telling. Yukos sought to avoid the assessments and to conceal its role as the trading shells' master puppeteer through a corporate reorganization that resulted in the liquidation of the shells before the authorities were able to collect even a kopek of evaded tax. Around the same time, in 2001 and 2002, the tax authorities and courts in the region of Kalmykia condemned the abuse of the low-tax region program by another covert Yukos affiliate, the Sibirskaya company. Again, Yukos responded by liquidating the company before its ties to Yukos could be uncovered, and Yukos thereafter concentrated its tax evasion program in regions where its affiliates had not yet been challenged.

6. Also in 2002, Yukos' main private sector competitor, Lukoil, announced that it was abandoning its reliance on a similar tax minimization program. Yukos again took the opposite tack. It added obfuscating embellishments to its existing scheme, including an elaborate network of companies and trusts in Cyprus, and the British Virgin Islands, whose sole

purpose was to siphon off the profits of Yukos' most important trading shells and to claim relief under a double taxation treaty that was clearly not available under the circumstances. This was all done in a manner intended to prevent the Russian authorities from discovering that the shells and off-shore structure were owned and controlled by Yukos and some of its favored managers. While this Counter-Memorial provides an account of some of that network's activities, Yukos' efforts to conceal the network's existence and operations were successful at the time, and even today the Russian Federation is unable to reconstruct completely the full scope of the network's illegal activities.

7. During this same period, a series of court decisions involving companies unrelated to Yukos furnished additional confirmation, if any were needed, of the illegality of Yukos' schemes. The Oligarchs as well as Yukos' managers understood this perfectly well, as confirmed by a series of incriminating internal Yukos documents prepared in the Spring and Summer of 2002 in connection with a proposal to list Yukos' (and Claimants') shares on the New York Stock Exchange. In order to implement this plan, Yukos would, under the U.S. securities laws, have needed to publicly disclose its "tax optimization" scheme, including the network of "trading companies" it was then using to "optimize" its taxes, as well as the offshore (Cypriot and British Virgin Islands) companies that were accumulating the network's untaxed profits. One of the most damning of these documents, prepared by an employee in Yukos' Finance Department, made explicit the risks that disclosure would entail -- "*substantial tax claims against the Company*" and potentially also against its officers individually. Rather than run this risk, the Oligarchs and Yukos' managers abandoned the planned New York Stock Exchange listing, but not their "tax optimization" scheme, which they continued in place and hid from the Russian authorities, even though fully conscious of its illegality, through and even beyond 2003.

8. Once caught, the Oligarchs and the Yukos managers they controlled, including through Claimants, turned to a well-worn playbook to continue their self-enrichment and tax evasion schemes. First, they developed a particularly well-funded public relations campaign to mask their wrongdoing.

That campaign had previously served to deflect attention from the company's abusive and illegal treatment of its minority shareholders, then as a helpful cover for Yukos' illegal tax scheme, and still later gave rise to a seemingly impenetrable fog of misinformation that, in many circles, persists to this day.

9. This public relations misinformation program was allied with a campaign of intimidation pursued by Yukos, Claimants, and the Oligarchs, who famously threatened all those who opposed them with a "*lifetime of litigation*," and have made more than good on that threat. Benefitting from an apparently limitless budget, Yukos and its shareholders aggressively resisted the Russian authorities' investigation of the company's wrongdoing, and then challenged in seemingly every available legal forum virtually every action taken by the Russian authorities to assess, enforce, and collect Yukos' unpaid tax bills, supported at every step by their well-paid image managers.

10. Yukos' ongoing campaign was -- and is -- intended to hide the fact that the company engaged in massive tax fraud, rooted in obfuscation. Even Yukos' much advertised adoption of U.S. GAAP reporting in fact served only to hide the company's "tax optimization" scheme, and to delay its discovery. While announcing to the world its purported new commitment to corporate good governance and transparency, behind the scenes Yukos' senior managers were lying to the company's U.S. GAAP auditors, intentionally deceiving them about, among other matters, Yukos' control over the trading shells at the heart of its "tax optimization" scheme. Thus, far from turning a page on their corrupt beginnings, Yukos and the Oligarchs continued their pattern of lawlessness, but by even more intricate and overlapping means.

11. As this brief account makes clear and is demonstrated fully in this Counter-Memorial, Claimants' case has always been overwhelmingly about "Taxation Measures" -- that is, measures involving the imposition, enforcement, and collection of taxes -- which fall outside the scope of the ECT. The Russian Federation has accordingly provided "*a complete record on the nature of the claims themselves and a fuller understanding of the facts*" in response to the Tribunal's discussion of Article 21 in the Interim Awards on Jurisdiction and Admissibility.

12. Claimants also place heavy emphasis on the invidious treatment supposedly afforded to Yukos. While Yukos is the only major Russian oil company to have failed in recent years, responsibility for that failure rests at the doorstep of Yukos and its controlling shareholders, including Claimants. As detailed in this Counter-Memorial, it is helpful to distinguish among three different types of Russian oil companies -- those, such as Surgutneftegaz, which never engaged in the type of "tax optimization" scheme illegally pursued by Yukos; those, such as Lukoil, which did use low-tax regions to evade taxes, but on a much more modest scale in comparison to Yukos and, of critical importance, paid their back taxes and terminated their programs when challenged by the Russian tax authorities; and Yukos. In a class by itself, Yukos' "tax optimization" scheme was singularly aggressive in its conception and implementation, as was Yukos' public tooth-and-nail resistance to the authorities' efforts to enforce and collect the same evaded profit taxes that were then being paid by many of its peers.

13. In rejecting Claimants' attempt to portray Yukos as a "victim," this Counter-Memorial notes the many occasions on which Yukos acted like anything but an innocent victim. For example, innocent victims, unlike Yukos, do not usually liquidate the companies they control before the local tax inspectorate can assess any taxes, and then reincorporate the same taxpayer, in a region thousands of miles away subject to audit by a different tax inspectorate, and then repeat that process several times over, all in order to stay literally one region ahead of the tax authorities. Nor do innocent victims, unlike Yukos, reward their controlling shareholders with an unprecedented giga-dividend just as a very substantial tax assessment is looming on the horizon, and then publicly proclaim that they lack the resources to pay their tax bills. Nor do innocent victims, unlike Yukos, usually arrange for their employees to be sent abroad and with all their expenses paid, in order to prevent them from telling the truth to government investigators. These are, rather, the actions of self-enriching criminal wrongdoers, intent on preventing discovery of their knowingly illegal schemes and on aggressively obstructing the discovery of their illegal actions. Nor, for that matter, do innocent victims, unlike Yukos, threaten the world's leading banks and oil

companies with a proverbial "*lifetime of litigation*" if they participate in a public auction organized by a foreign government. That is instead the action of a vengeful company seeking to intimidate all those who oppose a take-no-prisoners defense of its own wrongdoing.

14. This Counter-Memorial also addresses Claimants' grand conspiracy theory, and demonstrates that it is supported neither by fact nor logic, and necessarily assumes that at critical moments the misjudged actions of Yukos' own principals played an indispensable role in ensuring the conspiracy's success. Against Claimants' hypothesized and implausible conspiracy, supposedly carried out at all levels of the Russian Government and involving literally hundreds of tax officials, bailiffs, and no fewer than 60 judges, including many of Russia's leading jurists and legal scholars -- as well as a global network of commercial banks, industrial corporations, Russia's other major oil companies, the world's second largest accounting firm, and even a U.S. Bankruptcy Court judge, all purportedly responding to a puppeteer in Moscow -- the Russian Federation shows that the events complained of have a much more direct and likely explanation: Yukos engaged in massive, illegal tax fraud, and the Russian authorities sought, over Yukos' strenuous objections, to enforce and collect the company's back taxes in accordance with Russian law.

15. Pursuant to the Tribunal's Procedural Order No. 10 of May 13, 2010, the Russian Federation respectfully submits this Counter-Memorial to respond to the unfounded and unsubstantiated attack presented in Claimants' Memorial on the Merits. In accordance with the Tribunal's request in paragraph 9 of that Order, the Russian Federation presents its response in a single Counter-Memorial applicable to all three arbitrations, calling attention where necessary to distinctions among the circumstances of the three Claimants.

16. The Russian Federation's Counter-Memorial is organized into eight Sections -- this Introduction, the Statement of Facts, a Section that addresses Claimants' conspiracy theory, and then six Sections dealing with Legal Arguments -- and proceeds as follows:

(i) In Parts A-G of the Statement of Facts, the Russian Federation describes how the Oligarchs fraudulently came to acquire their stake in Yukos at a knock-down price in a rigged sham auction by corrupting the Russian Government's loans-for-shares privatization program, how they abused minority shareholders by diverting corporate profits to ostensibly independent trading counterparties they in fact controlled and through which they profited, how they then consolidated their control by illegally squeezing out minority shareholders, how they created Claimants to hold their Yukos shares and to deceive the tax authorities in Russia and Cyprus, fraudulently claiming hundreds of millions of dollars of tax benefits under the two countries' double taxation treaty, and how they engaged in a wide range of other crimes to protect their operations and profits. These facts are independently significant to the Russian Federation's defenses (to jurisdiction, admissibility, and the merits) based on Claimants' unclean hands. These facts are also important to show the building blocks Claimants and the Oligarchs used in ever more audacious ways in later years in their exploitation of Yukos to book enormous profits while evading taxes.

(ii) Part H of the Statement of Facts explains the core elements of Yukos' domestic tax fraud -- the creation of dozens of purportedly independent trading shells in Russia's low-tax regions, the company's total control of those shells to improperly capture the bulk of Yukos' profit, which was then taxed at a lower rate than the one to which Yukos was entitled, the absence of any meaningful investment or operations by the shells in the low-tax regions, defeating the purpose for which tax reductions were to be allowed, the round-tripping of the trading shells' artificial profits back to Yukos through another layer of tax evasion -- a thicket of opaque Cyprus, Isle of Man, and British Virgin Islands entities -- and, above all else, the company's concerted and elaborate efforts at

concealment. Part H then shows how the scheme started to unravel in 2003, when some of the participants became the subject of criminal investigations, which was followed by a broad-based supervisory tax audit of Yukos' operations that for the first time allowed all the disparate pieces of the company's tax scheme to be brought together. The gathering storm clouds in turn led to the suspension and then unwinding of Yukos' planned merger with Sibneft in litigation that is also described in this Part.

(iii) Part I of the Statement of Facts describes the Russian Federation's lawful enforcement of Yukos' tax liabilities, detailing how Yukos had more than three months -- not just "one day" as the Oligarchs' propaganda machine and Claimants would have it -- to pay the company's 2000 taxes, running from Yukos' receipt of the first audit report showing that it owed approximately $3.5 billion in taxes for that year. This Part then explains how, rather than using that time to prepare to pay its taxes (and to amend its previously filed returns for later years to avoid interest and penalties), Yukos did all it could to resist payment, expatriating ever more of the company's money, including an unprecedented US$ 2 billion giga-dividend, most of which went to Claimants. It concludes with a discussion of the enforcement proceedings commenced by the tax authorities in accordance with Russian law after Yukos made clear that it would not voluntarily pay its taxes, continued to deny any responsibility, and proposed fraudulent payment plans involving the use of impaired or illusory assets and unrealistic payment periods.

(iv) Part J discusses the sale of the common shares of Yuganskneftegaz ("YNG"), Yukos' largest production subsidiary. As explained in this Part, Yukos requested that the sale be conducted by auction -- as a matter of Russian law, the bailiffs could have entered into a negotiated private sale -- but Yukos later reversed course and did

all it could to frustrate the auction it had requested by threatening bidders with litigation and then initiating a sham bankruptcy in the United States and obtaining a temporary injunction there that prevented bidders and their banks from competing at the auction. This Part also recounts how the auction went forward as scheduled and, notwithstanding the dampened competition attributable to Yukos' and the Oligarchs' misconduct, achieved a selling price approximately US$ 500 million over the minimum bid, which was itself based on fair market value. The Russian Federation then shows that Claimants' current position -- that YNG's "fair" value was US$ 28 billion -- is absurd and based on an analysis that is flawed on its face, and once corrected, actually supports the price that was obtained.

(v) Parts K and L show that Yukos' tax liabilities thereafter continued to be enforced consistently with Russian law, and that Russian law is in many instances more taxpayer-friendly than international practice. These Parts also address Yukos' default on a commercial loan owed to the SocGen bank group -- a loan that Yukos' own counsel has acknowledged it had the means to pay (but chose not to) and that eventually led SocGen to initiate bankruptcy proceedings in Russia in its own interest, and not as part of some illicit plot with Rosneft. The Russian Federation also recounts here how Yukos' bankruptcy arose in part because the company's management contrived to hive-off and segregate Yukos' non-Russian assets in Dutch *stichtings*, described in Part K, and how this arrangement both immunized Yukos' very substantial foreign assets (never accounted for in Claimants' Memorial) from the collection efforts of the company's creditors, including Russia's tax authorities and SocGen, and vested control of those assets in Claimants and the Oligarchs who control them, the proceeds of serial thefts now resting in the hands of the thieves. As further explained in this Part, these assets are now under the management

of witnesses appearing on Claimants' behalf. Part M then refutes many of Claimants' scurrilous attacks on the criminal investigations into the company's tax fraud, which Yukos and the Oligarchs worked so hard to hide.

(vi) Finally, Part N of the Statement of Facts discusses how Yukos' managers and the Oligarchs, including some of Claimants' witnesses in these cases, systematically lied to Yukos' international auditors, PricewaterhouseCoopers ("PwC"), and through PwC to Yukos' minority shareholders, creditors, the international financial markets, and the investing public. The Russian Federation here shows that it was this deceit, and not pressure from the Russian Government, that caused PwC to definitively conclude, nearly four years ago, that Yukos' financial reports were no longer reliable and to withdraw all of its audit opinions, though Claimants continue this day to tout Yukos' financial "transparency."

(vii) Section III links the Statement of Facts and the Legal Arguments, and sets out Respondent's views on Claimants' central allegation – upon which their legal arguments significantly depend -- that the Russian Federation organized and implemented a vast conspiracy to renationalize Yukos and to punish the company for the Oligarchs' political activities. The Russian Federation here shows that Claimants' conspiracy theory does not meet even a low threshold of plausibility, let alone the high burden of proof required, and that the vast conspiracy hypothesized by Claimants, purportedly involving all levels of the Russian Government, aided by a network of bankers, industrialists, and others around the globe, is an implausible fantasy, not supported by facts and illogically reliant at critical times on the Oligarchs' own actions and miscalculations, which ultimately resulted in the company's demise. This Section also reviews the serious defects in the witness

statements and other circumstantial evidence cited by Claimants in support of their conspiracy theory.

(viii) The remainder of this Counter-Memorial consists of the Russian Federation's Legal Arguments. In Sections IV and V, Respondent presents a series of threshold objections: (1) the Tribunal lacks jurisdiction pursuant to Article 26(3)(b)(i) ECT because subsequent developments show that Claimants, as Yukos shareholders, are seeking recovery for the same alleged loss before the ECHR; (2) the Tribunal lacks jurisdiction, or the claims are inadmissible or should be dismissed on the merits, because the claims are "*with respect to Taxation Measures*" within the exclusion of Article 21(1) ECT and are not subject to the claw-back for the application of Article 13(1) ECT to "taxes" under Article 21(5) ECT, and there is no claw-back for claims under Article 10(1) ECT; and (3) the Tribunal lacks jurisdiction, or the claims are inadmissible, or in any event (4) Claimants are not entitled to Treaty protection because of Claimants' own illegal conduct and the illegal conduct attributable to them, some of which is outlined above.

(ix) Section VI examines from numerous perspectives the reasons why, in any case, Claimants have failed to establish a violation under Article 13 ECT. Claimants had no legitimate expectation that Russian tax law would not be applied to them and their investment when Yukos breached its obligations under the tax laws of the Russian Federation. Yukos' managers understood Yukos was at risk of further tax assessments because of their conduct and, reflecting their guilty knowledge, they tried to conceal it. Because the claimed loss is attributable to the actions of Claimants themselves, the Yukos managers they installed, and/or the Oligarchs, and not the conduct of the Russian Federation in violation of the ECT, the factual predicate of an expropriation claim under Article 13 ECT is lacking. Moreover, the assessment and

collection of taxes is in the public interest, as to which States are afforded a wide margin of discretion. The Russian Federation's conduct in this regard neither constituted a radical departure from Russian law nor deviated from international norms. To the extent Claimants allege discriminatory taxation, their claims fail because they do not contend that their investment was subjected to discrimination based on foreign ownership, and their allegations of discrimination are factually wrong. Claimants' allegations of due process violations, whether in respect of tax, tax enforcement, the auction of YNG, or the Yukos bankruptcy proceedings, lack merit, as do their other arguments for liability under Article 13 ECT.

(x) Claimants' assertion of a claim under Article 10(1) ECT, assuming it survives Article 21(1) ECT, fails for similar reasons, as explained in Section VII.

(xi) Finally, Claimants are not entitled to damages, as shown in Section VIII. Claimants cannot recover for the illegal conduct of, or for harm caused by, themselves or those attributable to them. They have shown no causal link between any violation of the ECT and any damages they can prove. There are, in addition, glaring fundamental flaws in Claimants' proffered damages expert report, which renders it wholly unreliable as a basis to measure damages in this case

17. In sum, once the Oligarchs and Claimants set Yukos irrevocably on the course of fraud and corruption -- and refused to deal responsibly with the consequences of their own misconduct -- they sealed the company's fate and brought about its ultimate liquidation. That they now seek US$ 104 billion in damages for a company they essentially stole and then grew on the basis of ill-gotten gains, and from which they have already extracted many billions of dollars, demonstrates just how outrageous their claims are. The Russian Federation bears no responsibility for any international wrong to Claimants, and all of their claims must be dismissed.

II. STATEMENT OF FACTS

A. The Oligarchs' Fraudulent Acquisition Of Yukos

18. From the very start of their involvement with Yukos, the Oligarchs' ownership, control, and domination of the oil company through Group Menatep, which the Oligarchs also controlled, has been characterized by violations of Russian law, deceit, opacity, and bad faith — all to the detriment of the Russian Government and foreign investors in Russia alike. As is described in the expert report that is being submitted with this Counter-Memorial by Harvard Law School Professor Reinier Kraakman, whose first scholarly study of these matters was published in the Stanford Law Review in 2000, this misconduct was particularly evident during the Oligarchs' fraudulent acquisition of Yukos through Bank Menatep (Group Menatep's predecessor) as part of the "loans-for-shares" program.[4]

19. The Russian Government created Yukos in 1993 as part of a large-scale reorganization of the former Soviet oil production and processing industry into vertically integrated oil companies. These new vertically integrated oil companies consisted of a "holding" company and various production and processing subsidiaries. For example, the holding company Yukos was initially made up of about a dozen subsidiaries, including the oil production company Yuganksneftegaz.[5] Yukos, the second largest oil company in Russia, remained largely a state-run oil company until 1995.

20. In March 1995, a consortium of Russian commercial banks, including Bank Menatep, proposed to the cash-starved Russian Government that

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4 *See* Expert Report of Professor Reinier Kraakman ("Kraakman Report"), ¶¶ 9-13 (describing a summary of Professor Kraakman's findings).

5 *See* Resolution of the Council of Ministers of the Russian Federation No. 354, "On Incorporation of an Open Type Joint Stock Company 'Oil Company Yukos'" (Apr. 15, 1993) (Exhibit RME-1); *see also* Resolution of the Head of Administration of the Khanty-Mansiysk Autonomous District No. 69, "On Registration of the Open Joint Stock Company – Oil Company 'Yukos'" (May 12, 1993) (Exhibit RME-2); Decree of the President of the Russian Federation No. 1403, "On Specifics of Privatization and Reorganization of State Enterprises, Production and Scientific Unions of Oil, Oil-Refining Industry and Oil-Product Provision in Joint Stock Companies" (Nov. 17, 1992) (Exhibit RME-3). Pursuant to similar legislation, many of Russia's other oil companies – such as Rosneft, Lukoil, and Surgutneftegaz – trace their origins to this initial "corporatization" of the Soviet oil industry.

they would lend the Government money in exchange for the right to hold and manage shares of major state-owned companies, such as Yukos, as collateral. Unlike other private businessmen who dismissed this plan to gain control over Russia's most valuable industries as too brazen to succeed, Mr. Khodorkovsky, in his capacity as Chairman of Bank Menatep, was an early and steadfast supporter. Indeed, Mr. Khodorkovsky was one of the three representatives of the banks to present this plan to the Government.[6]

21. The Russian Government, desperate for funds to pay wages and meet pension commitments, modified the banks' proposal in an effort to make the process more transparent and competitive than the banks, in their own self-interest, had proposed.[7] The Government's version, which contemplated auctioning off the right to hold and manage shares of individual companies to those bidders who could extend the most credit to the state, was approved by Presidential decree in August 1995.[8] Once the terms of the proposed management agreement were to expire, the Government could either (i) pay back the loan and reclaim its shares, or (ii) allow the lender to sell off the shares, with the Government keeping 70% of the difference between the sale price and the original amount of the loan, and the lender keeping the remaining 30%.[9]

22. With respect to Yukos, Bank Menatep's misconduct prevented the planned transparent and competitive process from ever being implemented.[10] As

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6 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 309 (Exhibit RME-4); CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 165-66 (Exhibit RME-5); Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild West Capitalism: Loans-for-Shares Transactions in Russia*, 29 Geo. Wash. J. Int'l L. & Econ. (1996), 737, 743 (Exhibit RME-6).

7 *See* Kraakman Report, ¶ 14-17 (discussing legal requirements designed to make the loans-for-shares program competitive and transparent); Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild West Capitalism: Loans-for-Shares Transactions in Russia*, 29 Geo. Wash. J. Int'l L. & Econ. (1996), 744 (Exhibit RME-6).

8 *See* Decree of the President of the Russian Federation No. 889, "On the Procedure for Pledging Shares Held in Federal Ownership" (Aug. 31, 1995) (Exhibit RME-7).

9 *See* CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 172 (Exhibit RME-5); Juliet Johnson, *Russia's Emerging Financial-Industrial Groups*, 13 Post-Soviet Affairs (1997), 333, 355 (Exhibit RME-8).

10 *See* Kraakman Report, ¶ 24 ("Menatep undercut the values of competitiveness and transparency at the foundation of Decree 889 before the auction began.").

Claimants' witness and former Bank Menatep President Mr. Nevzlin has admitted, he and his business partners divided up the spoils beforehand and never intended to allow the free and fair competition that would ensure maximum receipts to the Government: "'*We reached an agreement on who would take what. We agreed not to get in each others' way* […]. *In this respect there was an element of insider dealing*.'"[11] This "insider dealing" allotted Yukos to Bank Menatep.

23. Even in the context of the "insider dealing" and conflicts of interest characteristic of the loans-for-shares program generally, Bank Menatep's acquisition of Yukos stands out as "*the most complex and scandalous offering*" of late 1995.[12] Bank Menatep, which the Russian government retained to organize the auction for Yukos shares to be held on December 8, 1995, did everything in its power to manipulate the auction's results to serve its own interests and ensure its own victory, contrary to the Russian public interest that it was obligated to serve.

24. Rather than promoting a vigorous competition that would help the Russian Government's dismal fiscal standing, Bank Menatep warned bidders to stay away from the Yukos auction. Konstantin Kagalovsky, First Deputy Chairman of Bank Menatep, informed the media, "'*There should be no two opinions about this,* […] [w]*e will get Yukos*.'"[13]

25. Moreover, it was not enough for Bank Menatep to preclude non-Russians from bidding for Yukos based on its classification as a "strategic company." Instead, to prevent potential Russian competitors from partnering with or seeking financial assistance from non-Russians, Mr. Kagalovsky — who had previously worked in the Government as Russia's representative to the International Monetary Fund — has admitted that he inserted himself into the

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11 CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 166 (Exhibit RME-5).

12 Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild West Capitalism: Loans-for-Shares Transactions in Russia*, 29 Geo. Wash. J. Int'l L. & Econ. (1996), 750 (Exhibit RME-6).

13 PAUL KLEBNIKOV, GODFATHER OF THE KREMLIN: THE DECLINE OF RUSSIA IN THE AGE OF GANGSTER CAPITALISM (2000), 204 (Exhibit RME-9).

legislative process and intentionally drafted the law prohibiting foreign participation to be so vague that Bank Menatep could – and did – wield that law as a weapon against any non-Russian that contemplated assisting a rival bidder.[14]

26. When a rival consortium of banks seemed on the verge of turning the auction for Yukos that Bank Menatep had rigged for its own benefit into an actual competition to be won by the highest bidder, and thereby yielding the largest return for Russia, Mr. Khodorkovsky secretly sent a close associate to dissuade one of the rival's potential foreign investors from bidding, using the intentionally ambiguous law that Bank Menatep had helped to craft to threaten the potential investors with financial ruin.[15] Stifling the attempts of its potential rival to raise cash, Bank Menatep ultimately rejected the rival consortium's bid altogether on the ground that part of its security deposit was in short-term government treasury bills.[16]

27. While preventing any actual competition for Yukos through the use of strong-arm tactics and the abuse of its role as auction organizer,[17] Bank Menatep acted to maximize its success in the auction by creating two front companies, named Laguna and Regent, to submit bids. Menatep did so not only to obscure its own role as a bidder, which was prohibited, but also to lend the auction the appearance of complying with the legal requirement that it have at least two genuine participants.[18] Thus, Menatep created a false appearance that

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14 CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 175-76 (Exhibit RME-5).

15 DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 313, 316 (Exhibit RME-4).

16 PAUL KLEBNIKOV, GODFATHER OF THE KREMLIN: THE DECLINE OF RUSSIA IN THE AGE OF GANGSTER CAPITALISM (2000), 204 (Exhibit RME-9).

17 *See* Kraakman Report, ¶¶ 24 (describing the "insurmountable advantage" Menatep exploited through its controlling role in the auction process).

18 *See* Order of the State Property Management Committee of the Russian Federation No. 1458-R, "Regulations For the Order of Holding of Auctions on the Right To Sign Contracts of Credit, Pledge of Shares Being in Federal Property and Commission with the Aim To Secure Incomings of Funds from the Employment of Property Belonging to the State to the Federal Budget of 1995" (October 10, 1999), ¶ 26, App. 1 (Exhibit RME-10).

the auction was competitive, while in truth it was subverting this requirement completely.[19]

28. As a result, Menatep completely rigged the auction both by preventing any genuine competition and by affording itself a preferred position, all in order to serve Menatep's own interests. Unsurprisingly, in light of this misconduct, Menatep's front company Laguna, supported by a guarantee from Menatep, "won" the right to hold and manage a 45% stake in Yukos as collateral for a reportedly US$ 159 million loan to the Government, a mere US$ 9 million more than the starting bid price, and an additional investment obligation of US$ 200 million. Laguna also acquired an additional 33% stake in Yukos by pledging, as also reported, just over US$ 150 million in investments at a simultaneously held "investment tender." Bank Menatep then capped off its manipulation of the auction by acquiring Laguna's rights in the Yukos shares, thanks to a rule that assigned a bidder's rights to its guarantor if the bidder did not present its balance sheet to the auction committee; predictably, and to Bank Menatep's advantage, Laguna failed to present its balance sheet.[20]

29. Bank Menatep's misconduct continued thereafter. In 1996, with the Russian Government suffering continued financial hardships, Bank Menatep used another rigged auction and another shell affiliate, named Monblan, to purchase the collateralized stake in Yukos it had held since the previous year. Monblan paid US$ 160.1 million for these shares — which had decreased from a 45% stake in Yukos to about 33% due to additional share issuances and acquisitions by Bank Menatep and its affiliates — an amount that was barely above the US$ 160 million minimum bid and Laguna's original loan of US$ 159 million.

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19 *See* Kraakman Report, ¶ 20.

20 *See* Vadim Kravets, *Yukos and Menatep: Three Years that Shook Everyone*, Oil & Capital Magazine, Vol. 2 (1999) (Exhibit RME-11); CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 178 (Exhibit RME-5); Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild West Capitalism: Loans-for-Shares Transactions in Russia*, 29 Geo. Wash. J. Int'l L. & Econ. (1996), 751 (Exhibit RME-6).

30. By arranging the sale of Yukos to itself through the use of a shell company for no more than a nominal profit to the State, Bank Menatep was able to gain control over Yukos while preventing the Russian Government from reaping any substantial revenues from the 70% of the profit that it was due from the sale; rather, Bank Menatep could sell the company in the future and keep the real profit for itself.[21] Menatep was also able to further obscure who, if anybody, was liable for the US$ 200 investment obligation that had accompanied the 1995 loans-for-shares auction.[22] And having insulated itself from competing bids from within Russia by other means, Menatep put the Yukos shares up for auction as a block, thereby ensuring that non-Russians, who were forbidden from owning any more than 15% of the oil company, would not be able to participate.[23]

31. Just months after this last acquisition, Yukos was trading on the Russian RTS stock exchange at a market capitalization of US$ 6 billion, vastly more than Bank Menatep had paid for it, thereby proving Bank Menatep's bad faith manipulation of the auction and sale process to enrich itself at Russia's expense.[24]

32. Bank Menatep's complex use of shell companies, secret threats, and backroom deals makes it difficult to know precisely from where it obtained the money to initially acquire Yukos, including the required US$ 350 million deposit to participate in the 1995 loans-for-shares auction. Several sources suggest that Mr. Khodorkovsky and Bank Menatep did even more to undermine fair competition than collude with other banks, deceive the public with phony front companies, and prevent possible competitors from submitting bids.

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21 *See* Kraakman Report, ¶ 25-27; JULIET JOHNSON, A FISTFUL OF RUBLES: THE RISE AND FALL OF THE RUSSIAN BANKING SYSTEM (2000), 193 (Exhibit RME-12); Vadim Kravets, *Yukos and Menatep: Three Years that Shook Everyone*, Oil & Capital Magazine, Vol. 2 (1999) (Exhibit RME-11).

22 *See* Vadim Kravets, *Yukos and Menatep: Three Years that Shook Everyone*, Oil & Capital Magazine, Vol. 2 (1999) (Exhibit RME-11); Valery Kryukov & Arild Moe, Banks and the Financial Sector, *in* THE POLITICAL ECONOMY OF RUSSIAN OIL (David Lane ed. 1999), 47, 65 (Exhibit RME-13).

23 Sergey Lukianov, "*Managed" Yukos Sale Fetches $ 160M*, Moscow Times (Dec. 24, 1996) (Exhibit RME-14).

24 Paul Klebnikov, *The Khodorkovsky Affair*, Wall St. J. (Nov. 17, 2003), A20 (Exhibit RME-15).

33. According to these sources, Mr. Khodorkovsky and Bank Menatep exploited their pre-existing relationships with Yukos and, in part, used Yukos' own funds to pay for Bank Menatep's takeover of Yukos. Bank Menatep was therefore an insider among insiders, and co-opted Yukos' existing management.

34. An executive from one of the banks that unsuccessfully attempted to foil Bank Menatep's crooked auctioneering has been quoted as stating that "*Khodorkovsky was buying Yukos with the money of Yukos. They didn't pay their taxes and decided to accumulate the money, and the deal was, later on they would decide what to do with the taxes. That's what made us so angry — no, I would say, mad. They stole the company*."[25] Even the then-head of the State Property Committee has suggested that Bank Menatep obtained funds to pay for Yukos by pledging future oil deliveries of the company itself.[26]

35. Bank Menatep also was able to exploit Yukos itself in order to facilitate its takeover of Yukos, through connections between Bank Menatep and Yukos — and Bank Menatep and the state energy sector — that existed long before the loans-for-shares program. For example, in the early 1990s, Mr. Khodorkovsky and Mr. Nevzlin served as economic advisors to the Russian Prime Minister while continuing to work at Bank Menatep, and Mr. Khodorkovsky later became Deputy Minister of Fuel and Energy.[27] Contacts that Mr. Khodorkovsky had made in the Government led to collaboration between Bank Menatep and Yukos as early as in 1992.[28] Thus, it is no surprise that Yukos management itself supported Bank Menatep's bid for the company.[29]

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25 DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 317 (Exhibit RME-4).

26 *Ibid.*, 317-18 (Exhibit RME-4).

27 *See* CHRYSTIA FREELAND, SALE OF THE CENTURY: THE INSIDE STORY OF THE SECOND RUSSIAN REVOLUTION (2005), 117 (Exhibit RME-5); PAUL KLEBNIKOV, GODFATHER OF THE KREMLIN: THE DECLINE OF RUSSIA IN THE AGE OF GANGSTER CAPITALISM (2000), 203 (Exhibit RME-9).

28 *See* Valery Kryukov & Arild Moe, Banks and the Financial Sector, *in* THE POLITICAL ECONOMY OF RUSSIAN OIL (David Lane ed. 1999), 47, 57 (Exhibit RME-13).

29 *See* Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild West Capitalism: Loans-for-Shares Transactions in Russia*, 29 Geo. Wash. J. Int'l L. & Econ. (1996), 751 (Exhibit RME-6); ROSE BRADY, KAPITALIZM: RUSSIA'S STRUGGLE TO FREE ITS ECONOMY (1999), 140 (Exhibit RME-16).

36. Further and highly damning proof that Menatep had conspired with pre-existing Yukos management to facilitate the unlawful acquisition of Yukos by the Oligarchs came to light in 2002, when Yukos' auditor, Pricewaterhouse Coopers ("PwC"), became suspicious of an agreement entered into by "Yukos Universal" with Messrs. Muravlenko, Golubev, Ivanenko, and Kazakov (the "Yukos Universal Beneficiaries"), all of whom had been involved in Yukos' privatization in the mid-1990s.[30] Under this agreement, the Yukos Universal Beneficiaries received 15% of Group Menatep's beneficial interest in Yukos.[31] As a result, the Yukos Universal Beneficiaries were entitled, in the event Group Menatep sold any of its Yukos stock, to receive their proportionate share of the proceeds. Based on Yukos' market capitalization at the time, the Yukos Universal Beneficiaries' interest in Yukos was worth on the order of US$ 4 billion.[32] In light of the enormous sums involved, far in excess of the amounts typically paid to a company's employees, Douglas Robert Miller, PwC's lead auditor on the Yukos engagement, and his team questioned the true purpose of the agreement, suspecting that it was a "kickback" that had been previously promised to Yukos management for helping Menatep acquire Yukos during the loans-for-shares program.

37. With no rational, lawful explanation for the gigantic amounts to be paid out to Yukos' pre-privatization management, Mr. Lebedev insisted that the payments were for services rendered to Yukos. According to Mr. Miller:

> "Lebedev presented the agreement and indicated that the individuals were receiving these benefits for services provided to Yukos during their terms of employment. This assertion was challenged by the participants of the meeting but Lebedev insisted that was the case [...] [Despite Lebedev's insistence,] my colleagues and I had serious reservations as to whether the consideration was being provided for services rendered to Yukos. Accordingly, I initiated a series of meetings with Lebedev and Drel

30 *See* Record of Interrogation of Douglas Robert Miller, Dir. of PwC Russia, in Moscow, Russia (May 8, 2007, 13:19), 5-6 (Exhibit RME-17).

31 *See* Record of Interrogation of Douglas Robert Miller, Dir. of PwC Russia, in Moscow, Russia (May 10, 2007), 3 (Exhibit RME-18).

32 *See ibid.*, 3 (Exhibit RME-18).

> [counsel for Menatep Group] to discuss the reasons behind the compensation…. During these meetings, Lebedev insisted that the Beneficiaries were receiving these benefits as a result of services provided to Yukos. I strongly questioned this, as most of these individuals did not work for Yukos for very long following the privatization and because the value of the compensation did not appear to be in any way commensurate to any work they could have performed for Yukos."[33]

38. Not satisfied with the answer he received, Mr. Miller again raised the question, inquiring whether the agreement related to services that had been provided to Yukos' shareholders, for example, in assisting them in acquiring Yukos or in later obtaining control over the company:

> "At various points, I asked whether perhaps they were being compensated for other services to shareholders, such as assistance in acquiring Yukos or in bringing the company under control after privatization."[34]

39. Mr. Khodorkovsky's answer -- that the real reason for the agreement, if disclosed, might send him to prison -- confirmed that Menatep's acquisition, and Claimants' subsequent possession of Yukos shares, was the result of unlawful conduct. According to Mr. Miller:

> "Khodorkovsky said (and I do not remember his exact words, but they implied) that if he confirmed that my assumptions were right and that if he told me the true reasons why the beneficiairies were receiving this money, he could be imprisoned."[35]

40. But Yukos' own resources were not the only likely source of the funds used by Bank Menatep to acquire Yukos. The Audit Chamber of the Russian Federation (the "Audit Chamber"), which audits the State budget, has found that at least some of the money Bank Menatep loaned to the Russian Government during the loans-for-shares program came from the Government's

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33 Miller Interrogation Record (May 8, 2007, 13:19), 5-6 (Exhibit RME-17) [emphasis added]. In a subsequent statement, Mr. Miller reiterated, "I could not understand what work could have been done by them for YUKOS for this huge amount of money; it wasn't logical to me." Miller Interrogation Record (May 10, 2007), 8 (Exhibit RME-18).

34 Miller Interrogation Record (May 8, 2007, 13:19), 6 (Exhibit RME-17).

35 Miller Interrogation Record (May 10, 2007), 8 (Exhibit RME-18) [emphasis added].

own funds held at Bank Menatep — that is, in addition to rigging the auction of Yukos, Bank Menatep "won" that auction by lending the Government its own money.[36]

41. This finding is consistent with reports that Bank Menatep had long abused its status as a privileged "authorized bank" entitled to hold Government budget money, from which billions of dollars that should have been used for projects such as the re-building of Chechnya had disappeared without explanation.37

42. Thus, through breaches of its duties as auctioneer, coupled with multiple instances of coercion, fraud, and outright theft, the Oligarchs and Bank Menatep and its affiliates acquired more than 85% of Yukos' stock by the beginning of 1997.[38]

43. But the Oligarchs' disdain for honesty and openness, thanks to which it had been able to acquire its huge stake in the company at below market prices and with others' money, did not end there. Rather, it continued unabated even after the loans-for-shares program had ended.

B. The Oligarchs' Fraudulent Consolidation Of Ownership And Control Of Yukos Through Menatep's Abuse Of Basic Corporate Laws And Principles Of Proper Corporate Governance

44. As Russia's emerging democracy struggled against lawlessness in the late 1990s, the Oligarchs proved themselves to be among the country's worst abusers of basic corporate laws and principles of proper corporate governance.[39] In an effort to destroy the value of minority holdings in both Yukos and its

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36 *See* 2004 Audit Chamber Report, Analysis of Processes of Privatization of State Ownership in the Russian Federation for the Period from 1993 to 2003, 60-62 (Exhibit RME-19).

37 *See* Matt Bivens & Jonas Bernstein, *The Russia You Never Met*, 6 Demokratizatsiya 613 (1998), 618 (Exhibit RME-20).

38 *See* David Lane & Iskander Seifulmulukov, Structure and Ownership, in THE POLITICAL ECONOMY OF RUSSIAN OIL (Devid Lane ed. 1999), 15, 30-32 (Exhibit RME-21).

39 *See* Kraakman Report, ¶ 62 (noting that he has never "read – or read about – anything more chilling in a professional sense" than Yukos' treatment of its subsidiaries' minority shareholders); Bernard Black, *Does Corporate Governance Matter? A Crude Test Using Russian Data*, 149 U. Pa. L. Rev. (2001) 2131, 2137, 2140 tbl. 2 (Exhibit RME-22).

subsidiaries, and to ensure Group Menatep's total domination of Yukos, Yukos' controlling shareholders engaged in rampant willful misconduct, wielding share dilutions, asset stripping, unlawful transfer pricing, and the rigging of shareholder meetings to achieve their self-aggrandizing objectives.

45. Yukos' main production subsidiaries — OAO Yuganskneftegaz ("YNG") and Samaraneftegaz — were privatized separately from and prior to the loans-for-shares program that Bank Menatep corrupted to serve its own ends, although a controlling stake in each subsidiary remained with the Yukos holding company. Although Bank Menatep had rigged the auctions for Yukos in 1995 and 1996 to exclude foreign investors and ensure the absence of any real competition among Russian investors with Bank Menatep's bids, foreign and Russian investors held significant minority stakes in Yukos' production subsidiaries. In 1997 Yukos acquired a third production subsidiary — Tomskneft — that also had significant minority shareholders not controlled by Mr. Khodorkovsky and his associates.[40]

46. As soon as Menatep "won" its controlling stake in Yukos in the auction in December 1995 that Menatep abused to serve its own interests, the Oligarchs began to cheat Yukos employees and the subsidiaries' minority shareholders, and continued to defraud the Russian Government. For example, Yukos reported that its 1996 revenue per barrel of oil was US$ 8.60, about US$ 4 less than it should have been. The Oligarchs "skimmed over 30 cents per dollar of revenue while stiffing workers on wages, defaulting on tax payments, destroying the value of minority shares in Yukos and its production subsidiaries, and *not* reinvesting in Yukos' oil fields."[41]

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40 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 398-400 (Exhibit RME-4); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73, 75 (Exhibit RME-23); David Lane & Iskander Seifulmulukov, Structure and Ownership, in THE POLITICAL ECONOMY OF RUSSIAN OIL (Devid Lane ed. 1999), 15, 24 (Exhibit RME-21).

41 Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1731, 1736-37 (Exhibit RME-24); Jeanne Whalen, *Shareholders Rights: Round 2*, Moscow Times (February 17, 1998) (Exhibit RME-109).

47. Engaging in actions designed to beggar Yukos' subsidiaries and their minority shareholders, the Oligarchs also abused their majority control over Yukos' subsidiaries to appropriate 100% of the subsidiaries' wealth. Yukos illegally forced the subsidiaries to sell oil to the holding company at prices well below even the low domestic rates for oil in Russia. Yukos then turned around and sold this oil abroad at international market rates through trading companies. It then stashed its ill-gotten profits in offshore accounts free from claims of the subsidiaries' minority shareholders and Russia's tax authorities.[42]

48. Mr. Khodorkovsky and his associates also pledged this cheaply acquired oil, but at the much higher export prices, to Western lenders, including Goldman Sachs, Merrill Lynch, and Credit Lyonnais, in exchange for hundreds of millions of dollars in loans in late 1997.[43] Through these mechanisms, Menatep looted Yukos' subsidiaries, exploiting them as cost centers while reaping huge gains for itself.

49. Thus, in 1996, YNG and Samaraneftegaz lost US$ 345 million, while Yukos reported a consolidated after-tax profit of US$ 91.5 million. At YNG alone that year, Menatep's fraudulent transfer pricing caused around US$ 195 million in losses.[44] Moreover, Yukos stripped additional assets from its subsidiaries, such as shares in other companies, at knockdown prices.[45] It has been estimated that, from 1997 to 1998, Yukos deprived its production subsidiaries of assets with a book value of around US$ 3.5 billion.[46] Consequently, between January 30, 1997 and January 30, 1998, the share prices of

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42 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 446-47 (Exhibit RME-4); Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1769-70 (Exhibit RME-24); *see also* Kraakman Report, ¶¶ 39-41 (discussing, *inter alia*, internal Yukos correspondence showing legal violations with respect to oil purchases from subsidiaries).

43 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 398-99 (Exhibit RME-4).

44 Nat Moser & Peter Oppenheimer, *The Oil Industry: Structural Transformation and Corporate Governance, in* RUSSIA'S POST-COMMUNIST ECONOMY (Brigitte Granville & Peter Oppenheimer eds. 2001), 301, 316 (Exhibit RME-25).

45 *Ibid*.

46 Lee S. Wolosky, *Putin's Plutocrat Problem*, Foreign Affairs, Vol. 79, No. 2 (Mar./Apr. 2000), 18, 23 (Exhibit RME-26).

YNG and Samaraneftegaz dropped by 30% and 45% respectively, while Yukos' share price increased by 185%.[47]

50. The Oligarchs also mortgaged Yukos' assets in order to continue their quest for even more control over Russia's oil industry. To help finance the acquisition of Tomskneft's parent company Eastern Oil Company, the Oligarchs obtained loans from international banks — including Germany's West Merchant Bank, Japan's Daiwa Bank, and South Africa's Standard Bank – pledging over 30% of Yukos' shares to these banks in exchange for a US$ 236 million loan to Bank Menatep.[48] Menatep also secured a US$ 30 million loan from Banque Commerciale de l'Europe du Nord ("BCEN") by pledging more than 59 million Yukos shares.[49]

51. By early 1999, resistance among the production subsidiaries' minority shareholders to the Oligarchs' enrichment at the expense of those minority shareholders drove Menatep to embark on an even more audacious scheme to deprive the minority shareholders of the value of their investments and to gain unquestioned control over Yukos and its subsidiaries. Not even an order by Russia's Federal Securities Commission in 1998, requiring the reversal of unlawfully adopted decisions that facilitated the transfer of assets from subsidiaries to the Yukos holding company, could deter the Oligarchs from their systemic abuse of minority investors.[50]

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47 Nat Moser & Peter Oppenheimer, *The Oil Industry: Structural Transformation and Corporate Governance, in* RUSSIA'S POST-COMMUNIST ECONOMY (Brigitte Granville & Peter Oppenheimer eds. 2001), 301, 316 (Exhibit RME-25).

48 *See* Alan Cullison, *Vanishing Act: How Oil Giant Yukos Came to Resemble an Empty Cupboard*, Wall St. J. Europe (July 15, 1999) (Exhibit RME-27); DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 399 (Exhibit RME-4).

49 *See* Letter from BCEN affiliate and depositary JSB Finance to CJSC M-Reestr (Exhibit RME-28); Letter from BCEN counsel Freshfields Deringer to a Mr. Levinson of Menatep (Nov. 23, 1998) (Exhibit RME-29); Explanation of the BCEN loan and pledge structure faxed by Alexei Golubovich, finance director of Yukos (fax address is Yukos Oil Corporation) on Sept. 20, 1999 (Exhibit RME-30).

50 *See* Jeanne Whalen, *FSC Cracks Down on Yukos, Sidanko*, Moscow Times (Feb. 19, 1998) (Exhibit RME-31); Lee S. Wolosky, *Putin's Plutocrat Problem*, Foreign Affairs, Vol. 79, No. 2 (Mar./Apr. 2000), 23 (Exhibit RME-26).

52. Further fueling Menatep's lawlessness was the prospect that additional minority shareholdings might be forced upon Yukos following the 1998 financial crisis and Bank Menatep's subsequent collapse. Mr. Khodorkovsky and his associates risked losing more than 30% of Yukos to foreign creditors after Bank Menatep defaulted on its US$ 236 million loan from West Merchant Bank, Daiwa Bank, and Standard Bank; they also risked losing the millions of shares Bank Menatep had pledged to BCEN.[51]

53. What followed was a "*theft so blatant and extreme as to defy simple explanation*,"[52] through which the Oligarchs squeezed out unwelcome minority shareholders in both Yukos and its subsidiaries.

54. First, at extraordinary general shareholder meetings (EGMs) held by each production subsidiary in March 1999, Yukos illegally forced through a set of fraudulent and corrupt measures designed to inflict maximum damage on the rights of minority shareholders through share dilution, asset stripping, and transfer pricing that favored Yukos at the subsidiaries' expense.[53]

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51 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 446 (Exhibit RME-4); Letter from Hans Henning Offen, Westdeutsche Landesbank, to M.B. Khodorkovsky (June 24, 1999) (Exhibit RME-32); Letter from BCEN counsel Freshfields Deringer to a Mr. Levinson of Menatep (Nov. 23, 1998) (Exhibit RME-29); Explanation of the BCEN loan and pledge structure faxed by Alexei Golubovich, finance director of Yukos (fax address is Yukos Oil Corporation) on Sept. 20, 1999 (Exhibit RME-30). In the throes of the economic crisis, Menatep not only invented illegal schemes to frustrate Western creditors, it also defrauded ordinary Russians who deposited money and held accounts at the bank. Fearing a run on the bank by account holders, Mr. Khodorkovsky and his associates transferred all of Menatep's assets to a new entity, Menatep St. Petersburg, which they controlled. Bank Menatep was left an empty shell without any funds to pay its depositors, a situation exacerbated by Bank Menatep's blocking of all withdrawals and payments. A truck containing the bulk of Bank Menatep's records was driven into a river and never recovered. *See* Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1754-55 (Exhibit RME-24); Paul Klebnikov, *The Oligarch Who Came in From the Cold*, Forbes (Mar. 18, 2002) (Exhibit RME-34); Alan Cullison, *Vanishing Act: How Oil Giant Yukos Came to Resemble an Empty Cupboard*, Wall St. J. Europe (July 15, 1999) (Exhibit RME-27).

52 James Fenkner & Elena Krasnitskaya, Troika Dialog, *How To Steal an Oil Company*, *in* CORPORATE GOVERNANCE IN RUSSIA: CLEANING UP THE MESS (1999), 93 (Exhibit RME-35).

53 *See* Kraakman Report, ¶¶ 44-62; Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24); Nat Moser & Peter Oppenheimer, *The Oil Industry: Structural Transformation and Corporate Governance, in* RUSSIA'S POST-COMMUNIST ECONOMY (Brigitte Granville & Peter Oppenheimer eds. 2001), 301, 317 (Exhibit RME-25); James Fenkner & Elena Krasnitskaya,

55. These measures included issuances of millions upon millions of new shares in each production subsidiary to obscure offshore entities linked to Group Menatep, to be paid for by them with promissory notes (known as "veksels") from other production subsidiaries. The issuance of these new shares diluted minority interests in YNG, Samaraneftegaz, and Tomskneft, respectively, by 194%, 239%, and 243%.[54] Further, the new issuances were made at prices "*that valued the companies at 1% or less of their true value, and perhaps 10% of their depressed trading prices*."[55] The size of the issuances would "*transfer control from Yukos to the offshore entities*."[56]

56. The Oligarchs set up the offshore entities that were to acquire the new shares at these fraudulent prices in a variety of jurisdictions, including the Bahamas, Ireland, the Isle of Man, Cyprus, the British Virgin Islands, the Marshall Islands, and Niue.[57] Moreover, in order to subvert legal limitations on interested party transactions that would have required approval by supermajorities of the subsidiaries' shareholders if the relationships between Yukos and the offshore entities were disclosed, supermajorities that the Oligarchs

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Troika Dialog, *How To Steal an Oil Company*, *in* CORPORATE GOVERNANCE IN RUSSIA: CLEANING UP THE MESS (1999), 94 (Exhibit RME-35); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73 (Exhibit RME-23); DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 448-449 (Exhibit RME-4).

54 *See* Press Release, Acirota Limited, Three Days in March Are Critical for Russia's Oil Sector, Yukos Prepares Final Blows to Shareholders of Major Oil Producers (Mar. 15, 1999), 2-3 (Exhibit RME-36); *see also* OAO Yuganksneftegaz Board of Directors, Materials for the Board Meeting on Feb. 26, 1999, 5 (Exhibit RME-37); Minutes No. 1 of the OAO Yuganksneftegaz Extraordinary General Shareholders Meeting, March 30, 1999, 8-11 (Exhibit RME-38); Minutes No. 1 of the OAO Samaraneftegaz Extraordinary General Shareholders Meeting, March 23, 1999, 8-11 (Exhibit RME-39); Minutes No. 9 of the OAO Tomskneft Extraordinary General Shareholders Meeting, March 16-29,1999, 7-10 (Exhibit RME-40); Hermitage Capital Management, Illustrations of Proposed Yuganskneftegaz Share Issuance Scheme Based on Yuganskneftegaz Board of Directors Meeting Materials of Feb. 26, 1999, 2 (Exhibit RME-41). Hermitage Capital represented minority shareholders in Yuganskneftegaz.

55 Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24).

56 *Ibid.*

57 *See* Press Release, Acirota Limited, Three Days in March Are Critical for Russia's Oil Sector, Yukos Prepares Final Blows to Shareholders of Major Oil Producers (Mar. 15, 1999), 2-3 (Exhibit RME-36); David Hoffman, *Out of Step with Russia?; Outsider's Battle Over Stake in Oil Giant Offers a Glimpse of Nation's Uncertain Capitalist Ways*, Wash. Post (Apr. 18, 1999) (Exhibit RME-42).

knew they could not achieve, they attempted to shroud their control over these entities in secrecy,[58] but nonetheless the evidence of that control is unmistakable.

57. For example, at least two of the offshore companies that were to receive the new share issuances — Thornton Services Ltd. and Brahma Ltd. of the Isle of Man — had links to the offshore services company Valmet and its chief executive Peter Michael Bond, as well as links to Claimant YUL, which was founded by Scaan Limited ("Scaan") and Fovarranne Limited ("Fovarranne"),[59] two Isle of Man companies owned by Mr. Bond.[60] Menatep owned 20% of Valmet's parent company[61] and also used Valmet to implement its fraudulent transfer pricing schemes through a complex maze of additional shell companies.[62]

58. Further, Mr. Bond — who was listed as a YUL director in its amended annual return dated September 24, 1998, to be replaced by Messrs. Khodorkovsky and Lebedev by the time of the September 1999 annual return[63] — administered both Thornton Services and Brahma as of September 1999.[64]

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58 *See* Kraakman Report, ¶¶ 53-57; DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 449 (Exhibit RME-4); James Fenkner & Elena Krasnitskaya, Troika Dialog, *How To Steal an Oil Company*, *in* CORPORATE GOVERNANCE IN RUSSIA: CLEANING UP THE MESS (1999), 93 (Exhibit RME-35); Alan Cowell & Edmund L. Andrews, *Undercurrents at a Safe Harbor; Isle of Man (and Corporations) Is an Enclave of Intrigue*, N.Y. Times (Sept. 24, 1999) (Exhibit RME-43).

59 *See* Credof Limited, Certificate of Incorporation (Sept. 24, 1997) (Exhibit RME-206). The company's original name changed from "Credof Limited" to "Yukos Universal Limited" on (Oct. 20, 1997). *See* Special Resolution of Yukos Universal Limited (formerly Credof Limited) (Oct. 20, 1997) (Exhibit RME-207).

60 Scaan and Fovarranne were incorporated on January 23, 1990 (*see* Certificate of Incorporation of Scaan Limited (Jan. 23, 1990) (Exhibit RME-208) and Certificate of Incorporation of Fovarranne Limited (Jan. 23, 1990) (Exhibit RME-209)), by Mr. Bond acting on his behalf and on behalf of Riggs Valmet Isle of Man Limited (*see* Mr. Bond's signature on the Memorandum of Association of Scaan (Jan. 17, 1990), (Exhibit RME-124)).

61 *See* Alan Cowell & Edmund L. Andrews, *Isle of Man (and Corporations) Is an Enclave of Intrigue*, N.Y. Times (Sept. 24, 1999) (Exhibit RME-43).

62 *See*, *e.g.*, ¶¶ 81-98 *infra*.

63 Yukos Universal Limited, 1998 Annual Return (Exhibit RME-44); Yukos Universal Limited, 1999 Annual Return (Exhibit RME-45); Yukos Universal Limited, Notice of Change of Directors or Secretaries (July 16, 1999) (Exhibit RME-110).

64 *See* Alan Cowell & Edmund L. Andrews, *Isle of Man (and Corporations) Is an Enclave of Intrigue*, N.Y. Times (Sept. 24, 1999) (Exhibit RME-43).

Valmet employee and former Yukos Universal secretary Iain Gardiner (also a director of Fovarranne and Scaan[65]) was a founding director of Brahma, and served as secretary and director of Thornton Services as of July 30, 1999,[66] and Valmet officers Patrick David Donnelly (also a director of Fovarranne and Scaan[67]) and Ian James Plummer (also a director of Fovaranne and Scaan, as well as YUL and other Yukos affiliates[68]) also held positions in the companies.[69]

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65 Notices of Change of Directors or Secretaries or in their Particulars of Fovarranne Limited (May 9, 1997 and July 12, 2002) (Exhibit RME-46); Notices of Change of Directors or Secretaries or in their Particulars of Scaan Limited (May 9, 1997 and July 16, 2002) (Exhibit RME-47).

Mr. Gardiner also appears as a director of a number of other Yukos- and Valmet-related companies, including: (i) Yukos Supply & Trading Limited (formerly Yukos Brokerage Limited *(see* Statement of First Directors and secretary and intended situation of registered office and Notices of Change of directors or secretaries or in their particulars of Yukos Supply & Trading Limited (formerly Yukos Brokerage (IOM) Limited and Yukos Brokerage Limited) (Sep. 25, 1998 and Mar. 17, 1999) (Exhibit RME-48); Certificates of Change of Name of Yukos Supply & Trading Limited (formerly Yukos Brokerage (IOM) Limited and Yukos Brokerage Limited) (May 7, 1999) (Exhibit RME-49)); (ii) Valmet Nominees Limited (formerly Riggs Valmet Nominees Limited) (*see* Notice of Change of directors or secretaries or in their particulars of Valmet Nominees Limited (formerly Riggs Valmet Nominees Limited) (May 9, 1997 and July 18, 2002) (Exhibit RME-50); Certificate of Change of Name of Valmet Nominees Limited (formerly Riggs Valmet Nominees Limited) (Sept. 25, 1995) (Exhibit RME-51)); (iii) Pegasus Ireland Limited (formerly Valmet Ireland Limited) (*see* Notices of Change of directors or secretaries or in their particulars of Pegasus Ireland Limited (formerly Valmet Ireland Limited) (May 9, 1997 and July 16, 2002) (Exhibit RME-52); Certificate of Change of Name of Pegasus Ireland Limited (formerly Valmet Ireland Limited) (Jan. 7, 2005) (Exhibit RME-53)); (iv) Mutual Trust Management (Mauritius) Services Limited (formerly Valmet (Mauritius) Services Limited) (*see* Notice of Change of directors or secretaries or in their particulars of Mutual Trust Management (Mauritius) Services Limited (formerly Valmet (Mauritius) Services Limited) (May 9, 1997) (Exhibit RME-54); Certificate of Change of Name of Mutual Trust Management (Mauritius) Services Limited (formerly Valmet (Mauritius) Services Limited) (Oct. 2, 2001) (Exhibit RME-55)); and (v) Mutual Trust Management (Mauritius) Nominees Limited (formerly Valmet Mauritius Nominees Limited) (*see* Notice of Change of directors or secretaries or in their particulars of Mutual Trust Management (Mauritius) Nominees Limited (formerly Valmet (Mauritius) Nominees Limited) (May 9, 1997) (Exhibit RME-56); Certificate of Change of Name of Mutual Trust Management (Mauritius) Nominees Limited (formerly Valmet (Mauritius) Nominees Limited) (Oct. 2, 2001) (Exhibit RME-57)).

66 *See* Brahma Limited, Company Filings, July 2, 1998 (Exhibit RME-58); Thornton Services, Company Filings, Aug. 10, 1999 and Aug. 26, 1999 (Exhibit RME-59).

67 Notices of Change of Directors or Secretaries or in their Particulars of Fovarranne Limited (Feb. 8, 1999 and June 18, 2002) (Exhibit RME-46); Notices of Change of Directors or Secretaries or in their Particulars of Scaan Limited (Feb. 4, 1999 and June 20, 2002) (Exhibit RME-47).

68 *See* Statements of First Directors and secretary and intended situation of registered office of Yukos Universal Limited (Sep. 19, 1997) (Exhibit RME-60); Notices of Change of Directors or Secretaries or in their Particulars of Fovarranne Limited (Aug. 10, 1995 and Jan. 11, 2002)

59. Notably, in 2004, Mr. Bond, Mr. Donnelly, Mr. Gardiner, and Mr. Plummer were all disqualified from holding corporate offices by the Financial Supervision Commission of the Isle of Man, based on findings that they were unfit to serve.[70]

60. Additionally, another of the offshore entities — Wilk Enterprises Limited of Cyprus — was part of a group known as Russian Investors Group. Wilk Enterprises was owned by a Cyprus company named Sequential Holdings Russian Investors Limited, which itself was owned by a company named Russian Investors Group Limited in the Bahamas.[71] The directors of Sequential Holdings Russian Investors as of June 1998 included Yukos Finance Director Alexei Golubovich, an assistant to Mr. Khodorkovsky named Vladimir Moiseev, and one-time Valmet Director Felix Pole.[72] Previous shareholders of this company included Menatep Finance S.A. and Menatep S.A.[73]

61. But breathtaking degrees of share dilution by sales of shares to obscure Menatep affiliates were not the only means by which the Oligarchs destroyed the value of minority shareholdings in Yukos' production subsidiaries in the measures that they forced upon these subsidiaries at their March 1999

(Exhibit RME-46); and Notices of Change of Directors or Secretaries or in their Particulars of Scaan Limited (Aug. 10, 1995 and Jan. 11, 2002) (Exhibit RME-47)).

Mr. Plummer also appears as a director of a number of other Yukos- and Valmet-related companies, including: (i) Riggs Valmet Nominees Limited (*see* Notice of Change of directors or secretaries or in their particulars of Valmet Nominees Limited (formerly Riggs Valmet Nominees Limited) (Sep. 6, 2001 and Dec. 17, 2001) (Exhibit RME-50)); and (ii) Yukos Supply & Trading Limited (formerly Yukos Brokerage Limited) (*see* Notices of change of directors or secretaries or in their particulars of Yukos Supply & Trading Limited (formerly Yukos Brokerage (IOM) Limited and Yukos Brokerage Limited) (Mar. 1, 1999 and July 25, 1999) (Exhibit RME-48); Certificates of Change of Name of Yukos Supply & Trading Limited (formerly Yukos Brokerage (IOM) Limited and Yukos Brokerage Limited) (May 7, 1999) (Exhibit RME-49)).

69 *See* Brahma Limited, Company Filings, July 2, 1998 (Exhibit RME-58); Thornton Services, Company Filings, Aug. 10, 1999 and Aug. 26, 1999 (Exhibit RME-59).

70 Disqualification Orders under § 26 of the Companies Act 1992 -- F.S.C. Press Release (Nov. 19, 2004) (Exhibit RME-61).

71 *See* Russian Investors Group, Company Profile, 16 (Exhibit RME-62).

72 *See* Company search for Sequential Holdings Russian Investors (June 26, 1998) (Exhibit RME-63).

73 *See ibid.* (Exhibit RME-63).

EGMs. The packet of proposals for these meetings also included both the retroactive approval of past oil sales to Yukos and its affiliates, and a continuing obligation to make future oil sales to Yukos and its affiliates, at RUB 250 per ton, or about US$ 1.5 per barrel, well below cost.[74]

62. With the ruble expected to continue depreciating against the dollar, this multiyear price fixing, stretching back to 1997 and forward to 2002, would help Menatep cover-up its prior looting of the Yukos subsidiaries, while ensuring that it could continue to loot them at an even more profitable rate in the future.[75] Similarly, the proposals contained resolutions approving major past and unidentified future asset transfers from the subsidiaries to other obscure daughter companies of the subsidiaries, allowing the Oligarchs to further exploit the subsidiaries.[76]

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74 *See* Press Release, Acirota Limited, Three Days in March Are Critical for Russia's Oil Sector; Yukos Prepares Final Blows to Shareholders of Major Oil Producers (Mar. 15, 1999), 2 (Exhibit RME-36); James Fenkner & Elena Krasnitskaya, Troika Dialog, *How To Steal an Oil Company*, *in* CORPORATE GOVERNANCE IN RUSSIA: CLEANING UP THE MESS (1999), 93-94 (Exhibit RME-35); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73 (Exhibit RME-23); Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24); *see also* OAO Yuganksneftegaz Board of Directors, Materials for the Board Meeting on Feb. 26, 1999, 15, 17 (Exhibit RME-37); Minutes No. 1 of the OAO Yuganksneftegaz Extraordinary General Shareholders Meeting, March 30, 1999, 16-20 (Exhibit RME-38); Minutes No. 1 of the OAO Samaraneftegaz Extraordinary General Shareholders Meeting, March 23, 1999, 16-19 (Exhibit RME-39); Minutes No. 9 of the OAO Tomskneft Extraordinary General Shareholders Meeting, March 16-29,1999, 13-15 (Exhibit RME-40).

75 *See* James Fenkner & Elena Krasnitskaya, Troika Dialog, *How To Steal an Oil Company*, *in* CORPORATE GOVERNANCE IN RUSSIA: CLEANING UP THE MESS (1999), 93-94 (Exhibit RME-35); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73 (Exhibit RME-23); Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24).

76 *See* Kraakman Report, ¶ 46; Press Release, Alcirota Limited, Three Days in March Are Critical for Russia's Oil Sector Yukos Prepares Final Blows to Shareholders of Major Oil Producers (Mar. 15, 1999), 2-3 (Exhibit RME-36); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73 (Exhibit RME-23); Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24); *see also* OAO Yuganksneftegaz Board of Directors, Materials for the Board Meeting on Feb. 26, 1999, 14 (Exhibit RME-37); Minutes No. 1 of the OAO Yuganksneftegaz Extraordinary General Shareholders Meeting, March 30, 1999, 20-25 (Exhibit RME-38); Minutes No. 1 of the OAO Samaraneftegaz Extraordinary General Shareholders Meeting, March 23, 1999, 19-23 (Exhibit RME-39); Minutes No. 9 of the OAO

63. Minority shareholders who objected to these plans to strip the subsidiaries of their value were offered the opportunity to sell their shares to the company at fraudulent prices that valued the three subsidiaries, which had about 13 billion barrels of oil in proven oil and gas reserves, at a total of US$ 33 million — a mere US$ 0.0025 per barrel of proven reserves.[77]

64. But that was not all. The Oligarchs also wielded even cruder, virtually cartoonish weapons to defraud minority shareholders and rob them of the value of their shares. When representatives from the largest minority shareholders attempted to attend the EGMs, they were refused entry on the ground that a provincial court had arrested their shares. The minority shareholders had received no notice of any such order or the complaint on which it purportedly was based, and in at least one case were turned away by an armed guard.[78] At another shareholder meeting several months later, the minority shareholders arrived at the appointed meeting place in Moscow, only to find a notice that the meeting had been relocated to a town hundreds of kilometers away and would begin in two hours; when some of the minority shareholders finally reached the new location, they found an empty room and were told the meeting had ended.[79]

Tomskneft Extraordinary General Shareholders Meeting, March 16-29,1999, 15-17 (Exhibit RME-40).

77 Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1770 (Exhibit RME-24); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 73 (Exhibit RME-23).

78 *See* Press Release, Misoki Enterprises Limited, Major Russia Assets Are Seized Illegally (Mar. 30, 1999) (Exhibit RME-64); Alan S. Cullison, *Russian Firm Bars Minor Holders, Passes Contentious Share Increase*, Wall St. J. (Mar. 24, 1999) (Exhibit RME-65); Floyd Norris, *The Russian Way of Corporate Governance*, N.Y. Times (Apr. 5, 1999) (Exhibit RME-66); David Hoffman, *Out of Step with Russia?; Outsider's Battle Over Stake in Oil Giant Offers a Glimpse of Nation's Uncertain Capitalist Ways*, Wash. Post (Apr. 18, 1999) (Exhibit RME-42); Ben Aris, *Khodorkovsky – the Making of a Myth*, Business News Europe (Sept. 6, 2010) (Exhibit RME-67).

79 *See* Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in* OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow (Feb. 24-25, 2000), 74 (Exhibit RME-23); DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 450 (Exhibit RME-4).

65. By banishing minority shareholders and maintaining the fraud that the offshore companies to which so much value would be transferred were not connected to the Oligarchs, they ensured the passage of their self-aggrandizing share dilution, asset stripping, and unlawful transfer pricing schemes.[80]

66. Minority shareholders in the subsidiaries fought valiantly against Menatep's plans to dilute their shares and misappropriate the value of their investments. By obtaining injunctions in the offshore companies' jurisdictions, they were able to block at least some, if not all, from acquiring the newly issued shares.[81] Illustrative of Menatep's disregard for the law, an Isle of Man court expressed "*doubts . . . about the identity of the shareholders and directors*" of Thornton Services — one of the "*shell*" companies whose "*only identifiable business would have been to subscribe for and acquire shares in Yuganskneftegaz*" — and found that it had provided "*misleading information*" about the company's directors.[82]

67. But the Oligarchs were deterred neither by court injunctions abroad nor by an investigation into their misconduct that was launched by the Russian Federal Securities Commission ("FSC") under the leadership of Dmitry Vasiliev. The treatment by the Oligarchs of Mr. Vasiliev in retaliation for his investigation offers another window into the Oligarchs' disregard for the law.

68. Yukos responded with a direct attack against Mr. Vasiliev, alleging that he had submitted to lobbying by Kenneth Dart, an American minority shareholder of Yukos' production subsidiaries, and warning that it would "*put an end to the practice of lobbying in the interest of unscrupulous foreign investors*."[83] When Mr. Vasiliev refused to support Yukos in its attempt to squeeze out Mr.

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80 *See* Kraakman Report, ¶¶ 38-42, 44-62.

81 *See* Alan. S. Cullison, *Russian Oil Concern's Share Issues Blocked in Win for Some Investors*, Wall St. J. (June 25, 1999) (Exhibit RME-68); *see also* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 453 (Exhibit RME-4).

82 *See* High Court of Justice of the Isle of Man, Chancery Division, *Misoki Enters. Ltd. v. Thornton Servs. Ltd. & Brahman Ltd.*, Judgment of November 12, 1999, 12-13 (Exhibit RME-69).

83 Alan S. Cullison, *Russian Watchdog Sues Oil Giant, Seeks Probe of Share Shufflings*, Wall St. J., July 22, 1999, A22 (Exhibit RME-70). Conveniently for Menatep, a truck carrying 607 boxes of Menatep documents also plunged into the Dubna River. *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 452 (Exhibit RME-4).

Dart, Yukos' senior management, including Messrs. Khodorkovsky and Nevzlin, "*decided to show to Vasiliev compromising materials collected by the security service, to threaten him that it would be used and Prosecutor's office was mentioned; it was Khodorkovsky's decision, which allowed Nevzlin to do this.*"[84] Among the various pressure tactics used to obstruct the FSC's work, Yukos also filed a criminal complaint against Mr. Vasiliev for slander.[85]

69. The FSC, lacking in both staff and resources to pursue Menatep's persistent and pervasive frauds, ultimately registered the millions upon millions of shares issued by at least two of Yukos' production subsidiaries to the offshore entities controlled by the Oligarchs.[86] Mr. Vasiliev resigned in protest in October 1999.[87]

70. The Oligarchs likewise wielded improper influence over the Russian Duma to advance their own economic interests. Vladimir Dubov, who held high level positions at Yukos and was one of Group Menatep's principal owners — and notably has submitted a witness statement on Claimants' behalf in these proceedings — served as a Chairman of the Tax Sub-Committee of the Russian Duma after the December 1999 Duma elections. In addition to Dubov's control over tax issues, the budget committee had "*practically turned into a structural sub-unit of Yukos*."[88] Following the 1999 elections, approximately 100 Deputies, many of whom had leadership positions, were "'*under arms' for Yukos*," alone, according to Duma lobbyists.[89] Yukos' influence was so pervasive that

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84 *See* Extract of Protocol of Interrogation, A. D. Golubovich, Dec. 12, 2006, 6 (Exhibit RME-71); *see also* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 453, 455 (Exhibit RME-4) (recounting, similar to Mr. Golubovich, that a Yukos vice president warned Mr. Vasiliev to stop proceeding against Yukos in a private meeting, indicating that Yukos would do everything in its power to block the FSC.

85 *See* DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 455 (Exhibit RME-4).

86 *See ibid.*, 453-56 (Exhibit RME-4).

87 Neela Banerjee, *Frustrated, Russian Securities Regulator Resigns*, N.Y. Times (Oct. 16, 1999) (Exhibit RME-72).

88 RICHARD SAKWA, THE QUALITY OF FREEDOM (2009), 114 (quoting Natal'ya Arkhangel'skaya, *Dumskaya monopol'ka*, Ekspert, No. 3, Jan. 26, 2004) (Exhibit RME-73).

89 Vladimir Perekrest, *Why Khodorkovsky is in jail (Part 3)*, Izvestiya, June 7, 2006, 2. (Exhibit RME-74).

former Speaker of the State Duma, Gennady Seleznev, remarked that "*[w]hen bills affecting YUKOS's interest were discussed in the Duma, I had the impression that there were 250 [Vladimir] Dubovs in the Chamber*" — more than a majority.[90] Yukos used this power to shape government policies in its favor.[91]

71. Bank lenders to which Yukos shares had been pledged were no safer from Menatep's fraudulent machinations than were the minority shareholders in the production subsidiaries. The Oligarchs transferred Yukos' remaining shares in two of the three subsidiaries to offshore companies, leaving the holding company's creditors and potential minority shareholders — including the pledgee banks — with interests in an empty shell containing little more than debt. Of course, the offshore companies to which Mr. Khodorkovsky and his associates transferred these shares had ties to Menatep.[92]

72. Further, in a fax dated September 20, 1999, Yukos Finance Director Alexei Golubovich proposed the option of creating a Yukos-controlled, non-resident third party entity that could repurchase the millions of Yukos shares that had been pledged to BCEN.[93]

73. Indeed, the Oligarchs would stop at nothing to prevent Yukos' creditors-turned-minority shareholders from having a say in running Yukos, particularly because at least one of them — WestLB, parent of West Merchant — questioned both Yukos' abuses of its subsidiaries' minority shareholders and

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90 *Ibid*.

91 RICHARD SAKWA, THE QUALITY OF FREEDOM (2009), 114 (Exhibit RME-73). For example, Yukos arranged for amendments of the law on production sharing agreements, which regulated the participation of foreign companies in the production of Russian oil to ensure that it would have access to the best oilfields.

92 *See* Kraakman Report, ¶¶ 43-45, 64-65; Alan S. Cullison, *Yukos Transfers Two Oil Units to Offshore Firms – Move Angers Banks with 30% Share*, Wall St. J. (June 4, 1999) (Exhibit RME-75); Alan. S. Cullison, *Vanishing Act: How Oil Giant Yukos Came To Resemble an Empty Cupboard*, Wall St. J. Europe (July 15, 1999) (Exhibit RME-27); *see also* Yuganksneftegaz Quarterly Report for the First Quarter of 1999, at 6, 7, 36 (Exhibit RME-76); Yuganksneftegaz Quarterly Report for the Second Quarter of 1999, at 55, 56, 62 (Exhibit RME-77); Samaraneftegaz Quarterly Report for the First Quarter of 1999, at 5, 20 (Exhibit RME-78); Samaraneftegaz Quarterly Report for the Second Quarter of 1999, at 83, 84 (Exhibit RME-79).

93 *See* Explanation of the BCEN loan and pledge structure faxed by Alexei Golubovich, finance director of Yukos (fax address is Yukos Oil Corporation) on Sept. 20, 1999 (Exhibit RME-30).

Yukos' use of complex offshore vehicles of unknown origin and purpose for improper transfer pricing schemes, such as the Jurby Lake Structure discussed below.[94]

74. Furthering the Oligarchs' scheme to drive out minority shareholders and reclaim Yukos stock at artificially low prices, Yukos did not provide required financial disclosure documents to the FSC. As a result, trading in Yukos shares was suspended for approximately one year in the summer of 1999, resulting in a drastic devaluation of their shares, which insiders such as the Oligarchs could then reacquire for a small percentage of their actual value.[95]

75. Ultimately, the unrelenting pressure stemming from the full panoply of illegal schemes that the Oligarchs employed forced minority shareholders in Yukos' production subsidiaries to sell or swap their stock on terms that were highly advantageous to the Oligarchs, while creditors that had accepted pledges of Yukos shares suffered tens of millions of dollars in losses.[96] Having consolidated Menatep's control over Yukos and its subsidiaries by employing the most draconian abuses, the Oligarchs then wrote the final chapter in this massive fraud by cancelling the new share issuances and offshore asset

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94 *See* ¶¶ 81-98, *infra*.; Letter from Hans Henning Offen, Westdeutsche Landesbank, to M.B. Khodorkovsky (June 24, 1999) (Exhibit RME-32) (noting that Yukos' actions would "shift ownership of the entire Yukos production base from Yukos to the relevant offshore companies," which "would all but destroy the value of our shareholding in Yukos"); Kraakman Report, ¶¶ 31-40 (discussing Yukos' dismissive response); Fax from Ulrich Zierke, WestLB, to a Mr. Kurakin at Yukos (July 15, 1999) (Exhibit RME-80) (requesting information about, *inter alia*, the beneficiaries of offshore companies, and asking for an emergency shareholder meeting to vote on their continuing use).

95 *See* Letter from D.E. Bobrov of the RTS Trading System to Yukos Securities Department (July 1, 1999) (Exhibit RME-81); Letter from A.M. Sarachev of the Moscow Interbank Currency Exchange to S.V. Muravlenko, General Director of Yukos (July 5, 1999) (Exhibit RME-82).

96 *See* Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1771, n.71 (Exhibit RME-24); Oleg Fedorov, 3 Cases on Abusive Self-Dealing, *in OECD/World Bank Corporate Governance Roundtable for Russia, Shareholders Rights and Equitable Treatment, Moscow* (Feb. 24-25, 2000), 75-76 (Exhibit RME-23); DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 456-57 (Exhibit RME-4); Alan. S. Cullison, *Vanishing Act: How Oil Giant Yukos Came To Resemble an Empty Cupboard*, Wall St. J. Europe (July 15, 1999) (Exhibit RME-27); Alan S. Cullison, *Yukos Cancels Controversial Share Issue*, Wall St. J. (Feb. 29, 2000) (Exhibit RME-83).

transfers,[97] thereby confirming they had been shams intended mainly to squeeze out minority shareholders in the first place. The Oligarchs had succeeded in achieving precisely this goal, consolidating the control over Yukos that they had originally acquired through fraud and corruption in the loans-for-shares program.

C. The Oligarchs Also Committed Fraud And Other Illegal Acts In Acquiring Their Shareholdings In Other Companies

76. The notorious Yukos loans-for-shares transactions were only one part of a broader program of outright theft masterminded by the Oligarchs and conducted by Bank Menatep and its affiliates. It is only because of the scale of the subsequent Yukos corruption and extortion that other such cases have received less public scrutiny. In fact, however, Bank Menatep engaged in systematic abuses of the Russian privatization program, as demonstrated by the fraudulent misappropriation of shares during the privatization of the Institute for Scientific Research on Fertilizers and Insectofungicides ("AO NIYIF") and OAO Apatit.

77. In 1995, Bank Menatep used two companies it secretly controlled as fronts to bid in the investment tender for a 44% stake in the state company AO NIYIF. As in the Yukos share auctions, the value of a prospective bidder's investment commitments would be determinative of the outcome of the tender. As in the Yukos auction, two the Bank Menatep fronts, AOZT Walton and AOZT Polinep, relied on guarantees from Bank Menatep to submit inflated investment commitments for AO NIYIF.

78. When AOZT Polinep withdrew from the bidding process, AOZT Walton won the auction by promising the next largest investment. But in violation of the Russian privatization law, and with the knowledge of Bank Menatep, Walton never intended to fulfill its investment obligations.[98] Rather,

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97 DAVID HOFFMAN, THE OLIGARCHS: WEALTH AND POWER IN THE NEW RUSSIA (2002), 547 n.23 (Exhibit RME-4); Alan S. Cullison, *Yukos Cancels Controversial Share Issue*, Wall St. J. (Feb. 29, 2000) (Exhibit RME-83).

98 *Case of Messrs. M.B. Khodorkovsky, P.L. Lebedev and A.V. Krainov*, Meshansky Court of Moscow, Verdict of May 16, 2005, 4, 7-8 (Exhibit RME-160).

Walton entered into a sham transaction to suggest that its investment had been made and then sold the shares of AO NIYIF, unburdened by any investment guarantees, to Oligarch-controlled entities.[99]

79. After the Federal Property Fund discovered the fraud in 1997, the Moscow Arbitrazh Court ruled that the transaction was void, but Menatep's criminality continued unabated.[100] In order to deprive the court's order of effect, the shares were transferred under the Oligarchs' direction to shell companies organized under a labyrinth of foreign and offshore holding entitles, thus rendering the shares unrecoverable. All of the shell companies involved in these fraudulent transactions had accounts with Bank Menatep.[101]

80. The Oligarchs also fraudulently misappropriated shares in OAO Apatit, again taking advantage of the chaotic conditions of post-Soviet Russia. As majority shareholders they restructured the company's management, thus allowing Mr. Khodorskovsky to direct a scheme whereby intermediate entities also controlled by him acquired Apatit products at below-market prices. The Oligarchs would then profit on the resale of these products at market prices to foreign companies.[102]

D. The Oligarchs' Fraudulent Pattern Of Siphoning Off Revenue And Profits From Yukos And Other Illegally Acquired Companies

1. Jurby Lake

81. In 1997, while fraudulently consolidating their holdings in Yukos, the Oligarchs set up the so-called "Jurby Lake Structure." The Jurby Lake Structure consisted of a group of offshore trading and investment holding

99 *Ibid.*, 11-12.

100 *Ibid.*, 12.

101 *Ibid.*, 13.

102 *Ibid.*, 14.

companies used by the Oligarchs to siphon off Yukos proceeds from the sale of oil and oil products for their own benefit.[103]

82. As Professor Kraakman describes in his report, evidence that the Oligarchs were skimming profits from Yukos appeared soon after they took control of the company. Continuous transfers of value out of Yukos are reflected in the fact that between US$3 and US$4 in gross revenue per barrel of oil disappeared from Yukos' books in 1996. Even if Menatep's obsessive secrecy and its web of offshore companies (which would come to include the Jurby Lake structure) make it difficult to track the lost revenue, the question remains: where did the money go?[104]

83. The companies that were part of the Jurby Lake Structure included: (i) Jurby Lake Limited ("Jurby"); (ii) Baltic Petroleum Trading Limited ("Baltic"); (iii) Behles Petroleum Limited ("Behles"); and (iv) South Petroleum Limited ("South").

84. Jurby, Baltic, Behles, and South were at all relevant times nominally owned and controlled by Peter Bond and his partners at the offshore services company Valmet who — as discussed at paragraphs 57 to 58 above — were also directors of Claimant YUL and key figures in the implementation of the fraudulent consolidation of the Oligarchs' holdings in Yukos.[105] In fact, all of the

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103 *See, e.g.*, Thomas Catan, *Before the Crash*, OffshoreNet (May 14, 2004) (Exhibit RME-120); Lucy Komisar, *Yukos Kingpin on Trial*, Corpwatch, (May 10, 2005) (Exhibit RME-121).

104 Bernard Black, Reinier Kraakman, & Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 Stan. L. Rev. (2000), 1731, 1736-37 (Exhibit RME-24); Jeanne Whalen, *Shareholders Rights: Round 2*, Moscow Times (February 17, 1998) (Exhibit RME-109).

105 Specifically:

(i) Jurby was incorporated in the Isle of Man on May 8, 1973 (Articles of Association of Jurby Lake Limited (May 8, 1973) (Exhibit RME-122)). On March 10, 1993, the totality of the issued share capital of Jurby was acquired by Scaan and Fovarranne (*see* ¶ 57 *supra*) (Annual Return of Jurby Lake Limited (Nov. 29, 1993) (Exhibit RME-123)), two Isle of Man companies owned by Mr. Bond (Memoranda of Association of Scaan and Fovarranne (Jan. 17, 1990) (Exhibit RME-124). At all relevant times, Mr. Bond and his partners at Valmet, including Messrs. Donnely, Gardiner, and Plummer (*see also* ¶ 58 *supra*), acted as directors of Jurby from (a) May 1, 1998 to September 16, 2003 (Mr. Bond); (b) February 2, 2002 to May 31, 2002 (Mr. Donnelly); (c) November 3, 1997 to July 16, 1998 (Mr. Gardiner); and (d) from March 26, 1999 to December 17, 2001 (Mr.

Yukos-related companies established and/or managed by these individuals, including YUL, were used as instruments for the Oligarchs' wrongdoing.[106] The Jurby Lake Structure was no exception.

85. The Jurby Lake Structure entailed sales of oil and oil products from Yukos and/or its producing subsidiaries (*e.g.*, YNG) to Behles (Switzerland), which in turn sold the oil to South (Gibraltar), and sales of oil products to Baltic (Ireland). South and Baltic ultimately sold the oil and oil products to third-party independent customers. The proceeds generated through these multiple sales and re-sales of oil and oil products were accumulated -- tax free -- in Baltic, Behles, and South, thanks to the favorable tax laws in the jurisdictions where they had been registered. Those proceeds were then transferred -- also tax free -- to

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Plummer) (*see* Notices of Change of Directors or Secretaries or in their Particulars of Jurby) (Exhibit RME-125);

(ii) Baltic was incorporated in Ireland on January 2, 1997 by Fovarranne (Certificate of Incorporation of Baltic; Exhibit RME-126), and was owned by Jurby and Mr. Bond (Baltic, Annual Return for Financial Year from January 2, 1997 to January 31, 1998; Exhibit RME-127). Baltic's directors included Valmet officers: (i) Mr. Bond, (ii) Mr. Plummer, (iii) Mr. Bean, and (iv) Christopher Samuelson (*see* Notices of Change of directors or secretaries or in their particulars of Baltic; Exhibit RME-128);

(iii) Behles was incorporated in Switzerland on January 10, 1972. Mr. Peter Levonovich, a Yukos' oil broker (*see* Transcript of the Brennan Trial (Mar. 13, 2001) 7:24 (Exhibit RME-129A), was a director of Behles from December 18, 1997 to December 18, 1998 (*see* Excerpt of Report of Behles Petroleum SA) (Nov. 17, 2010) (Exhibit RME-130). Behles shared the same office as Menatep S.A. in Geneva, Switzerland at 46 rue du Rhone (*see* Lucy Komisar, *Yukos Kingpin on Trial,* Corpwatch (May 10, 2005) (Exhibit RME-121); and

(iv) South was incorporated in Gibraltar on December 17, 1996 as "Yukos (International) Trading Limited" (Report of the Latest / Current Available Information on Company (Feb. 2, 2011) (Exhibit RME-131). South was owned by Valmet and another seemingly Valmet-related entity, Finsbury Nominees Limited, from March 16, 1998 to July 14, 1999, when the totality of South shares were transferred to Jurby (Annuals Return of South (Mar. 16, 1998 and Mar. 16, 2000) (Exhibit RME-132)). South too was managed by Mr. Bond and Valmet officers Messrs. Samuelson and Bransom Bean (Annual Return of South Petroleum Limited) (Exhibit RME-133).

Another company related to Jurby included Karran Tankers Limited ("Karran"), an Isle of Man company incorporated on June 8, 1998, by Scaan and Fovarranne (*see* Certificate of Incorporation and Articles of Association of Karran) (Exhibit RME-135) and (Exhibit RME-134). Karran was managed, *inter alia*, by Valmet officers Messrs. Gardiner (from June 5, 1998 to October 12, 1998) and Bean (from October 12, 1998 to October 9, 2001) (*see* Notices of Change of directors or secretaries or in their particulars of Karran) (Exhibit RME-136).

106 *See also* ¶¶ 97-98, 124 *infra*.

their Irish holding company, Jurby Lake, and ultimately diverted to the Oligarchs or their proxies in the guise of dividend distributions or other forms.[107]

86. Jurby Lake, Baltic, Behles, and South were formally unrelated to Yukos, and thus they were never consolidated in Yukos' financial statements. But the volume of Yukos' oil and oil products that flowed through Jurby Lake in 1997-1999 was so large that it attracted the attention of PwC, Yukos' own auditors.[108]

87. Specifically, PwC wanted to understand the relationships between Yukos and Jurby Lake and, in particular, whether Baltic, Behles, and South were "related" to Yukos. PwC's concern stemmed from the fact that, if the companies were related, Yukos was required to disclose its transactions with them as "related-party transactions" pursuant to applicable accounting standards.[109]

88. In that regard, PwC "*asked* […] *many times*"[110] whether Baltic, Behles and South were related to Yukos, and "*got confirmations from YUKOS management that these companies were not related parties.*"[111] Thus, for instance, in a letter addressed to PwC on May 24, 2002, Mr. Khodorkovsky and Bruce

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107 These abuses prompted Yukos' minority shareholders to seek clarifications about Yukos' operations with Baltic, Behles and South. *See*, *e.g.*, Letter from U. Zierke to B.E. Jurajin (Yukos Board) of July 15, 1999 (Exhibit RME-146).

108 As testified by Mr. Miller, PwC "*wanted to know about these companies, as at that time practically all the export oil was sold through them and we needed to have a confirmation that they were related parties of YUKOS.*" *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia. May 4, 2007), 14 (Exhibit RME-137).

109 That requirement stems from the fact that, "*[t]ransactions involving related parties typically are not conducted on an arm's length basis. Generally, all transactions and events reported in financial statements are presumed to be completed on an arm's length basis, unless otherwise indicated. Without disclosure of related party transactions, users of financial information may be misled to believe that such transactions are consummated on an arm 's length basis. Consequently, the Board* [*i.e.*, Financial Accounting Standard Board] *feels that financial reports are more complete and reliable if related party disclosures are required*" (Bill D. Jarnagin, U.S. Master GAAP Guide, 2004, 52-3; Exhibit RME-138). *See also* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia. May 4, 2007), 14, 15. (Exhibit RME-137).

110 Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia. May 4, 2007), 14 (Exhibit RME-137).

111 *Ibid*.

Misamore — Yukos' former Chief Financial Officer and a witness on behalf of Claimants in these proceedings — stated that:

> "[A]t December 31, 2001 and during the three-year period then ended, Behles Petroleum S.A., South Petroleum Limited, Baltic Petroleum Trading Limited […] were not related to [Yukos] under the provisions of Statement of Financial Accounting Standards No. 57, *Related Party Disclosure*."[112]

89. Messrs. Khodorkovsky and Misamore flatly lied.[113]

90. As a matter of fact, Baltic, Behles, and South were "*related*" to Yukos, insofar as, among other things, Yukos "*could take control*" of them at any time by "*exercising certain call options.*"[114] The affiliation between Yukos and Jurby Lake is confirmed by the minutes of a meeting held on June 1, 1999 between Mr. Bond, Mr. Bean (a Valmet partner and a director of Baltic, South, and Karran), Stephen Curtis (the Oligarchs' tax and corporate advisor[115]), and

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112 *See* ¶ 17 of the Letter from Yukos Oil Company to ZAO PricewaterhouseCoopers Audit (May 24, 2002) signed by M.B. Khodorkovsky and B.K. Misamore (Exhibit RME-139) [emphasis added].

113 Yukos' management, including Mr. Lebedev — Mr. Khodorkovsky's closest associate and a director of Claimants — made similarly untrue representations to PwC on various occasions. *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia. May 8, 2007, started at 15:56), 17, 18 (Exhibit RME-140).

114 *See, e.g., International Accounting Standard (IAS) 27.4 -- Consolidated and Separate Financial Statements, defining "control" as "the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities*" (International Accounting Standard (IAS) 27.4) (Exhibit RME-141). In that regard, according to IAS 27.14, "[a]*n entity may own* […] *share call options* […] *or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity.*" *See also* Statement of Financial Accounting Standards (SFAS) No. 57 (March 1982), 10 (Exhibit RME-142), defining "related parties" as including "*other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests*". For these purposes "*control*" shall mean "*the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an enterprise through ownership, by contract, or otherwise*." It is thus clear that Yukos and Jurby Lake were "related" and their transactions had to be disclosed as "related party" transactions.

115 Mr. Curtis, a London-based solicitor who had advised and/or set up most of the Oligarchs' international financial web, was killed in a helicopter crash following the appearance of press reports that he was about to disclose the Oligarchs' wrongdoing to British law enforcement

Peter Clucas (an Isle of Man corporate lawyer representing Valmet). Among other things, the purpose of the meeting was to discuss Jurby Lake and its potential development. A note of that meeting states as follows:

> "[Stephen Curtis] briefed [Peter Clucas] and the rest of the parties as to the background of the structure. [Stephen Curtis] said that there was initially one structure called 'Jurby Lake Structure' which owned the principal trading companies (Behles, South, and Baltic). [Stephen Curtis] confirmed that South and Behles were very important to Yukos as all of the Yukos oil flowed through them. […] Jurby Lake owned the entire structure and […] Yukos could take control via the exercising of certain call options."[116]

91. The use of call options — a familiar feature in the Oligarchs' dealings[117] — allowed Yukos to include in its financial statements revenues that were entirely dependent on Yukos' sales to Baltic, Behles, and South. Due to the call options, these entities were "related" to Yukos and these sales should have been reported as "related-party transactions." Yukos, instead, never made any such disclosures, and misled not only its own auditors, but also the investors, creditors and others who relied on Yukos' audited financial statements as accurate depictions of Yukos' finances and affairs.

92. Yukos' management never disclosed the company's related-party transactions with the Jurby Lake Structure because the Oligarchs were using that structure to siphon off from Yukos the proceeds of the oil and oil products sales for their own benefit.[118] In that regard, at the same 1999 meeting, Mr. Curtis reported to have:

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authorities. *See*, *e.g.*, Lucy Komisar, *Yukos Kingpin on Trial* Corpwatch (May 10, 2005) (Exhibit RME-121),

116 Attendance Note (June 1, 1999), 1 (Exhibit RME-143).

117 *See* ¶¶ 1014 *infra*.

118 Further evidence of the sensitivity of the Jurby Lake Structure is contained in two internal memoranda produced by Yukos' manager P.M. Maliy on August 9 and 14, 2002, respectively, in the context of "Project Voyage," the code name for the listing of Yukos shares on the New York Stock Exchange. Specifically, the August 9, 2002 memorandum reports that, with respect to "*Interested Party Transactions*," "*The shareholders are thinking it over.* […] *The value of the matter in question is recognition of 1999 and earlier exports through affiliates and to take the risk of the interest of the authorities toward this fact*" (Exhibit RME-147). This memorandum, which was

> "met with Deloitte & Touche and Yukos's tax adviser approximately 4 weeks ago. It transpired that Yukos's objective was to consolidate the structure and to individually show all of the transactions (to the shareholders). However, because of the nature of the call option, all of the trading companies effectively became associated companies and as a result would have to be detailed in the accounts. Yukos did not want this and as a consequence, the Jurby Lake structure was cut off and made into a 'stand alone structure' with its only link to Yukos being the fact that Yukos supplied the oil."[119]

93. Yukos ultimately decided to abandon the call option mechanism that linked Yukos with the companies belonging to the Jurby Lake Structure, Yukos' oil and oil products continued to flow through Baltic, Behles, and South, and the proceeds of the related sales continued to be siphoned off, through Jurby, to the Oligarchs. It was against this backdrop that Mr. Curtis noted that "*a huge amount of the structure was based on trust*,"[120] and that even though Yukos' management had abandoned the call option mechanism:

> "[T]here was a way of calculating how much was being taken out of the Jurby Lake structure and if too much was being taken out then Yukos could always turn off the oil supply. […] [O]ne had to ask the question what was the commercial benefit to Yukos of this structure."[121]

94. Eventually, PwC discovered that the Jurby Lake Structure was related to Yukos, which contributed to PwC's withdrawal in 2007 of its

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produced ten weeks after the letter in which Messrs. Khodorkovsky and Misamore had represented to PwC that Yukos and the companies belonging to the Jurby Lake Structure were "not related" states that: "*The lawyers and Misamore are to confer at a meeting scheduled for Monday, with PLL* [Platon Lebedev] *and MBKh* [Mikhail Khodorkovsky]" on the subject matter of Jurby Lake (*ibid.*). *See also* the August 14, 2002 memo, confirming that "*PLL and MBKh keep discussing the situation with Behles, Baltic, and South. They promise to produce a solution by the end of this week – either to recognize that they are connected with the group or its individual members (we all know which)*" (Exhibit RME-148).

119 Attendance Note (June 1, 1999), 2 (Exhibit RME-143). [emphasis added]

120 *Ibid*, 3.

121 *Ibid.* The attendance note also mentions a "*Newco structure*" which Mr. Bond and other proxies for the Oligarchs had created in parallel to Jurby Lake (*Ibid.*, ¶ 6). The details of this "*Newco structure*" are unclear at this stage, but it appears that this could have been the Pronet Holdings Limited / Routhenhold Holding Limited structure (*see, e.g.*, Pronet Holdings Financial Statements for the Years ended 2000 and 2001; Exhibit RME-144).

certification of Yukos' financial statements because the management of Yukos had lied to it:

> "During our audit, [Yukos] management represented to us on numerous occasions that Behles Petroleum S.A., Baltic Petroleum Trading Limited, and South Petroleum Limited (collectively 'BBS'), to which [Yukos] sold much of its export crude oil and refined products, were unrelated to [Yukos]. During the course of the Investigation, we were provided information indicating that BBS were controlled by and existed for the benefits of shareholders of Group Menatep."[122]

95. Jurby Lake was thus another scheme through which the Oligarchs siphoned off large amounts of cash from Yukos, to the detriment of the company itself and its minority shareholders.

2. Avisma and Apatit

96. Similarly, Mr. Khodorkovsky implemented transfer pricing schemes to skim profits from two other companies over which he had gained control in 1995: the Russian titanium giant OJSC Avisma and AOA Apatit, a fertilizer company. At the direction of Mr. Khodorkovsky and his accomplices, a "huge percentage" of OJSC Avisma's revenues and profits were diverted from local tax authorities, currency regulators, and minority shareholders pursuant to a sophisticated transfer pricing scheme.[123] Avisma's titanium sponge output was sold far below market value to offshore companies controlled by Bank Menatep (the "TMC companies"), which in turn would sell the titanium to international

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122 *See* Letter from PWC to Rebgurn E.K and Yukos' Board of Directors (June 15, 2007) (Exhibit RME-145).

123 Avisma Proceedings Filing, Transcript of Avisma/VSMPO investor's meeting of Oct. 14, 1998, 2:52-54, 15:495-98 (Exhibit RME-161). In 1996 Avisma showed profits of US $2.69 million while the TMC companies made up to US$20 million. *See* Letter from Rakisons, Investors' attorney, to Creditanstalt (Dec. 22, 1998), 4 (Exhibit RME-162). This letter was included in exhibits to a submission filed in proceedings brought by OJSC Avisma (*Avisma Titano-Magnesium Kombinat v. Dart Management*, US Dist. Ct. of NJ, Civil Action No. 99-3979 (JWB) (1990)).

companies at market prices.[124] The profits of the sales were then secreted to various Swiss and offshore bank accounts.[125]

97. As with the Yukos transfer pricing schemes, the Avisma fraud involved the offshore services company Valmet and its Chief Executive, Peter Bond. In order both to evade Russian taxes and to circumvent U.S. anti-dumping rules, the Avisma scheme also utilized an arrangement that was similar to Yukos' Jurby Lake Structure, whereby there was no formal legal or official relationship between the TMC companies and Avisma.[126] In reality, however, the TMC companies were managed and controlled on behalf and on the instruction of Bank Menatep by their principal, Mr. Bond, who managed the TMC companies' operations from Valmet's offices in the Isle of Man.[127]

98. Mr. Khodorkovsky and Bank Menatep also engaged in illegal transfer pricing schemes at OAO Apatit. Between 1995 and 2002, Messrs. Khodorkovsky and Lebedev directed the transfer of OAO Apatit products to offshore and Russian entities under the guise of genuine sale transactions. The profits from the onward sale of the misappropriated apatite concentrate to foreign companies at full market price were diverted to the accounts of Russian and foreign companies, including an Isle of Man company under the management of Valmet.[128] The lost profit to shareholders of the embezzlement has been estimated at US$ 200 million.[129]

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124 Mary Canniffe and John Helmer, *Dublin-based firm is named in fraud conspiracy claims. TMC denies its involvement in metal dealing in Russia was fraudulent. However, these transactions are at the centre of a multi-million dollar US law suit*, The Irish Times (Sept. 10, 1999) (Exhibit RME-163).

125 *See* Ernst & Young, Draft Report on Trading by TMC (Sept. 22, 1998), 24 ¶¶ 4.1.1, 4.1.2 (Exhibit RME-164).

126 Avisma Proceedings Filing, Transcript of Avisma/VSMPO investor's meeting of Oct. 14, 1998, 3:68-69, 17:551-552 (Exhibit RME-161.

127 *Ibid.*, 17:541-46 (Exhibit RME-161).

128 *Case of Messrs. M.B. Khodorkovsky, P.L. Lebedev and A.V. Krainov*, Meshansky Court of Moscow, Verdict of May 16, 2005, 15, 467-468, 482 (Exhibit RME-160).

129 *Ibid.*, 22-23.

E. The Oligarchs' Illegal Activity Was Not Confined to Financial Crimes, But Also Extended to Attempted Murder and Murder

99. In the aftermath of the Yukos acquisition, key Yukos and Group Menatep officials sought, through a ruthless campaign of intimidation and violence, to silence anybody who opposed their interests.

100. In 2005, former Yukos security chief Alexei Pichugin was convicted of organizing the double murder in November 2002 of Olga and Sergei Gorin.[130] The couple was killed because Sergei Gorin had been threatening to disclose his involvement in Yukos' criminal activities. Mr. Pichugin was found to be acting on the orders of Leonid Nevzlin, a major Group Menatep shareholder, senior Yukos executive, and head of Yukos' security services. In August 2008, Mr. Nevzlin, who fled to Israel in 2003, was found guilty *in absentia* of several counts of conspiracy to murder individuals who had stood in Yukos' way.[131] Mr. Nevzlin is also associated with Claimants, having submitted a witness statement on their behalf in these proceedings.

101. Mr. Pichugin was also convicted in 2005 of the attempted murder of Olga Kostina, a former adviser to Mr. Khodorkovsky and head of public relations at Moscow City Hall. On November 28, 1998, a bomb exploded in front of the apartment listed as Ms. Kostina's place of residence in her Yukos personnel file. She did not actually live there, and thus escaped injury. Ms. Kostina testified at Mr. Pichugin's trial that Mr. Nevzlin wished to punish her because he believed that she was acting against his and Yukos' interests.[132] Mr. Nevzlin was also convicted of conspiracy to murder Ms. Kostina.[133]

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130 *Criminal Trial of Alexei Pichugin*, Moscow City Court, Closing Submissions of the Russian Prosecutor, (Mar. 2005), 1-2 (Exhibit RME-165). Upheld by the Supreme Court of the Russian Federation on July 14, 2005.

131 *Nevzlin found guilty of organizing murders, sentenced to life*, Russia & CIS Business & Investment Weekly (Aug. 8, 2008) (Exhibit RME-166).

132 *Criminal Trial of Alexei Pichugin*, Moscow City Court, Closing Submissions of the Russian Prosecutor, Mar. 2005, at 6 (Exhibit RME-165).

133 *Nevzlin found guilty of organizing murders, sentenced to life*, Russia & CIS Business & Investment Weekly (Aug. 8, 2008) (Exhibit RME-166).

102. Mr. Pichugin was also later convicted, as was Mr. Nevzlin, for the attempted murder of Evgeny Rybin, head of the Austrian oil company East Petroleum Handelsges.[134] Mr. Rybin was twice the subject of assassination attempts: in November 1998, he escaped the assassin's bullets, and in March 1999, he had a second narrow escape when his company car was blown up, killing his driver. By chance, Mr. Rybin was not in the car at the time. The motive behind the murder attempts was that East Petroleum had sued Yukos at The Hague for terminating a contract with Yukos subsidiary Tomskneft.[135] Mr. Rybin was shot at after leaving negotiations at the house of a Yukos manager, Leonid Filimonov, and Yukos security services had made attempts to trace Mr. Rybin via the government address information bureau around the time of that attempted assassination.[136]

103. Mr. Pichugin and Mr. Nevzlin have also been found guilty of organizing the murder of Vladimir Petukhov, Mayor of Nefteyugansk (Siberia), where Yukos subsidiary YNG was headquartered.[137] Mr. Petukhov was a highly vocal critic of Yukos, protesting against Yukos' failure to pay its taxes and decreasing its workers' wages. In May 1998, he encouraged YNG's employees to protest against their treatment.[138] He began a hunger strike on June 15, 1998, demanding that criminal action be taken against Yukos for tax evasion and that the "oligarchs of Rosprom-Yukos-Menatep" stop interfering with the city's policies. He was shot dead eleven days later, on June 26, 1998.

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134 *Ibid*.

135 ReshetnikovSentence, Moscow City Court, Case 2 – 350/2000 (Nov. 13, 2000), 1-2 (Exhibit RME-167).

136 *Ibid.*, 2, 7-8.

137 *Nevzlin found guilty of organizing murders, sentenced to life*, Russia & CIS Business & Investment Weekly (Aug. 8, 2008) (Exhibit RME-166).

138 Telegram from V.A. Petukhov to Russian Federation Prime Minister S.V. Kiriyenko (undated) (Exhibit RME-168); Telegram from V.A. Petukhov to Russian President B. Yeltsin et al. (June 15, 1998) (Exhibit RME-169).

F. The Oligarchs' Fraudulent Internationalization Of Their Yukos Holdings Through Sham Companies -- Including Claimants -- In Various Tax Havens

104. After having used Russian front companies such as Laguna and Monblan to corrupt the loans-for-shares auctions and fraudulently acquire Yukos in 1995 and 1996, thereafter Menatep quickly moved to internationalize its holdings in Yukos through an even more opaque network of shell companies scattered among various tax havens around the globe. This internationalization of Yukos shares allowed the Oligarchs to achieve the dual aims of illusorily distancing themselves from the original misconduct by which they had acquired Yukos and then evading taxes, by multiple means, on their ill-gotten gains.

105. At the jurisdictional stage of these Arbitrations, Claimants failed to produce documents that reveal the full picture of how they came to possess their interests in Yukos. Nevertheless, it is clear that by early 1998, Menatep had dispersed hundreds of millions of Yukos shares to sham affiliates it established in tax haven jurisdictions such as Cyprus, the Seychelles, the British Virgin Islands, the Isle of Man, Ireland, and Gibraltar. Menatep gave these companies innocuous names that belied their connections to the Oligarch's empire and the ruthless means they used to establish and preserve it.[139]

106. For example, over 324 million of Claimant Hulley's shares in Yukos can be traced to companies named Ebon Crown (of Ireland) and TBH Transworld (of Cyprus), which held these shares until March 24, 1998, and May 17, 1998,

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139 *See, e.g.*, Sale Agreement between Barion Enterprises Limited, Hulley Enterprises Limited, Hawksmor Enterprises Ltd., Henry Assets Inc., & MQD International Inc. (Mar. 9, 2000) (Exhibit RME-175); Sale Agreement between Cayard Enterprises Lmited, Hulley Enterprises Limited, & Avimore Enterprises Limited (Mar. 9, 2000) (Exhibit RME-176); Sale Agreement between Kincaid Enterprises Limited, Hulley Enterprises Limited, & Kandall Limited (Mar. 3, 2000) (Exhibit RME-177); Sale Agreement between Temerain Enterprises Limited, Hulley Enterprises Limited, Ebon Crown Limited, & TBH Transworld Holding Company Limited (Mar. 9, 2000) (Exhibit RME-178); Sale Agreement between Wandsworth Enterprises Limited, Hulley Enterprises Limited, & Medusa Shipping Limited (Mar. 9, 2000) (Exhibit RME-179).

respectively, before being transferred to another Cyprus company named Temerain and ultimately to Claimant Hulley.[140]

107. Of course, exercising ultimate control over the network of offshore companies that held Yukos shares were the Oligarchs, who acted through the mechanism of Group Menatep Limited, itself incorporated in Gibraltar in 1997, originally under the name Flaymon Limited.[141] While the relationship between Menatep and its networked shell companies was intentionally kept obscure, the connection is evident, for example in the person of Christis Christoforou, an early Group Menatep shareholder who was also a shareholder of a number of the offshore companies used by Menatep to hold Yukos shares.[142]

108. By obfuscating the owners and ownership of Yukos shares through these means, the Oligarchs ensured that it would be extremely difficult to challenge, let alone to identify, this network of ownership and control that traces its origins to Menatep's fraudulent conduct during the loans-for-shares program. Even in 2002, Yukos officials expressed their fear that "*[b]y disclosing the beneficiary holders of its shares and how they acquired them the Company may trigger the attempts for the revision of the entire privatization.*"[143]

109. This concern that the Oligarchs might be held to account for their unlawful actions must have been all the greater when those actions were fresh in the public consciousness, with even the Duma concluding in late 1998 that the loans-for-shares transactions were shams.[144] Indeed, Claimants' failure to

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140 *See* Sale Agreement between Temerain Enterprises Limited, Hulley Enterprises Limited, Ebon Crown Limited, & TBH Transworld Holding Company Limited (Mar. 9, 2000) (Exhibit RME-178).

141 *See* Certificate of Incorporation of Flaymon Limited (Sept. 5, 1997); Certificate of Incorporation of Group Menatep Limited (Jan. 23, 1998) (Exhibit RME-180).

142 *See, e.g.*, Special Resolution of Flaymon Limited (Dec. 29, 1997) (changing name to Group Menatep Limited) (Exhibit RME-181); Company Search for Barion Enterprises Limited (Exhibit RME-182); Company Search for Cayard Enterprises Limited (Exhibit RME-183).

143 Memorandum of P.N. Maly to Vice-President/Director of Corporate Finance Directorate O.V. Sheyko (May 14, 2002), ¶ 4 (Exhibit RME-184).

144 *See* Resolution of the State Duma of the Federal Assembly of the Russian Federation, No. 3331-II GD, "On the non-admissibility of passing shares of joint-stock companies of strategic importance for the national security into the ownership of non-residents of the Russian Federation" (Dec. 4, 1998) (Exhibit RME-185).

produce documents that fully explain the origins of their shares in these proceedings suggests that this concern remains prominent in the minds of the Oligarchs today.

110. Menatep's diffusion of its ownership of Yukos shares to this network of sham companies Menatep established in tax havens around the globe also facilitated rampant tax evasion. Just as Yukos admits it used a "*complex structure of subsidiaries in various jurisdictions* […] *to exploit the inconsistencies between the legal regimes*" and hide information that could form the basis of Russian tax claims, the Oligarchs used sham offshore companies to which they allocated Yukos shares to abuse international tax treaties and domestic tax laws, and mask facts that would allow the Russian government to collect taxes rightfully owed to it.

111. As explained below, for example, the Oligarchs' funneling of shares to sham Cypriot entities, including Claimants Hulley and VPL, which had no actual business in Cyprus, and held those shares only temporarily, solely for the purpose of claiming lower tax rates under a double taxation treaty between Russia and Cyprus, fostered the Oligarchs' multi-faceted efforts to evade hundreds if millions of dollars in Russian taxes that were properly due and owing.

G. The Oligarchs' Creation of Claimants To Fraudulently Evade Hundreds Of Millions Of Dollars in Russian Taxes By Perverting And Misapplying The 1998 Russia-Cyprus Tax Treaty

112. The fraudulent and illegal acquisition by the Oligarchs of control over Yukos by corrupting and exploiting for their own enrichment the "loans-for-shares" program, their subsequent consolidation of that control by way of fraudulent squeeze outs and dilutions of Yukos' minority shareholders, their siphoning off of revenues and profits from Yukos and other illegally acquired companies, their fraudulent internationalization of their Yukos holdings through sham companies (including Claimants) established in various tax havens, and their all too frequent resort to violent crimes -- all as shown above -- are just a few examples of the Oligarchs' repeated and consistent violations of law, lying to

government officials, Yukos own auditors and therefore to creditors and investors, and subverting core principles of corporate governance to amass ill-gotten gains, in most instances at the expense of the Russian Federation and the interests of the Russian people.

113. Importantly for these proceedings, rampant tax evasion was a common thread of many of the Oligarchs' unlawful schemes. Through a complex web of trusts and sham companies linking the Oligarchs to Yukos and to the Yukos offshore entities, they implemented a series of tax evasion schemes that involved abuses not only of Russia's low-tax regions,[145] but also of the withholding and corporate income tax regimes of Russia and other jurisdictions.[146]

114. And even more importantly for these proceedings, the shell companies that appear as Claimants — Hulley and VPL — which come before the Tribunal seeking relief from what they allege to be the Russian Federation's violation of their rights, and therefore must themselves demonstrate their own "clean hands" and their faithful adherence to principles of law, fairness, and equity, were themselves conceived by the Oligarchs to serve no purpose other than to evade hundreds of millions of U.S. dollars in Russian taxes, which is precisely what they did, through the unmistakable and serial misconduct detailed below, which is for all practical purposes the international version of the Russian tax evasion reflected in the abuses of Russia's low-tax regions.

115. One of those tax evasion schemes was perpetrated directly by Claimants and their parent company GML, and involved patently fraudulent abuse of the 1998 Agreement between the Government of the Republic of Cyprus and the Government of the Russian Federation for the Avoidance of Double Taxation With Respect to Taxes on Income and on Capital (the "Russia-Cyprus

145 *See* Section II.H. *infra*.

146 *See* ¶¶ 154-208 and Section H, ¶¶ 266-275 *infra*.

Tax Treaty").[147] As described in the expert report by leading international tax law expert and New York University Law School Professor H. David Rosenbloom submitted with this Counter-Memorial, the purpose of the Russia-Cyprus Treaty, in the respects pertinent here, is to permit genuine Cypriot businesses to avoid the double taxation of their Russian income.[148] But Claimants and their masters wrongfully exploited the Treaty, including through hundreds of sham transactions in Yukos stock that served no legitimate business purpose, simply to evade Russian taxes, not only perverting the Treaty's essential objective, but also knowingly misrepresenting to Russian and Cypriot taxation authorities that they qualified to claim benefits under the Treaty when demonstrably they did not.

116. The Russian Federation estimates that, for tax years 2000-2003, Claimants' abuses of the 1998 Russia-Cyprus Tax Treaty resulted in their unlawfully evading withholding taxes on dividends paid by Yukos from Russia[149] in excess of US$ 245 million, not including interest and fines.[150]

117. As also shown below, Claimants' abuses of the Russia-Cyprus Tax Treaty also violated the criminal laws of Russia and Cyprus.[151]

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147 The Russia-Cyprus Tax Treaty was signed on December 5, 1998, and entered into force on January 1, 2000. *See* Russia-Cyprus Income and Capital Tax Agreement (Dec. 5, 1998) (Annex (Merits) C 916).

148 *See generally*, Expert Report of H. David Rosenbloom (the "Rosenbloom Report"), ¶¶ 78-90.

149 *See* ¶¶ 166-199 *infra*.

150 *See* ¶¶ 200-203 *infra*. The extent of Claimants' abuses is still not fully defined at this stage, because the evidence available to the Russian Federation is still far from complete. The Russian Federation will make specific requests for document production at the appropriate stage of these proceedings, but even the documents that are currently available to it leave no doubt regarding the magnitude of the abuses and criminal violations perpetrated by Claimants in this respect.

151 *See* ¶¶ 209-224 *infra*. On the violation of Cypriot criminal law *see* Expert Report of Polyvios G. Ployviou (the "Polyviou Report"), 8-18.

1. The Creation, Ownership, And Control Of Claimants And Their Parent Company, GML, Pursuant To The Tax Evasion Scheme Designed By The Oligarchs To Abuse The Russia-Cyprus Tax Treaty

118. Claimants were critical instruments for the Oligarchs' abuse of the Russia-Cyprus Tax Treaty.

119. In particular, Hulley and VPL fraudulently claimed that Russian income in excess of US$ 2.4 billion[152] was eligible for favorable treatment under the Russia-Cyprus Tax Treaty based on their representations that they complied with the Treaty's requirements that they (i) did not have a permanent establishment in Russia to which the income in question is attributable, and (ii) were beneficial owners of that income.[153]

120. To the contrary, as shown below, both companies had permanent establishments in Russia to which the dividend income for which they claimed favorable treatment under the Russia-Cyprus Tax Treaty indisputably was attributable, and neither was a beneficial owner of the income for which they claimed that favorable treatment.

121. Indeed, and tellingly, Hulley and VPL could only purport to be even nominal owners of Yukos shares temporarily, and for very short periods of time — in certain instances, for no more than seven days — pursuant to a ludicrous scheme in which they engaged with YUL, an Isle of Man company which was not even nominally eligible to claim the benefits of the Russia-Cyprus Tax Treaty, and as part of which YUL entered into hundreds of artificial

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152 *See* Expert Report of Thomas Z. Lys (the "Lys Report"), ¶¶ 94, 99. *See also* Hulley Enterprises Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Apr. 7, 2004) (Exhibit RME-190); Hulley Enterprises Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2004 (Oct. 17, 2005) (Exhibit RME-191) (English and Russian); Veteran Petroleum Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Dec. 15, 2006) (Exhibit RME-192) (English and Russian).

153 *See*, *e.g.*, Hulley Enterprises Limited, Claims for an Exemption of Passive Incomes Sourced in Russia before the Payment is Made (Form 1013DT) for 2000, 2001 (Exhibit RME-193) (English and Russian); Veteran Petroleum Limited, Claims for an Exemption of Passive Incomes Sourced in Russia before the Payment is Made (Form 1013DT) for 2001, 2002 (Exhibit RME-194) (English and Russian).

transactions with each of Hulley,[154] VPL,[155] and a number of other Cypriot entities owned and controlled by the Oligarchs.[156] As is detailed in the expert report of leading accounting scholar and Northwestern University School of Management Professor Thomas Z. Lys submitted with this Counter-Memorial, in these artificial transactions, YUL sold or transferred for no consideration Yukos shares to each of Hulley and VPL, and then it promptly repurchased or otherwise reacquired these shares for no consideration, at times in multiple transactions on the same or consecutive days, importantly with the sales immediately preceding and the repurchases immediately following the dates as of which Yukos declared dividends on those shares, known as the "ex-dividend" date. The sole purpose of these hundreds of back-to-back transactions in Yukos shares was to allow YUL's Cypriot affiliates, including Hulley and VPL, to claim nominal ownership of those shares as of the relevant ex-dividend dates so that they could purport to claim, as Cypriot residents, lower tax rates on those dividends pursuant to the Russia-Cyprus Tax Treaty.[157]

122. As discussed in greater detail at paragraphs 125 to 153 below, the Oligarchs have at all relevant times owned and controlled each of YUL, Hulley, and VPL, and their income relating to the Yukos shares.

123. Thus, the very inception and *raison d'être* of Claimants and their nominal holdings in Yukos were part of a broader tax evasion scheme entailing the abuse of the Russia-Cyprus Tax Treaty and violations of Russian and Cypriot criminal laws pursuant to that scheme so that the Oligarchs could evade Russian taxes on their Russian income.

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154 Lys Report, ¶¶ 48, 50-51, 67-77, *and* Exhibits 5-8, 10-13 attached thereto.

155 Lys Report, ¶¶ 48, 78-86 *and* Exhibits 5-8, 14-16 attached thereto; *see also*, *e.g.*, UBS AG (Moscow), Customer Account Statement for Veteran Petroleum Limited, Account No. 3889-01-01S (Exhibit RME-195).

156 Lys Report, ¶¶ 48-49 and Exhibit 5 thereto. Specifically, YUL engaged in similar transactions with Menatep Asset Management Limited, a Cypriot company owned by GML through Menatep Limited. *See, e.g.*, GML Limited (formerly Group Menatep Limited), Financial Statements for the year ended Dec. 31, 2001 (Feb. 14, 2006) (Exhibit RME-196); Summary of corporate information of Menatep Asset Management Limited (Mar. 8, 2000) (Exhibit RME-238).

157 Lys Report, ¶¶ 73-77, 83-86, and Exhibits 10-13, 14, 16 attached thereto.

124. Equally tellingly, Claimants and Claimants' Gibraltar parent company, GML, were established in 1997 by Mr. Bond and his associates, the same individuals who set up the sham vehicles through which the Oligarchs had fraudulently consolidated their holdings in Yukos by way of unlawful squeeze outs and dilutions of Yukos' minority shareholders[158] and the Jurby Lake Structure that was used to siphon off from Yukos large amounts of the proceeds of oil and oil products sales.[159] They, together with the Oligarchs' tax and corporate advisors, Stephen Curtis and Nicholas Keeling,[160] set up and/or managed on behalf and for the benefit of the Oligarchs each of GML, YUL, Hulley, and VPL.

a) GML

125. GML,[161] Claimants' Gibraltar parent company,[162] was incorporated on September 5, 1997 by FG Management Limited,[163] an Isle of Man company controlled by Mr. Keeling.[164]

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158 *See* ¶¶ 44-75, especially at ¶¶ 56-60 *supra*.

159 *See* ¶¶ 81-85 *supra*.

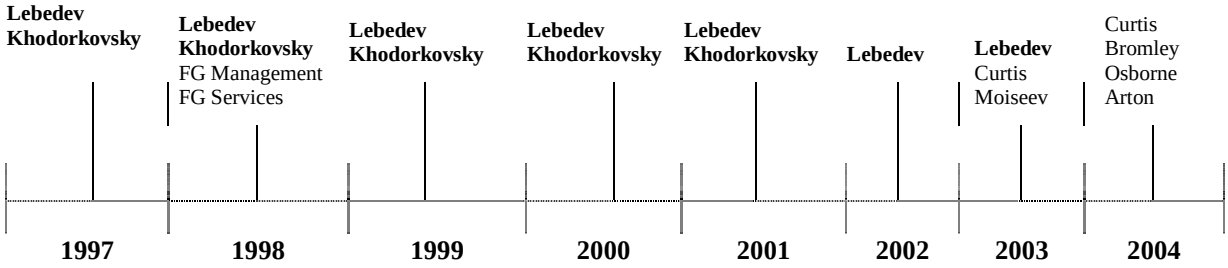
160 Mr. Keeling is a Gibraltar-based solicitor who was a director of: (i) Yukos Brokerage Limited, a company with its seat of management at Mr. Curtis' law firm in London (*see* Yukos Brokerage Limited, D&B Comprehensive Report (U.K.) (July 7, 1999) (Exhibit RME-199)); (ii) YUL (*see* Yukos Universal Limited, Statements of First Directors and Secretary and Intended Situation of Registered Office and Notices of Change of Directors or Secretaries or in their Particulars (1997 - 2004 excerpts), 10-13 (Exhibit RME-60)); (iii) Harpley Limited (Harpley Limited, Notice of Change of Directors or Secretaries or in their Particulars (excerpts) (1999) (Exhibit RME-200)) (another Jurby-related company); (iv) FG Management Limited, an Isle of Man-based company (GML Limited (formerly Group Menatep Limited and Flaymon Limited), Articles of Association (Aug. 28, 1997) (Exhibit RME-239)); and (v) Arton Consult Limited, a BVI-based company acting as one of GML's directors (GML Limited (formerly Group Menatep Limited and Flaymon Limited), Particulars of Directors and Managers and of any changes therein (excerpts) (1997-2004), 12-14 (Exhibit RME-201)).

161 The company changed its name from "Flaymon Limited" to "Group Menatep Limited" (Dec. 29, 1997), and then to "GML Limited" (Nov. 1, 2005) (*see* GML Limited (formerly Group Menatep Limited and Flaymon Limited), Special Resolutions (1997-2007 excerpts), 7, 13-14 (Exhibit RME-228)).

162 GML wholly owns YUL (*see* GML Limited (formerly Group Menatep Limited), Financial Statements for the year ended Dec. 31, 2001 (Feb. 14, 2006), 12 (Exhibit RME-196)), which in turn wholly owns Hulley (*see* Hulley Enterprises Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Apr. 7, 2004), 4 (Exhibit RME-190)). VPL, the other Cypriot Claimant in these proceedings, is wholly owned by WJB Chiltern Trust Company (Jersey) Limited as the custodian trustee of the Petroleum Trust ("VPT") (*see* ¶¶ 148-151 *infra*).

126. As illustrated below, the Oligarchs have at all relevant times managed and controlled GML, either directly or through their proxies (Chart 1), and have been the majority shareholders of GML since its inception (Table 1).

CHART 1 - GML'S DIRECTORS (1997-2004)[165]



163 Flaymon Limited, Certificate of Incorporation (Sep. 5, 1997) (Exhibit RME-180); GML Limited (formerly Group Menatep Limited and Flaymon Limited), Articles of Association (Sept. 28, 1997) (Exhibit RME-239).

164 *See* note 160 *supra*.

165 GML Limited (formerly Group Menatep Limited and Flaymon Limited), Particulars of Directors and Managers and of any changes therein (excerpts) (1997-2004) (Exhibit RME-201).

TABLE 1 - HOLDINGS IN GML (2000-OCT. 2003)[166]

Shareholder	GML shares (2000)	GML shares (2001)	GML shares (2002)	GML shares (Oct. 2003)
Brudno	387,321 7.74%	387,321 7.74%	348,101 6.96%	348,101 6.96%
Dubov	387,321 7.74%	387,321 7.74%	n/a	n/a
Golubovitch	246,477 4.92%	246,477 4.92%	221,517 4.43%	221,519 4.43%
Khodorkovsky	528,165 10.56%	528,165 10.56%	474,685 9.49%	474,685 9.49%
Lebedev	387,321 7.74%	387,321 7.74%	348,101 6.96%	348,101 6.96%
Nevzlin	457,743 9.15%	457,743 9.15%	411,393 8.22%	411,393 8.22%
Shakhnovsky	n/a	n/a	348,103 6.96%	348,101 6.96%
Palmus Foundation (the Liechtenstein Foundation whose ultimate beneficiary was Mr. Khodorkovsky) / **Palmus Trust**	2,499,999 49.99%	2,499,999 49.99%	2,499,999 49.99%	2,499,999 49.99%
Curtis	n/a	n/a	348,101 6.96%	348,101 6.96%
Christoforou	105,653 2.11%	105,653 2.11%	n/a	n/a
Total	**5,000,000** **100%**	**5,000,000** **100%**	**5,000,000** **100%**	**5,000,000** **100%**

166 GML Limited (formerly Group Menatep Limited), Voluntary Returns of Members (2001-2003) (Exhibit RME-202); GML Limited (formerly Group Menatep Limited), Annual Return (Sep. 29, 2000) (Exhibit RME-231).

127. On or about October 25, 2003, the day on which Mr. Khodorkovsky was arrested,[167] following the arrests of Messrs. Pichugin (June 19, 2003)[168] and Lebedev (July 2, 2003),[169] and the prosecution of Mr. Shakhnovsky (October 17, 2003),[170] the Oligarchs transferred the entirety of their shareholdings in GML to eight Guernsey trusts (the "Guernsey Trusts"), through which they appear to have owned and controlled GML ever since.[171]

128. The restructuring of the Oligarchs' holdings in GML was designed to shield legal title of the GML shares behind the Guernsey Trusts, while creating "a mechanism for a structure being under personal control of each of the shareholders of [GML]" which would secure the conveyance of the profits of GML's operations to the Oligarchs.[172]

129. Table 2 below illustrates the Guernsey Trusts' shareholdings in GML starting from October 25, 2003.

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167 Claimants' Memorial on the Merits, ¶ 112.

168 *Ibid.*, note 137.

169 *Ibid.*, ¶ 109.

170 *See ibid.*, note 139.

171 Specifically, each of the Oligarchs was a settlor of a Guernsey Trust. Thus: (i) Mr. Brudno was the settlor of the Auriga Trust; (ii) Mr. Dubov was the settlor of the Draco Trust; (iii) Mr. Golubovitch was the settlor of the Carina Trust; (iv) Mr. Khodorkovsky was the settlor of the Pavo Trust (which was later replaced by the Southern Cross Trust) and, through the Palmus Foundation, of the Palmus Trust; (v) Mr. Lebedev was the settlor of the Mensa trust; (vi) Mr. Nevzlin was the settlor of the Pictor trust; and (vii) Mr. Shakhnovsky was the settlor of the Tucana trust (Guernsey Trusts Documents (Oct. 20, 2003) (Exhibit RME-203)).

The Russian Federation sought disclosure of certain documents concerning the operations of the Guernsey Trusts, including the so-called "letter of wishes" that the settlors provided to the trustees, which Claimants have failed to produce.

172 *See*, *e.g.*, Witness Statement of Neil Simon Peter McLarnon (July 21, 2008), ¶ 14 (Exhibit RME-204).

TABLE 2 - HOLDINGS IN GML (OCT. 2003-2006)[173]

Shareholder	GML shares 2003	GML shares 2004	GML shares 2005	GML shares 2006
Auriga Trust **Brudno**	348,101 6.96%	348,101 6.96%	348,101 6.96%	348,101 6.96%
Draco Trust **Dubov**	348,101 6.96%	348,101 6.96%	348,101 6.96%	348,101 6.96%
Carina Trust **Golubovich**	221,519 4.43%	221,519 4.43%	n.a.[174]	n.a.
Pavo / Southern Cross Trust **Khodorkovsky**	474,685 9.49%	474,685 9.49%	474,685[175] 9.49%	474,685 9.49%
Mensa Trust **Lebedev**	348,101 6.96%	348,101 6.96%	348,101 6.96%	348,101 6.96%
Pictor Trust **Nevzlin**	411,393 8.22%	411,393 8.22%	411,393 8.22%	411,393 8.22%
Tucana Trust **Shakhnovsky**	348,101 6.96%	348,101 6.96%	348,101 6.96%	348,101 6.96%
Palmus Trust **Palmus Foundation**	2,499,999 49.99%	2,499,999 49.99%	2,499,999 49.99%	2,499,999 49.99%
Total	**5,000,000** **100%**	**5,000,000** **100%**	**5,000,000** **100%**	**5,000,000** **100%**

130. GML has wholly owned YUL since September 25, 1997.[176] However, pursuant to GML's Articles of Association, any decision relating to the

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173 GML Limited (formerly Group Menatep Limited), Voluntary Returns of Members (2001-2003), 5-6 (Exhibit RME-202); GML Limited (formerly Group Menatep Limited), Annual Return (Sep. 26, 2004) (Exhibit RME-232); GML Limited (formerly Group Menatep Limited), Annual Return (Sep. 30, 2005) (Exhibit RME-233); GML Limited (formerly Group Menatep Limited), Annual Return (Sep. 26, 2006) (Exhibit RME-234).

174 According to GML's annual returns of Sep. 30, 2005, the GML shares owned by the Carina Trust were "[c]ancelled on [r]epurchase." (*See* GML Limited (formerly Group Menatep Limited), Annual Return (Sep. 30, 2005), 2 (Exhibit RME-233)).

175 According to GML's annual tax return dated September 30, 2005, the GML shares owned by the Pavo Trust were transferred to the Southern Cross Trust. *Ibid.*

YUL shares nominally owned by GML, as well as GML's indirect shareholdings in Hulley and Yukos, are subject to "the prior written consent of Members holding a majority of the [GML shares]," namely the Oligarchs[177, 178]

131. Specifically, pursuant to Article 42(3) of the Articles of Association of GML, without the "*prior written consent*" of the Oligarchs, GML "shall not," inter alia:

> "[…](a) permit the disposal or dilution of the interest of [GML], directly or indirectly, in any subsidiary; […] (b) sell, transfer, lease, mortgage, pledge or otherwise dispose of any part of the business, undertaking or assets of [GML] or any subsidiary with a value in excess of US$ 1,000 [and] (v) exercise any rights as members in relation to any subsidiary," including "a subsidiary of a subsidiary."[179]

132. Thus, despite its formal status as the sole shareholder of YUL, GML has no genuine power over YUL, the YUL shares of which it is the record owner, or any of YUL's subsidiaries, because the "*exercise*" by GML of "*any rights*" as YUL's sole shareholder, including the exercise of any rights on any of YUL's subsidiaries, is subject to the "*prior written consent*" of the Oligarchs, who have at all times owned and controlled GML and, through it, Yukos.[180]

133. In short, GML has at all times been the vehicle through which the Oligarchs have owned GML's subsidiaries and their income.

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176 Scaan Limited and Fovarrane Limited transferred the entirety of their interest in YUL to GML (then Flaymon Limited) on Sep. 25, 1997, *see* Annual Return of Yukos Universal Limited (Sep. 24, 2001), 3 (Exhibit RME-205).

177 *See* GML Limited (formerly Group Menatep Limited and Flaymon Limited), Special Resolutions (1997-2007 excerpts), 9 (Exhibit RME-228).

178 GML's Articles of Association changed slightly over time in a series of Special Resolutions passed on Sep. 16, 1997, Oct. 23, 1997, Feb. 20, 1998, Mar. 6, 2003, May 12, 2005, and Mar. 16, 2007 (GML Limited (formerly Group Menatep Limited and Flaymon Limited), Special Resolutions (1997-2007 excerpts) (Exhibit RME-228)).

179 *See* GML Limited (formerly Group Menatep Limited and Flaymon Limited), Articles of Association, Art. 42 (Exhibit RME-239).

180 *Ibid*.

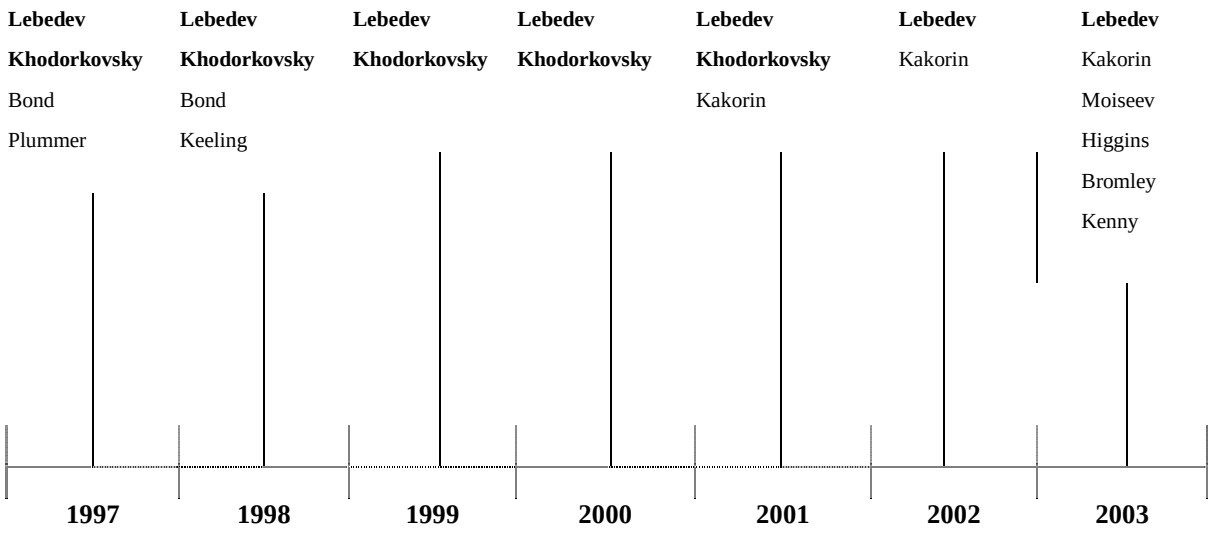
b) YUL

134. YUL was incorporated in the Isle of Man on September 24, 1997 by Scaan and Fovarranne, two Isle of Man companies owned and controlled by Mr. Bond and Valmet.[181]

135. The interests of Scaan and Fovarranne in YUL were transferred to GML on September 25, 1997.[182]

136. As illustrated in Chart 2 below, YUL has been managed by Messrs. Khodorkovsky and Lebedev since September 25, 1997.

CHART 2 – PARTICULARS OF YUL'S DIRECTORS (1997-2003)[183]



137. YUL has owned (i) the majority of the Hulley shares since September 29, 1997,[184] (ii) a minority interest in Yukos since October 28, 1999,[185]

181 *See* ¶¶ 58-59 *supra*.

182 *See* Annual Return of Yukos Universal Limited (Sep. 24, 2001), 3 (Exhibit RME-205).

183 Statements of First Directors and secretary and intended situation of registered office and Notices of Change of directors or secretaries or in their particulars of Yukos Universal Limited (1997 - 2003) (Exhibit RME-60).

184 More specifically, on Sep. 29, 1997, A.T.S. Nominees Limited transferred to YUL 99.9% of its holding in Hulley, the remaining 0.01% being held by A.T.S Trustees Limited transferred. That holding in Hulley was transferred to YUL in Dec. 2, 2003 (*see* Cyprus Companies Registry, Report on Search for Hulley Enterprises Limited (Mar. 17, 2005) (Exhibit RME-214)).

185 *See* Trust Investment Bank Custody Account Statements for Yukos Universal Limited, Account No. 90045, from Oct. 27, 1999 to Oct. 3, 2006 (Oct. 4, 2006) (Exhibit RME-230). *See also* Claimants' Counter-Memorial on Jurisdiction and Admissibility (YUL), ¶ 282.

and (iii) the entirety of the VPL shares from February 7, 2001 until April 28, 2001.[186]

138. Pursuant to YUL's Articles of Association, any management decision relating to the Hulley and Yukos shares nominally owned by YUL is subject to "*the prior written consent of Members holding not less than 100%* […] *of the* [YUL shares]," which is GML,[187] whose management decisions with respect to the YUL shares are, in turn, subject to the Oligarchs' consent.[188]

139. Specifically, Article 23 of YUL's Articles of Association provides that, without the prior written consent of GML, YUL "*shall not*," *inter alia*:

> "(a) […] permit the disposal or dilution of [its] interest […], directly or indirectly, in any subsidiary […] (b) sell, transfer, lease, mortgage, pledge or otherwise encumber or dispose of any part of the business, undertaking or assets of [YUL] or any subsidiary or associate of [YUL] with a value in excess of US$ 1,000 […]" and "(j) exercise any rights as Members in relation to [YUL's] subsidiary or associated companies."[189]

140. Thus, like its Gibraltar parent company GML, and despite its formal status as the sole shareholder of Hulley and Yukos, YUL has no genuine power over Hulley, Yukos, or any of their shares. To the contrary, YUL has at all times simply been another nominee in the chain of shell companies through which Mr. Khodorkovsky and his associates owned and controlled Yukos and its income.

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186 *See* Cyprus Companies Registry, Report on Search for Veteran Petroleum Limited (Mar. 17, 2005) (Exhibit RME-213). Moreover, as discussed in greater detail at ¶ 149 *infra*, YUL transferred approximately 223 million of its Yukos shares to VPL on Apr. 26, 2001, and the entirety of its VPL shares to the custodian trustee of the Veteran Petroleum Trust ("VPT") on or around Apr. 29, 2001.

187 Yukos Universal Limited (formerly Credof Limited), Memorandum and Articles of Association (Nov. 18, 1999), Art. 23 (Exhibit RME-240)

188 *See* ¶¶ 130-132 *supra*.

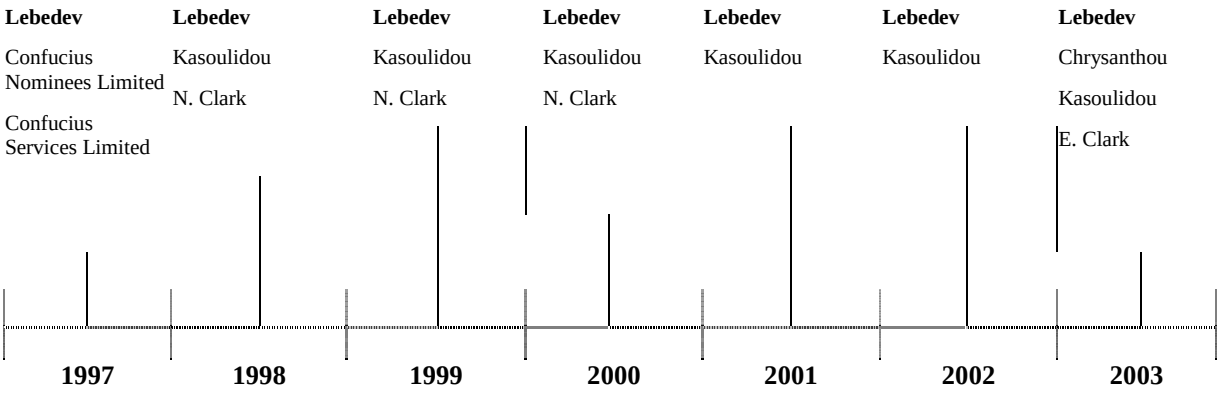
189 Yukos Universal Limited (formerly Credof Limited), Memorandum and Articles of Association (Nov. 18, 1999), Art. 23(4) (Exhibit RME-240)

c) Hulley

141. Hulley was incorporated in Cyprus on September 17, 1997. YUL has owned the majority of the Hulley shares since September 29, 1997.[190]

142. As shown in Chart 3 below, Hulley, like YUL, has been managed by the Oligarchs since its inception.

CHART 3 – HULLEY'S DIRECTORS (1997-2003)[191]



143. Hulley became the record owner of a majority interest in Yukos in a series of transactions from April 1999 to April 2000.[192]

144. Pursuant to Hulley's Articles of Association, any management decision relating to the Yukos shares nominally owned by Hulley is subject to YUL's consent, which in turn is subject to the Oligarchs' consent through GML.[193]

145. Specifically, pursuant to Article 87 of Hulley's Articles of Association, Hulley may not, without the prior consent of YUL, *inter alia*:

> "[dispose] of the interest of [Hulley], directly or indirectly, in any subsidiary; [sell], transfer, lease, mortgage, pledge or otherwise encumb[er] and/or [dispose of] any part of the business, undertaking or assets of [Hulley] or any subsidiary or associated of [Hulley] with a value in excess of US$ 1,000

190 *See* ¶ 137 *supra*.

191 Hulley Enterprises Limited, Particulars of Directors and Managers (1997-2003) (Exhibit RME-210).

192 Lys Report, ¶ 36, 57, *and* Exhibit 8.

193 *See* ¶ 138 *supra*.

> […] exercise […] any rights as member in relation to [Hulley's] subsidiary or associated companies."[194]

146. Thus, as with YUL and GML, Hulley was yet another nominal holder in the chain of shell companies through which the Oligarchs owned and controlled Yukos and its income, and Hulley had no genuine power in relation to the Yukos shares that it nominally owned.

d) VPL

147. VPL was incorporated on February 7, 2001 by Eleni Chrysanthou, who was at that time VPL's sole shareholder.[195] Immediately upon the incorporation of VPL, Ms. Chrysanthou transferred all of her VPL shares to YUL.[196]

148. On April 25, 2001, Mr. Lebedev -- acting on behalf of YUL-appointed WJB Chiltern Trust Company (Jersey) Limited ("Chiltern") as the custodian trustee of VPT,[197] a Jersey trust which was purportedly created to benefit long-term Yukos employees.

149. Pursuant to an "*instruction to deliver free*" dated April 26, 2001, Mr. Lebedev — again acting on behalf of YUL — transferred 223,699,175 of the Yukos shares owned by YUL to VPL's account at UBS.[198]

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194 Hulley Enterprises Limited, Memorandum and Articles of Association, Art. 87 (Exhibit RME-236)

195 *See* Veteran Petroleum Limited, Certificate of Incorporation (Feb. 7, 2001) (Exhibit RME-211); Cyprus Companies Registry, Report on Search for Veteran Petroleum Limited (Mar. 17, 2005), 2 note (b) ("On incorporation of the Company Eleni Chrysanthou was a shareholder of the Company holding 10,000 shares. The 10,000 shares were transferred from Eleni Chrysanthou to Yukos Universal Limited on 7/2/01.") (Exhibit RME-213). *See also* Veteran Petroleum Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Dec. 15, 2006), 12 (Exhibit RME-192).

196 *See* Cyprus Companies Registry, Report on Search for Veteran Petroleum Limited (Mar. 17, 2005), 2, note (b) (Exhibit RME-213).

197 *See*, *e.g.*, Appointment of Custodian Trustee in respect of "The Veteran Petroleum Trust" between Yukos Universal Limited and WJB Chiltern Trust Company (Jersey) Limited (Apr. 25, 2001) (Exhibit RME-215).

198 *See* Yukos Universal Limited, Instructions to Deliver Free Into and Out of ZAO "Brunswick UBS Warburg Nominees" (Apr. 26, 2001) (Exhibit RME-212).

150. On or around April 29, 2001, YUL transferred all of its shares in VPL to Chiltern.[199]

151. Thus, as of April 29, 2001, Chiltern, acting as the custodian trustee of VPT, owned the totality of the VPL shares and, through VPL, approximately 223 million of Yukos shares (corresponding to a 10% shareholding in Yukos).

152. Article 4 of the Deed of Appointment of Chiltern as a custodian trustee of VPT provides that "[a]*ny income arising on the* [Yukos shares] *shall be paid to* [YUL]."[200] Moreover, pursuant to Article 6 of that Deed, Article 4 applies with "*respect of* [the Yukos shares] *which are not owned by the Custodian Trustee but are owned by a company or a subsidiary of any company which is owned by the Custodian Trustee*."

153. In sum, pursuant to Article 4 of the Deed of Appointment, all of the dividends that Yukos paid to VPL were subject to Article 6 of that Deed and, accordingly, were to "*be paid to* [YUL]."

2. Claimants' Fraudulent Abuse Of And Their Fraudulent Representations That They Satisfied The Requirements Of The Russia-Cyprus Tax Treaty

154. The Russia-Cyprus Tax Treaty was signed on December 5, 1998 and entered into force on January 1, 2000.[201]

155. As Professor Rosenbloom explains:

> "The primary purpose of a tax treaty is to promote international trade by removing any 'obstacles that double taxation presents to the development of economic relations between countries.' […] [T]ax treaties are designed to

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199 *See* Cyprus Companies Registry, Report on Search for Veteran Petroleum Limited (Mar. 17, 2005), 2 note (b) (Exhibit RME-213).

200 Appointment of Custodian Trustee in respect of "The Veteran Petroleum Trust" between Yukos Universal Limited and WJB Chiltern Trust Company (Jersey) Limited (Apr. 25, 2001), Art. 4 (Exhibit RME-215).

201 *See* note 147 *supra*.

> mitigate 'the most common problems that arise in the field of international juridical double taxation.'"[202]

156. In the respects pertinent here, the Russia-Cyprus Tax Treaty was intended to avoid the double taxation between Russia and Cyprus of genuine Cypriot companies owning Russian businesses with respect to income generated by those Russian businesses.

157. The Oligarchs, instead, exploited the Russia-Cyprus Tax Treaty not for its intended purpose, but by causing Claimants to abuse the Treaty by improperly invoking it to avoid the payment of Russian taxes that were due with respect to income related to Yukos, and by causing Claimants to falsely represent to Russian and Cypriot authorities that they met the requirements of the Treaty when in fact they did not, in the process violating both Russian and Cypriot criminal laws.

158. Specifically, Claimants abused the Russia-Cyprus Tax Treaty to evade Russian taxes on income in the form of dividends paid on Yukos shares.

a) The Russia-Cyprus Tax Treaty's Requirements Relating To Dividend Income And Claimants' Fraudulent Representations That They Met Those Requirements

159. Pursuant to Article 10(2) of the Russia-Cyprus Tax Treaty, dividend income paid by a Russian subsidiary to its Cypriot parent which "*directly invested*" in the Russian subsidiary "*not less than the equivalent of 100,000 US dollars*" is taxable in Russia at a reduced withholding tax rate of 5% in lieu of the ordinary 15% rate applicable pursuant to Article 284.3(3) of the Russian Tax Code.[203]

160. However, pursuant to Article 10(4) of the Russia-Cyprus Tax Treaty, the reduced withholding tax rate of 5% does not apply if the Cypriot company claiming Russia-Cyprus Tax Treaty benefits:

(i) is not the "*beneficial owner*" of the dividend income; or

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202 Rosenbloom Report, ¶ 78.

203 Expert Report of Oleg Konnov ("Konnov Report"), ¶ 31.

(ii) has a "*permanent establishment*" in Russia, to which the dividend income is attributable.

161. The Russia-Cyprus Tax Treaty does not define "*beneficial owner,*" but the meaning of that term is well settled in this context. As Professor Rosenbloom explains:

> "The concept of 'beneficial ownership' was added to the OECD Model in 1977 to prevent improper use of tax treaties. An OECD report in 1987 entitled 'Double Tax Conventions and the Use of Conduit Companies' explained the purpose of the 'beneficial ownership' requirement. Treaty benefits are denied when they economically benefit a person not entitled to a treaty who uses an agent, nominee, or conduit company to act as an intermediary between himself and the payer of income. This reasoning was incorporated in the 2003 Commentaries to the OECD Model," which "clarified the definition of beneficial ownership by stating that the definition was intended to exclude both:
>
> (a) mere nominees or agents, who are not treated as owners of the income in their country of residence and
>
> (b) any other conduit who though the formal owner of the income, has very narrow powers over the income which render the conduit a mere fiduciary or administrator of the income on behalf of the beneficial owner."[204]

162. Pursuant to Article 5(2) of the Russia-Cyprus Tax Treaty, "*the term 'permanent establishment' includes especially: (a) a place of management; (b) a branch; (c) an office* […]." In addition, Article 5(5) of the Russia-Cyprus Tax Treaty provides that:

> "where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting in a Contracting State of behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such person has and

204 Rosenbloom Report, ¶¶ 94, 96.

habitually exercises in that State an authority to conclude contracts in the name of the enterprise."[205]

163. In sum, the Russia-Cyprus Tax Treaty provisions on dividend income do not apply if the Cypriot recipient of that income:

(i) is a mere nominee, agent, or other conduit with no or very narrow power over the income for which tax-treaty benefits are claimed; or

(ii) has a "place of management" in Russia or a Russian "agent" who "habitually exercises […] an authority to conclude contracts" on its behalf.

164. The evidence confirms that neither Hulley nor VPL satisfied the Treaty's requirements, but nonetheless each claimed benefits under the Treaty on dividends Yukos paid to them for 2000 through 2003. Specifically, Hulley and VPL filed with the Cypriot and the Russian tax authorities Treaty-related forms in which they falsely claimed to be the "beneficial owner[s]" of the dividend income received from Yukos, and misrepresented that "the above mentioned income is not connected with activities carried out in the Russian Federation."[206]

165. As discussed below, these filings and representations were fraudulent and, in any event, Claimants' reliance on the Russia-Cyprus Tax Treaty to minimize Russian taxes was a complete perversion of the Treaty's purpose, and this repeated and deliberate misconduct allowed Claimants to evade substantial amounts of Russian withholding dividend tax.[207]

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205 Pursuant to Article 5(6) of the Russia-Cyprus Tax Treaty, "[a]n enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status […]."

206 *See*, *e.g.*, Hulley Enterprises Limited, Claims for an Exemption of Passive Incomes Sourced in Russia before the Payment is Made (Form 1013DT) for 2000, 2001 (Exhibit RME-193) (English and Russian); Veteran Petroleum Limited, Claims for an Exemption of Passive Incomes Sourced in Russia before the Payment is Made (Form 1013DT) for 2001, 2002 (Exhibit RME-194) (English and Russian). *See also* Hulley Enterprises Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Apr. 7, 2004) (Exhibit RME-190); Veteran Petroleum Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Dec. 15, 2006) (Exhibit RME-192).

207 *See* ¶¶ 200-203 *infra*.

b) Claimants Perverted The Russia-Cyprus Tax Treaty To Evade Russian Taxes On Dividend Income

166. Before addressing the objective facts demonstrating that neither Hulley nor VPL was a beneficial owner of the dividends on Yukos shares for which they claimed benefits under the Russia-Cyprus Tax Treaty, and that both had a Russian permanent establishment that precluded them from relying on the Treaty, at the threshold it bears emphasis that Claimants' invocation of the Treaty to minimize Russian taxes under the circumstances present here completely perverted the Treaty's purpose. As noted above, that purpose is to "*promote international trade by removing any 'obstacles that double taxation presents to the development of economic relations between countries.'*"[208] That purpose plainly does not apply here.

167. It is indisputable that Claimants are mere shell companies ultimately owned and controlled by the Oligarchs. In fact, as Professor Rosenbloom notes, each of Hulley and VPL is:

> "a paper entity organized in Cyprus with minimal substance or reality, total control of its 'decisions' and 'management' vested in Russian individuals operating within Russia, and ultimate ownership by those same Russian individuals."[209]

168. Thus, in the instant case:

> "[t]he income for which treaty benefits were claimed derived from economic activities occurring solely in Russia and only Russian nationals enjoyed the economic benefit of that income. No international commercial activity transpired. This situation involved a claim of reduced taxation in one State (the Russian Federation) by nationals of that same State. This was ostensibly accomplished by the invocation of rights belonging to hollow 'residents' of Cyprus, which itself made no tax claim."[210]

169. As Professor Rosenbloom concludes, Claimants' invocation of the Treaty to reduce their tax liabilities was therefore inherently an abuse, because:

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208 Rosenbloom Report, ¶ 78.

209 *Ibid.*, ¶ 77.

210 *Ibid.*, ¶ 79.

> "[t]ax treaties are not intended to accord benefits in these circumstances. The use of the Yukos structure to generate benefits under the Convention constituted a blatant example of tax treaty abuse."[211]

170. As Professor Rosenbloom continues, Claimants' reliance on the Russia-Cyprus Tax Treaty was therefore a "perversion" because the Oligarchs:

> "created the appearance of double taxation by using artificial Cypriot entities in a structure geared exclusively to Russian income of Russian persons."[212]

171. The conclusion is therefore inescapable that "the claim to treaty benefits by the Cypriot entities in the Yukos structure […] represented a perversion of internationally accepted tax treaty law."[213]

172. Thus, Hulley and VPL were not eligible to claim any of the Russia-Cyprus Tax Treaty benefits even if they had satisfied the Treaty's own requirements. But, as shown below, plainly they had not.

c) Even If Claimants Were Relying On The Treaty For A Proper Purpose, They Were Not The Beneficial Owners Of The Russian Income For Which They Claimed Benefits Under the Russia-Cyprus Tax Treaty

173. In any event, the Oligarchs, not their Cypriot nominees appearing as Claimants in these proceedings, were the beneficial owners of the dividend income relating to Yukos shares. Thus, under the terms of the Russia-Cyprus Tax Treaty, Hulley and VPL were not eligible to any of the Treaty benefits that they claimed.

174. First, as discussed above, Hulley and YUL had no power at any relevant time with regard to Yukos or the Yukos shares they nominally owned. As shown above, absent GML's consent — which was in turn subject to the consent of Mr. Khodorkovsky and his associates — Hulley and YUL could not

211 *Ibid.*, ¶ 77.

212 *Ibid.*, ¶ 89.

213 *Ibid.*, ¶ 89.

exercise "*any rights*" in relation to their holdings in Yukos, including the right to vote the Yukos shares or to claim any economic rights arising out thereof.[214]

175. Therefore, with respect to Hulley's dividend income from Yukos shares:

> "Hulley is not the beneficial owner of any of the dividend payments received from Yukos because the Yukos structure constituted an abusive arrangement under which Hulley was substituted for the Russian individual shareholders in order to benefit from the Convention, to the detriment of the Russian Federation. […] Hulley, a paper entity, did not have authority to exercise any control over Yukos or Yukos dividends. […] The Articles of Association precluded Hulley's directors from exercising any rights in regard to Hulley's subsidiaries. This naturally included the right to Hulley's nominally controlling interest in Yukos."[215]

176. Second, YUL was not even the nominal owner of those dividends, and Hulley was certainly not their beneficial owner, because, in an obvious contrivance involving repeated back-to-back sales and purchases of Yukos shares between YUL and Hulley that were intended solely to create the appearance that Hulley was the beneficial owner of dividends declared on those shares, YUL sold to Hulley (as well as to VPL) immediately before the date as of which Yukos was scheduled to pay dividends (the "ex-dividend" date) Yukos shares which YUL nominally owned, and promptly after the ex-dividend date — in certain instances on the very same day — YUL repurchased those shares. This created the artifice that Hulley (and VPL) beneficially owned those dividends. In truth, this was a complete hoax, intended only to evade Russian withholding taxes by abusing the Russia-Cyprus Tax Treaty.

177. Specifically, between 2000 and 2003, YUL and Hulley entered into a series of artificial sales and repurchases of Yukos shares nominally owned by YUL whereby:[216]

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214 *See* ¶¶ 138-140, 144-146 *supra*.

215 Rosenbloom Report, ¶ 113.

216 Lys Report, ¶¶ 43, 73-77, *and* Exhibits 10-12.

(i) YUL sold to Hulley its Yukos shares shortly before the ex dividend date, subject to a prearranged right to repurchase those shares from Hulley;

(ii) Hulley kept the Yukos shares that YUL sold to it only for as long as necessary to be eligible to collect the dividends, in certain instances for one day; and

(iii) YUL thereafter exercised its right to repurchase from Hulley the Yukos shares for a predetermined price, which typically resulted in a loss for YUL[217] and a profit for Hulley.[218]

178. These transactions clearly had no purpose other than as part of an attempt to lend facial legitimacy to Hulley's claim, as a Cypriot company, to Russia-Cyprus Tax Treaty benefits with respect to Yukos dividends for which YUL, an Isle of Man company, was not eligible.[219] Chart 4 below illustrates the artificiality of those transactions and their unmistakable contrivance solely as blunt and crude instruments of Treaty abuse and Russian tax evasion:

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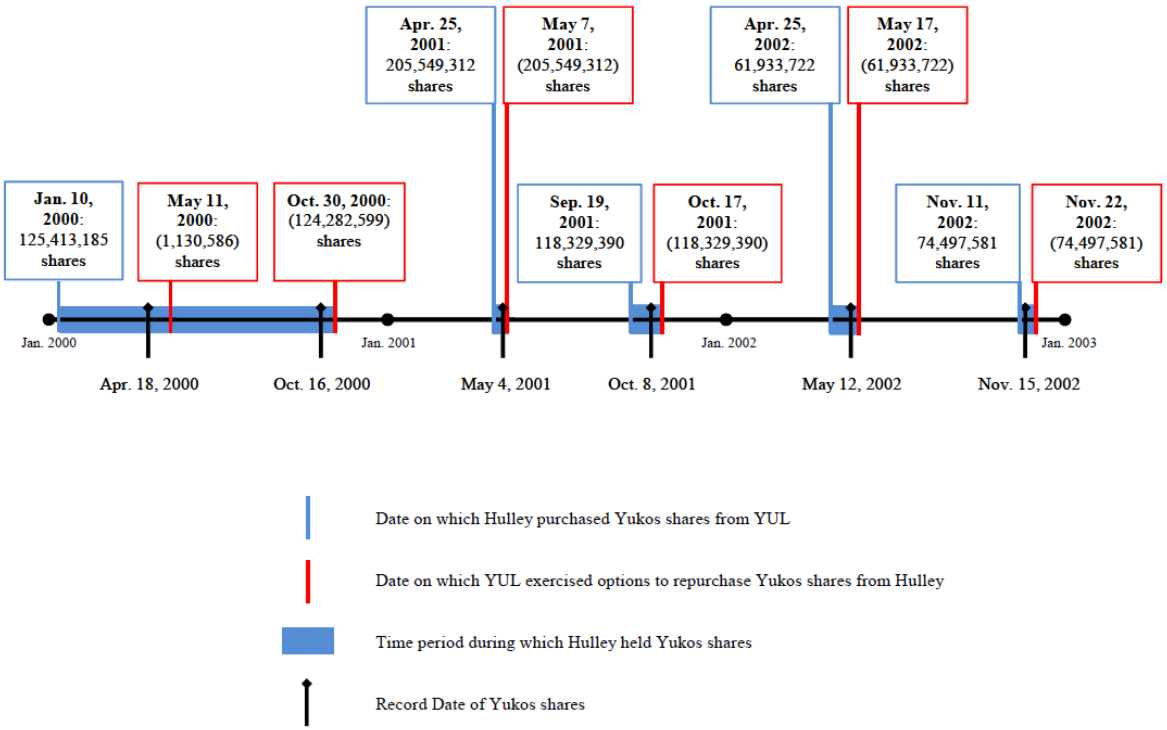
217 Thus, for instance, on April 25, 2001, YUL transferred 205,549,312 shares to Hulley in exchange for US$ 575,538,073. *See* Sales Agreement No. Y-H/1-2001 between Hulley Enterprises Limited and Yukos Universal Limited (Apr. 25, 2001) (Exhibit RME-216). On the same date as that transaction, YUL paid Hulley US$ 1 for the option to repurchase all of those shares for a predetermined price of US$ 575,825,850 within three months. *See* Option Agreement #H-Y/07-2001 between Hulley Enterprises Limited and Yukos Universal Limited (Apr. 25, 2001) (Exhibit RME-217). Then, on May 7, 2001, just three days after Hulley had received a US$ 18,316,499 dividend distribution for the shares transferred from YUL, YUL exercised its option to repurchase all of those shares for the predetermined price. *See* Letter from Yukos Universal Limited to Hulley Enterprises Limited re: Option Agreement of 25th day of April 2001 (May 7, 2001) (Exhibit RME-218). YUL thus repurchased its shares for US$ 287,777 *more* than the original purchase price, in addition to foregoing the dividends it could have received if it had it repurchased the shares just days earlier. *See* Sales Agreement No. Y-H/2-2001 between Hulley Enterprises Limited and Yukos Universal Limited (May 7, 2001) (Exhibit RME-219). *See generally* , Lys Report, ¶¶ 55-77.

218 *See*, *e.g.*, Hulley Enterprises Limited, Annual Report and Financial Statements for the year ended Dec. 31, 2003 (Apr. 7, 2004) (Exhibit RME-190).

219 This motive is evidenced by the fact that there was no apparent economic benefit from these transactions for YUL, other than the intended tax benefit derived by way of Hulley's improper reliance on the Russia-Cyprus Tax Treaty. Indeed, on many occasions, the predetermined price for the Yukos shares was higher than the price for which YUL had initially sold them to Hulley, seemingly causing YUL to lose money from the transaction. *See* Lys Report, Exhibit 5.

CHART 4 – HULLEY/YUL TRANSACTIONS ON YUKOS SHARES[220]



179. Thus, for instance:

(i) After its January 10, 2000 sale of Yukos shares to Hulley, YUL exercised its option to repurchase the shares on two dates. The first set of options was exercised on May 11, 2000, a mere 23 days after the April 18, 2000 dividend record date, and the second set of options was exercised on October 30, 2000, a mere 14 days after the October 16, 2000 dividend record date.[221]

(ii) On April 25, 2001, 9 days before Yukos' May 4, 2001 dividend record date, YUL sold to Hulley 205,549,312 Yukos shares, and then YUL repurchased all of those Yukos shares from Hulley three

220 Lys Report, Exhibit 13.

221 *Ibid.*, ¶ 75.

days after the dividend record date, on May 7, 2001, and a month before the dividend was declared on June 20, 2001.[222]

(iii) Likewise, on September 19, 2001, 20 days before Yukos' October 8, 2001 dividend record date, YUL sold to Hulley 118,329,390 Yukos shares, and then YUL repurchased all of those Yukos shares from Hulley on October 17, 2001, a mere nine days after the dividend record date.[223]

(iv) Consistent with this same pattern, on April 25, 2002, 17 days before Yukos' May 12, 2002 dividend record date, YUL sold to Hulley 61,933,722 Yukos shares, and then YUL repurchased all of those Yukos shares from Hulley on May 17, 2002, a mere five days after the ex-dividend date.[224]

(v) Again, consistent with this same pattern, four days before Yukos' November 15, 2002 dividend record date, on November 11, 2002, YUL sold to Hulley 74,497,581 Yukos shares, and then YUL repurchased all of those Yukos shares from Hulley on November 22, 2002, a mere seven days after the dividend record date.[225]

180. These facts demonstrate that "*the transactions were deliberately timed in order to present Hulley as the shareholder of record for the purpose of receiving Yukos dividend payments on these shares, that were thereafter repurchased by YUL pursuant to the pre-existing Option Agreements.*"[226]

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222 *Ibid.*

223 *Ibid.*

224 *Ibid.*

225 *Ibid.*

226 *Ibid.*, ¶ 76.

181. In his expert report, Professor Rosenbloom concludes that "*such circular transactions in which Hulley held Yukos shares only temporarily represents abusive tax avoidance*."[227]

182. Third, nor was VPL the beneficial owner of the dividends paid to it by Yukos because, pursuant to the deed of appointment of Chiltern as a custodian trustee for the VPT, any dividend relating to the Yukos shares nominally owned by VPL "*shall be paid*" by Chiltern to YUL.[228] VPL was thus another front for the Russian Oligarchs.

183. Specifically, as Professor Rosenbloom observes:

> "the relevant documents indicate that VPL was a nominee for YUL, and legally obligated to transmit all Yukos dividends to YUL. VPL stock is owned by VPT and managed by Chiltern. VPT was settled by YUL and, according to the Agreement, Chiltern and VPL are required to pay all dividends in respect of Yukos shares to YUL. I have seen nothing that suggests this obligation was not met."[229]

184. Thus, "[a]*lthough it held legal title to the Yukos shares at the time of the dividend declarations, VPL's contractual obligation to immediately transfer the Yukos dividend payments indicates that it was only acting as a nominee*."[230]

185. Fourth, VPL's status as a mere nominee and the fact that it was not the beneficial owner of dividends paid on Yukos shares, and therefore was not entitled to claim favorable withholding tax treatment of those dividends under the Russia-Cyprus Tax Treaty, is further confirmed by the statements for the account through which the Yukos shares nominally owned by VPL were held. They disclose precisely the same type of contrivance to place Yukos shares temporarily in the hands of VPL through several back-to-back transfers and

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227 Rosenbloom Report, ¶ 114.

228 *See* Appointment of Custodian of Trustree in respect of "The Veteran Petroleum Trust" between Yukos Universal Limited and WJB Chiltern Trust Company (Jersey) Limited (Apr. 25, 2001) (Exhibit RME-215).

229 Rosenbloom Report, ¶ 110.

230 Rosenbloom Report, ¶ 111.

retransfers, apparently for no consideration, of Yukos shares between YUL and VPL, in order to create the appearance that VPL was the beneficial owner of dividends declared on those shares, as was done with Hulley. Once again, as with Hulley:

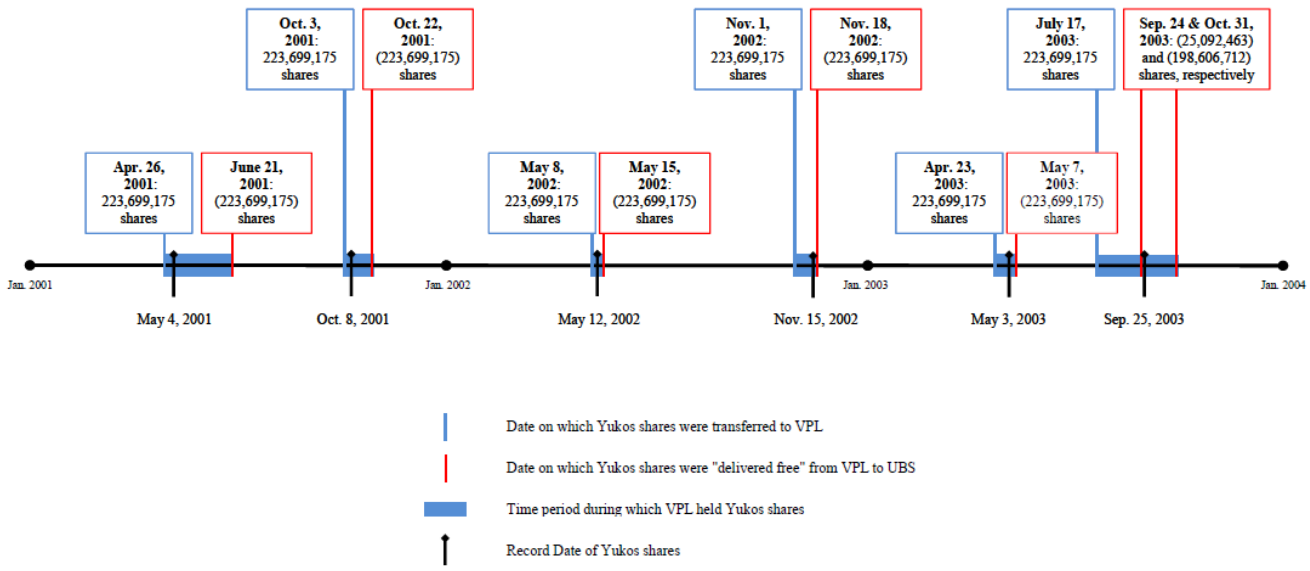
(i) YUL transferred to VPL its Yukos shares shortly before the "ex dividend" date;

(ii) VPL kept the Yukos shares that YUL had transferred to it only for as long as necessary to be eligible to collect the dividends; and

(iii) VPL thereafter retransferred back to YUL the Yukos shares.

186. Chart 5 below depicts how YUL transferred Yukos shares to VPL only for as long as necessary for VPL to claim Treaty benefits for dividends, following which YUL promptly repurchased these shares from VPL, once again in a flagrant abuse of the Russia-Cyprus Tax Treaty:

CHART 5 – VPL/YUL TRANSACTIONS ON YUKOS SHARES[231]



187. Thus, for example:

231 Lys Report, Exhibit 16.

(i) Eight days before Yukos' May 4, 2001 dividend record date, on April 26, 2001, YUL transferred to VPL 223,699,175 Yukos shares and then YUL retransferred all of those Yukos shares from VPL on June 21, 2001.[232]

(ii) Likewise, on October 3, 2001, five days before Yukos' October 8, 2001 dividend record date, YUL again transferred to VPL 223,699,175 Yukos shares, the same amount of shares YUL had transferred and retransferred in April and June 2001, and then YUL retransferred all of those Yukos shares from VPL on October 22, 2001, a mere 14 days after the dividend record date.[233]

(iii) Consistent with this same pattern, on May 8, 2002, four days before Yukos' May 12, 2002 dividend record date, YUL again transferred to VPL 223,699,175 Yukos shares, the same amount of shares YUL had transferred and retransferred in April and June and again in October, 2001, and then YUL retransferred all of those Yukos shares from VPL on May 15, 2002, a mere three days after the dividend record date.[234]

(iv) Again consistent with this same pattern, on November 1, 2002, 14 days before the November 15, 2002 dividend record date, YUL again transferred to VPL 223,699,175 Yukos shares, the same amount of shares YUL had transferred and retransferred in April and June and in October 2001 and again in May 2002, and then YUL retransferred all of these Yukos shares from VPL on November 18, 2002, three days after the dividend record date.[235]

(v) Again consistent with this same pattern, on April 23, 2003, 10 days before the May 3, 2003 dividend record date, YUL again

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232 *Ibid.*, ¶ 83.

233 *Ibid.*

234 *Ibid.*

235 *Ibid.*

transferred to VPL 223,699,175 Yukos shares, the same amount of shares YUL had transferred and retransferred in four separate instances during 2001 and 2002, and then YUL retransferred all of these shares from VPL on May 7, 2003, a mere four days after the dividend record date.[236]

(vi) Again consistent with this same pattern, on July 17, 2003, a few weeks before the September 25, 2003 dividend record date, YUL again transferred to VPL 223,699,175 Yukos shares, the same amount of shares YUL had transferred and retransferred in five separate instances during 2001, 2002 and 2003, and then YUL retransferred all of these shares from VPL on September 24, one day before the dividend record date, and on October 31, 2003, peculiarly a few weeks after the dividend record date.[237]

188. As Professor Rosenbloom explains:

> "VPL's temporary ownership arrangement with UBS, whereby VPL held Yukos stock only long enough to qualify as dividend recipient, constituted an abuse of law requiring the conclusion that VPL was not the beneficial owner of those dividends. VPL and UBS engaged in circular transfers of a 10 percent stock interest in Yukos. VPL held the stock only long enough to assert formal qualification for benefits of the Convention with respect to the receipt of Yukos dividends; at all other times it claimed zero interest in Yukos."[238]

189. Tellingly, after Yukos declared the last (and largest[239]) dividends in its history (on November 28, 2003), the Yukos shares held by VPL were

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236 *Ibid.*

237 *Ibid.*

238 Rosenbloom Report, ¶ 112.

239 *See* ¶¶ 349-352 *infra*.

transferred to a Swiss UBS account, which was later found by the Swiss authorities to be beneficially owned by Mr. Khodorkovsky and his associates.[240]

d) All Of The Russian Dividend Income From Yukos Shares For Which Claimants Claimed Russia-Cyprus Tax Treaty Benefits Was Attributable To Claimants' Russian Permanent Establishment

190. As explained above, the Russia-Cyprus Tax Treaty provisions on dividend income require not only that the Cypriot recipient of that income be the beneficial owner of that income and not the type of mere nominee or other conduit that both of Hulley and VPL plainly were, but also that the recipient does not have a permanent establishment in Russia to which the dividend income is attributable. Once again, contrary to Hulley's and VPL's representations to Russian and Cypriot authorities, neither had substantial business activities in Cyprus, as both previously admitted to the Tribunal,[241] and both of them were at all times owned, controlled and managed by the Oligarchs from Russia.[242]

191. In fact, Claimants' actual place of management has at all relevant times been in Moscow, at the representative office of GML Management Services S.A. ("GML MS"), a BVI company wholly owned by GML. [243]

192. Claimants themselves have acknowledged that GML MS "was a service provider supplying administrative, record-keeping, accounting and other services in Russia for various companies, including Hulley and Yukos

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240 Judgment of the Swiss Federal Tribunal (June 10, 2004), *WJB Chiltern Trust Company (Jersey) Limited, St. Helier Jersey (Great Britain), and Veteran Petroleum Limited v. Public Prosecutor's Office of the Swiss Confederation*, ¶ 6 (Annex (Merits) C-474).

241 *See, e.g.*, Claimants' Counter-Memorial on Jurisdiction and Admissibility (YUL), ¶ 287 ("The Claimant […] acknowledges that it has no substantial business activity in Isle of Man"); Claimants' Counter-Memorial on Jurisdiction and Admissibility (Hulley), ¶ 288 ("The Claimant […] acknowledges that it has no substantial business activity in Cyprus").

242 *See* ¶¶ 141-153, *supra*.

243 *See* GML Limited (formerly Group Menatep Limited), Financial Statements for the year ended Dec. 31, 2001 (Feb. 14, 2006), 12 (Exhibit RME-196).

Universal,"[244] based on "Administrative Services Agreements" entered into by GML MS with each of them.[245]

193. And searches conducted by the Russian authorities in 2003 revealed that the Moscow-based office of GML MS held the corporate seals and a number of documents relating to the operations of Claimants, confirming that they were in fact managed from Moscow.[246]

194. In particular, the minutes recording the activities relating to these searches confirm that the Moscow-based office of GML MS held, *inter alia*:

(i) the official corporate seals of Hulley and VPL;[247] and

(ii) corporate and other documentation relating to a broad range of transactions entered into by entities at all levels of the Yukos on-shore and off-shore structures, including:

(a) 69 documents evidencing transactions relating to the acquisition and disposal of Yukos shares by Hulley, 63 of which had been executed by Russian individuals and residents, including Mr. Lebedev, who was a Director and the Chairman of Hulley from September 17, 1997 until November 29, 2003;[248] and

(b) 388 documents evidencing transactions relating to the acquisition and disposal of Yukos shares by YUL, 319 of

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244 Letter from Emmanuel Gaillard (counsel for the ECT Claimants) to L. Yves Fortier, Judge Stephen Schwebel, and Daniel Price (Aug. 18, 2006), 14 (Exhibit RME-220).

245 *See* Letter from GML Management Services to Hulley Enterprises Limited re: Administrative Services Agreement of 03 July 2003 (Oct. 15, 2003) (Exhibit RME-221); Letter from GML Management Services to Yukos Universal Limited re: Administrative Services Agreement of 03 July 2003 (Oct. 15, 2003) (Exhibit RME-222). *See also* GML Limited (formerly Group Menatep Limited), Financial Statements for the year ended Dec. 31, 2001 (Feb. 14, 2006), 13 (Exhibit RME-196).

246 *See* Office of the Prosecutor General of the Russian Federation, Search Warrant (Oct. 8, 2003) and Protocols of Search (Oct. 9, 2003), 9, 13-17, 59-60 (Exhibit RME-223).

247 *Ibid.*, 59-60.

248 *See* Chart 3 *supra*.

> which had been executed by Russian individuals and residents, including Mr. Lebedev, who was also a Director of YUL from September 25, 1997 until January 5, 2004.[249]

195. Because the Moscow-based office of GML MS was Claimants' "*place of management*," "*branch*," or "*office,*" Claimants each had a Russian permanent establishment pursuant to Article 5(2) of the Russia-Cyprus Tax Treaty, contrary to their representations to Russian and Cypriot authorities.

196. Also, in any event, Claimants had a Russian agency-permanent establishment pursuant to Art. 5(5) of the Russia-Cyprus Tax Treaty[250] because all of the activities relating to their nominal holdings in Yukos were carried out by the Oligarchs, as evidenced, *inter alia*, by the many agreements relating to the Yukos shares executed by Mr. Lebedev and other Russian individuals.[251] In fact, as Professor Rosenbloom explains:

> "That Lebedev had authority to conclude contracts on Hulley's behalf is indisputable. Not only did Lebedev execute every decision regarding Yukos shares held by Hulley, but he personally signed a number of sales agreements entered into by Hulley with YUL. Lebedev's activities occurred in Russia. Those contracts with YUL that were not signed by Lebedev were signed by Gouline, also a Russian national acting in Russia."[252]

197. Finally, pursuant to Article 10(4) of the Russia-Cyprus Tax Treaty, all of the income with respect to which Claimants abused the Russia-Cyprus Tax Treaty is attributable to their Russian permanent establishment. That is because: (i) that income unquestionably related to the Yukos shares; (ii) Claimants carried out no business activities other than holding Yukos shares; and (iii) virtually all of the transactional documents relating to those activities were executed by Russian individuals, in their capacity as "*agents*" for the Cypriot Claimants. As Professor Rosenbloom explains:

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249 *See* Chart 2 *supra,* showing YUL's succession of directors.

250 *See* ¶ 162 *supra*.

251 *See* ¶ 194 *supra*.

252 Rosenbloom Report, ¶ 122.

> "Hulley's business activities involved the holding of shares in Yukos and the trading of Yukos shares with YUL. The holding of Yukos shares may have required little activity, but it is clear that Lebedev oversaw whatever activities were needed. Furthermore, Lebedev was responsible for designing and executing Hulley's share trading activities with YUL. His authority to act for both Hulley and YUL enabled him to design sale and option agreements that disproportionately benefited Hulley for the greater economic benefit of the Yukos structure. Lebedev signed many of these pertinent contracts on Hulley's behalf. On several occasions, he was also the signing representative in letters from YUL informing Hulley of the exercise of options.
>
> The conclusion is inescapable that all of Hulley's income was attributable to activities undertaken by Lebedev within Russia. As a result, even if Hulley was covered by the Convention, it was not entitled to reduced tax under paragraph 2 of Art. 10. Rather, the Russian Federation was entitled to tax Yukos dividends received by Hulley as business profits of a Russian permanent establishment covered by Article 7 of the Convention. Furthermore, the substantial gains reaped by Hulley on the disposition of Yukos shares were undoubtedly attributable to Hulley's permanent establishment in Russia (assuming Hulley was entitled to invoke the Convention)."[253]

198. As shown above, the same holds true for VPL, too.[254]

199. In sum, each of YUL, Hulley, and VPL had a permanent establishment in Russia to which the dividend income on Yukos shares was attributable, thereby disqualifying Hulley and VPL from claiming benefits under the Russia-Cyprus Tax Treaty, which they nonetheless did.

3. Claimants' Abuse Of The Russia-Cyprus Tax Treaty Resulted In Massive Losses For The Russian Treasury

200. Hulley and VPL received dividend income for which they claimed the benefit of a reduced withholding tax rate, which they could not have otherwise claimed had they not fraudulently relied on the Russia-Cyprus Tax Treaty, including by:

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253 *Ibid.*, ¶¶ 131-132.

254 *Ibid.* ¶ 125.

(i) making false representations to the Cypriot tax authorities with respect to their status;

(ii) obtaining, in reliance on those false representations, Cypriot tax authorities' certifications confirming eligibility to the Russia-Cyprus Tax Treaty; and

(iii) filing with the Russian authorities tax returns in reliance on those certifications.[255]

201. Professor Lys estimates that from 2000 to 2003, Hulley and VPL received pre-tax dividends from Yukos of US$ 2,144,266,251 and US$ 319,097,191, respectively.[256] Hulley's after-tax dividends amounted to US$ 2,037,052,939, and VPL's to US$ 303,104,332 (*i.e.*, at the abused 5% Treaty-withholding tax rate).

202. Had they not abused the Russia-Cyprus Tax Treaty, Hulley and VPL would have received after-tax dividends for the relevant period totaling US$ 1,822,626,314 and US$ 271,232,613, respectively (*i.e.*, at the applicable 15% withholding tax rate).

203. Thus, Claimants' abuses of the Russia-Cyprus Tax Treaty with respect to dividend income resulted in losses to the Russian treasury exceeding US$ 245 million, not including interest and fines.

4. Hulley's Failure To Account For Profits From Sales Of Securities

204. In addition to Claimants' abuses of the Russia-Cyprus Tax Treaty with respect to the Russian withholding tax due on dividends on Yukos shares, Hulley also failed to account to Russian tax authorities for the profits it gained from its sales of Yukos shares.

205. Hulley's 2003 financials show that Hulley received "*net profits from transactions*" relating to, and "*profits from sale of*," Yukos shares in excess of US$

255 *See* ¶¶ 111-117 *supra*.

256 *See* Lys Report, ¶¶ 94, 99, *and* Exhibits 20, 24.

2.9 billion.[257] Those financials also confirm that Hulley did not pay any Russian or Cypriot tax on those profits.

206. As explained in the expert report of Russian tax law expert Oleg Konnov, submitted with this Counter-Memorial, non-Russian entities are subject to Russian corporate income taxes with respect to income attributable to their Russian permanent establishment.[258]

207. As discussed in greater detail at ¶¶ 190 to 199 above, Hulley had a permanent establishment in Russia, to which all of the income relating to its Yukos shares was attributable.

208. In 2003, the Russian tax rate applicable to profits from sales of securities, such as Hulley's profits from its sales of Yukos shares, was 24%.[259] Thus, in addition to evading Russian withholding tax on dividends received on "its" Yukos shares, Hulley separately evaded Russian taxes on profits arising out of sales of Yukos shares in excess of US$ 696 million, not inclusive of interest and fines.

5. Claimants' Misconduct Constituted Crimes Under The Laws Of Russia And Cyprus

a) Russian Criminal Law

209. Claimants' abusive reliance on the Russia-Cyprus Tax Treaty to evade Russian withholding tax constitutes tax evasion under Russian criminal law. Specifically, Article 199 of the Russian Criminal Code in force at the relevant time condemned:

> "evasion of tax payments by organizations by means of including into accounting documents of deliberately false information on profits and losses, or through other means, as well as evasion of

257 *See* Annual Report and Financial Statement for Hulley Enterprises Limited for 2003, 7 (Exhibit RME-190).

258 *See* Konnov Report, ¶ 29.

259 *Ibid*., ¶ 29.

insurance payments to the State non-budgetary funds by organizations on a large scale."[260]

210. The Russian Constitutional Court has explained that tax evasion "*through other means*" covers any conduct aimed at the deliberate non-payment (or underpayment) of taxes in violation of tax law.[261] Russian criminal law scholars uniformly agree.[262]

211. It is clear from the foregoing that Claimants Hulley and VPL filed tax treaty-related forms containing fraudulent representations with respect to their purported entitlement to Russian-Cyprus Tax Treaty benefits which resulted in the "*large scale*" evasion of Russian taxes.

212. Specifically, Hulley and VPL:

(i) fraudulently obtained from the Cypriot tax authorities the certifications which allowed them to invoke the benefits provided for in the Russia-Cyprus Tax Treaty; and

(ii) filed tax treaty-related forms containing those certifications for the purpose of evading Russian withholding tax on dividends.

213. It is also clear that Hulley failed to account for profits from sales of securities, which in itself amount to a violation of Article 199 of the Russian Criminal Code.

214. Thus, this conduct and the persons responsible for it -- namely, the persons behind Hulley and VPL -- violated Article 199 of the Russian Criminal Code.

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260 Russian Criminal Code, Art. 199 (Exhibit RME-241)

261 Resolution of the Constitutional Court of the Russian Federation, No. 9-P (May 27, 2003) (Exhibit RME-244)

262 *See, e.g.*, Yu. R. Potoker, *Tax Crimes in the Criminal Code of the RF,* Articles and Theoretical Conference Abstracts of PhD candidates of the institute of State and Law of the Russian Academy of Sciences, 282 (2000), 287 (Exhibit RME-245), noting that: "[T]*he fact that the list of [methods of tax evasion] is not exhaustive evidences that the very fact of evasion is now treated by the legislator as so socially dangerous that any methods of evasion will be criminal*."

b) Cypriot Criminal Law

215. Claimants' misconduct also constitutes criminal offenses under the laws of Cyprus.

216. Specifically, pursuant to Article 305 of the Cypriot Criminal Code:

> "[a]ny person who willfully procures or attempts to procure for himself or any other person any registration, license or certificate under any Law or regulations by any false pretence, in guilty of a misdemeanour."[263]

217. The definition of "false pretence" is contained in Article 297 of the Cypriot Criminal Code. It includes:

> "[a]ny representation made by words, writing or conduct, of a matter of fact, either past or present, which representation is false in fact, and which the person making it knows to be false or does not believe to be true, is a false pretence."[264]

218. As explained in the expert report of Polyvios G. Polyviou, a leading Cypriot attorney and an expert on Cypriot law, submitted with this Counter-Memorial:

> "[b]y declaring/confirming on the said Forms that the relevant dividends received from Yukos were not connected with activities carried in Russia and that Hulley/[VPL] (as applicable) was the beneficial owner of the relevant dividends, the signatory of the written declaration/confirmation was making a representation of a matter of fact that was false in fact to the Cypriot officials who would read the said Forms,"[265]

thereby giving rise to the company's and that director's or officer's criminal liability.

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263 Cypriot Criminal Code, Art. 305 (Exhibit RME-235).

264 Cypriot Criminal Code, Art. 297 (Exhibit RME-235).

265 Polyviou Report, ¶ 11.

219. It is clear that under Cypriot criminal law "the acts and state of mind of the offending natural person, a director or office, can be imputed to the respective company on whose behalf he was acting."[266]

220. Thus, Hulley and VPL, as well as their duly authorized agents who provided to the Cypriot tax authorities the "false pretence" that Hulley and VPL were the "beneficial owner[s]" of the dividends paid to them by Yukos, and that those dividends were "not connected with activities carried in the Russian Federation,"[267] violated Article 305 of the Cypriot Criminal Code.

221. In addition, Claimants' misconduct, and the misconduct of their authorized agents, violated Article 341 of the Cypriot Criminal Code, pursuant to which:

> "[a]ny person who, by means of any fraudulent representations as to the nature, contents or operation of a document, procures another to sign or execute a the document is guilty, of an offence of the same kind and is liable to the same punishment as if he has forged the document."[268]

222. Specifically, as is detailed by Mr. Polyviou, not only were the representations made to the Cypriot tax authorities "*false in fact*," they were also "*fraudulent*" insofar as they were "*made with the intent to defraud, inter alios, the Cypriot officials who would read the said Forms and who would be asked to complete, date, sign and stamp Box 4 thereof*."[269]

223. Finally, Claimants and their authorized agents violated Article 311 of the Cypriot Criminal Code by failing to disclose in the financial statements of

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266 *Ibid.*, ¶ 12.

267 Cypriot Criminal Code, Art. 305 (Exhibit RME-235).

268 Cypriot Criminal Code, Art. 341 (Exhibit RME-235).

269 Polyviou Report, ¶ 14.

Hulley and VPL that the tax treaty benefits those companies obtained under the Russia-Cyprus Tax Treaty were improperly claimed. [270]

224. Accordingly, Claimants not only perverted the Russia-Cyprus Tax Treaty and claimed benefits they were not entitled to claim under that Treaty, but in so doing they committed crimes in violation of Russian and Cypriot criminal laws.

H. Yukos' Russian Tax Evasion Scheme

225. The biggest tax evasion scheme was the one that Claimants perpetrated through Yukos, which over its lifetime resulted in the evasion of hundreds of billions of rubles in taxes[271] and ultimately in the demise of Yukos.[272]

226. Over the course of its effective life (1999-2004), Yukos' "tax optimization" scheme—as it was sometimes euphemistically referred to by the Oligarchs—underwent a number of refinements, but none of these changes altered its basic structure or purpose,[273] which entailed the abusive exploitation of the low-tax regions program that Russia's federal government had authorized

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270 Polyviou Report, ¶ 16. Specifically, pursuant to Article 311(b) of the Cypriot Criminal Code, "[a]ny person who […] being a director, officer or member of a corporation or company, does any of the following acts with intent to defraud, that is to say […] (iii) omits or is privy to omitting any material particular from any such book, document or account, is guilty of a felony and is liable to imprisonment for seven years" (Exhibit RME-235). Likewise, Article 143(6) of the Cypriot Companies Law provides that "[i]f any person being a director of a company fails to take all reasonable steps to secure compliance as respects any account laid before the company in general meeting […] as to the matters to be stated in accounts, he shall, in respect of each offence, be liable on conviction to imprisonment." *See* Polyviou Report, Exhibit K.

271 *See* ¶¶ 360, 412 *infra*.

272 *See* Section II.L. *infra*.

273 Year by year, Yukos carefully selected the most friendly low-tax regions to establish the trading shells that would allow it to evade taxes. Thus, for instance, after the authorities had started auditing its trading shells in *Zakrytoe Administrativno-Territorial'noe Obrazovaniye* ("ZATO") of Lesnoy, Yukos moved out of that and other ZATOs (*see* ¶¶ 281-287 *infra*). Likewise, Yukos abandoned the Republic of Kalmykia after the local tax authorities had launched a series of tax audits on Kalmykia-registered shell companies, including Sibirskaya Transportnaya Kompaniya, another trading shell that Yukos had been using to evade taxes (*see* ¶¶ 291-294 *infra*). While abandoning the riskiest low-tax regions, Yukos gradually concentrated its "tax optimization" efforts in the Republic of Mordovia and the Evenkiysky Autonomous District, where the Oligarchs' economic and political influence was overwhelming, and which would ensure that the local tax authorities would not challenge Yukos' abuses (*see*, *e.g.*, ¶¶ 254-255 *infra*).

in the early-1990s to foster economic development in the country's most economically depressed areas.[274]

227. In Russia's low-tax regions, corporate profit tax was typically assessed at a rate equal to only one third the normal rate or less, depending on the tax year.[275]

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[274] These areas included, but were not limited to, ZATOs. ZATOs (or "Closed Administrative Territorial Units") were settlements established in the former Soviet Union from the late 1940s as defense and nuclear power plant cities, which included communities with sensitive military, industrial or scientific facilities, such as arms plants or nuclear research sites. Due to their special status and the fact that their economic health was often related to military activities, ZATOs faced catastrophe after the end of the Cold War. As a result, on July 14, 1992, the Russian State Duma enacted a federal law to define the special tax regime of the ZATOs and the financing of these territories by the federal government, and guarantee ZATOs' residents certain social and health benefits. *See* Law of the Russian Federation No. 3297-1 (July 14, 1992), "On Closed Administrative Territorial Units" (Annex (Merits) C-404). Among the ZATOs used by Yukos in furtherance of its tax evasion scheme were the ZATOs of Lesnoy, Trekhgorny, and Sarov. *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004) (Annex (Merits) C-104). Other low-tax regions included the Republics of Evenkia, Kalmykia, and Mordovia, as well as the city of Baikonur. *See*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sep. 2, 2004) (Annex (Merits) C-155).

The purpose of incentivizing economic development within these regions was generally proclaimed in the laws governing their special tax regimes. Thus, for instance, pursuant to Article 1 of the Law of the Republic of Mordovia "On the Conditions of the Efficient Use of the Social and Economic Potential of the Republic of Mordovia" No. 9-Z (Mar. 9, 1999) (Annex (Merits) C-414), "[t]*his Law,* [which seeks] *to create a favorable tax climate to attract capital to the Republic of Mordovia in order to strengthen the social and economic potential of the Republic, to develop the securities market and to create additional jobs, provides for specific terms in respect of taxation of entities, which operations meet the requirements listed in Article 2 of this Law*." Likewise, pursuant to Article 1 of the Law of the Republic of Kalmykia "On the Tax Benefits Granted to Enterprises Making Investments in the Economy of the Republic of Kalmykia" No. 12-II-Z (Mar. 12, 1999) (Annex (Merits) C-413), "[t]*his Law is aimed at further enhancement of the investment climate in the Republic of Kalmykia, attraction of enterprises making investments in the economy of the Republic of Kalmykia as well as international investors, and provision of incentives for small businesses, while securing efficient tax collection and compliance with tax laws*." Likewise, Article 1 of the Law "On the Particularities of the Tax System in Evenkiysky Autonomous District" No. 108 (Sep. 24, 1998) (Annex (Merits) C-412) provided that "[t]*he present Law is directed on improvement of an investment climate in the Evenkiysky Autonomous District, attraction of investors from other regions and foreign investors to the District, encouragement of a direction of means for financing of priority projects for District, stimulation of small-size business and simultaneous maintenance of a high rate of collection of taxes and observance of the tax laws.*"

[275] Thus, for instance, PwC's lead auditor on the Yukos engagement, Mr. Miller (*see*, ¶ 36 *supra*), estimated that "*tax expenses*" of the trading shells constituted "*only 6% of the received profit*" (*see* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 14, 2007), 5 (Exhibit RME-353)). Conversely, the ordinary, non-minimized Russian corporate profits tax rate varied over the 1999-2004 time-period as follows: (i) 35% for January-March 1999; (ii) 30% for April-December 1999; (iii) 30% for 2000; (iv) 35% for 2001; and (v) 24% for 2002-2004. *See* Konnov Report, ¶¶ 29, 33-34.

228. As explained by Mr. Konnov in his expert report,[276] in order to be entitled to claim benefits from any low-tax region, a taxpayer needed to comply with three sets of norms: (i) the specific requirements relating to the establishment of business activities in accordance with the relevant region's statutes; (ii) the specific agreements entered into with the local or regional authorities (if any); and (iii) the federal statute authorizing the low-tax regions program and applicable federal anti-avoidance rules, whose roots go back to the mid-1990s, and which—in the case of the low-tax region program—required the local company to have economic substance and that investments be made in the local economy, the sole *raison d'être* of the program,[277] in amounts that are proportional to the tax benefits received.[278]

229. As discussed in greater detail below (*see* ¶¶ 279-296, 993-1002 *infra*), Yukos failed to comply with these requirements, and the tax assessments that were levied against it were entirely proper.

1. The Structure Of The Yukos Tax Evasion Scheme

230. Yukos' controlling shareholders—Claimants in these proceedings—pursued their objective of having Yukos engage in large-scale tax evasion with determination, imagination, and sophistication.[279] By using a broad panoply of subterfuges in remote regions of Russia, they tried to confuse and mislead the tax authorities, and for years were largely successful.

231. Reduced to its essentials, Yukos' "tax optimization" scheme involved five key ingredients.

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276 Konnov Report, ¶ 35.

277 Specifically, as explained by Mr. Konnov, "[t]*he primary purpose of taxes is the replenishment of the budget to ensure a normal operation of the state. Tax preferences and tax incentives, in particular, are designed to stimulate investment of resources in entrepreneurial activities*." Konnov Report, ¶ 27.

278 Konnov Report, ¶¶ 39-52.

279 Thus, for instance, as pointed out by GML's former financial administrator, Elena Collongues-Popova, "'*[t]hey cheated nearly everyone -- they cheated the people who worked for them, they cheated their partners, they cheated other shareholders. It's a chain of swindles.*'" *See* Jeanne Whalen, *Tales of Yukos Empire by Insider May Undermine Defense of CEO,* Wall St. J. (Jan. 7, 2004), B4 (Exhibit RME-250).

232. First, it entailed the interposition of dozens of purportedly independent trading shells established in Russia's low-tax regions, with no business purpose other than facilitating tax evasion.[280]

233. Second, those trading shells would intercept the lion's share of the artificially inflated profits resulting from purchases of oil from Yukos' production subsidiaries at prices far below those that a seller would have charged in arm's length transactions[281] and the sale of oil and oil products to independent customers at vastly higher prices.[282]

234. Third, there was no meaningful investment by the trading shells in the low-tax regions where they were established.[283] Because the trading shells were nominally established in, and purported to operate from, Russia's low-tax regions, their artificially inflated profits were lightly taxed at those regions' low rates.

235. Fourth, the scheme entailed the transfer of the trading shells' artificially inflated profits to Yukos—which was not established in a low-tax region—and other offshore entities ultimately owned by the Oligarchs, through Claimants. Specifically, Yukos resorted to a variety of techniques designed to mask its affiliation with the trading shells, make it extremely difficult, if not impossible, for Russian authorities to trace the proceeds of Yukos' "tax optimization" scheme, and shelter those profits from taxes which would have

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280 As noted by the authorities in the December 2003 audits of Yukos leading to the tax assessment for the year 2000, these entities included: (i) OOO Norteks, OOO Greis, OOO Muscron, OOO Kverkus, OOO Yuksar, OOO Virtus, OOO Vald Oil, OOO Mitra, and OOO Business-Oil in various ZATOs; (ii) OOO Sibirskaya Transportnaya Kompaniya in the Republic of Kalmykia; (iii) OOO Mars XII (which Yukos later renamed OOO Energotrade), OOO Ratmir, OOO Alta Trade, ZAO Yukos-M, OOO Yu-Morodvia, OOO Fargoil, OOO Makro Trade in the Republic of Morodovia; (iv) OOO Petroleum Trading, OOO Ratibor and OOO Evoil in the Evenkiysky Autonomous District; and (v) OOO Mega-Aliance in the City of Baikonur. *See* ¶¶ 237-243 *infra*.

281 *See*, *e.g.*, Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09-AP-7979/05-AK (Aug. 16, 2005) (Exhibit RME-251), noting that "*by executing the documents for re-selling of oil through a number of companies, Senior Vice-President of OAO NK YUKOS, Mr. M.V. Elfimov, sold the same oil with an increase of RUB 5,171 per tone or 4.8 times more expensive*."

282 *See* ¶¶ 244-248 *infra*.

283 *See* ¶¶ 249-255 *infra*.

been otherwise levied by Russia and other countries upon receipt by Yukos or its affiliates, including by way of:

(i) "donations" or "gifts" to a purported "Production Development Financial Support Fund";[284]

(ii) fictitious transactions involving "promissory notes" issued by Yukos or its affiliates;[285] and

(iii) the siphoning off from Russia of the trading shells' profits through offshore intermediary shell companies.[286]

236. Fifth, each of the foregoing key elements was concealed, including by keeping secret Yukos' continued *de facto* ownership and control of the trading shells, masking the artificial transfer pricing scheme implemented through the trading shells, and interposing multiple layers of non-transparent offshore entities between Yukos and the trading shells.

a) The Trading Shells Were "On Paper" Fictions

237. The entire purportedly independent trading shell system was a sham—a fiction that existed only "on paper," and that had no business purpose other than tax evasion.[287]

238. In fact, the trading shells never controlled "their" inventories—they possessed none, except on paper. It was Yukos that decided which oil would be nominally transferred to the trading shells, and to which final customer the oil would be sold, and at what price. Thus, at various times Yukos passed itself off: (i) as a "purchasing agent" acting for the trading shells in the purchase

284 *See* ¶¶ 258-260 *infra*.

285 *See* ¶¶ 261-265 *infra*.

286 *See* ¶¶ 266-277 *infra*.

287 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 12 (Exhibit RME-137): "*Question: You said that, first of all, you were concerned about the sale and repurchase of oil and oil products. What was wrong about them? What are these transactions? Answer: We could not understand the logic.* […] *Question: In other words, when they told you that these transactions were conducted for tax optimization, the essence of these transactions became clear? Answer: Yes*."

of oil at non-arm's length prices from the producing subsidiaries; and/or, on the other end, (ii) as a "selling agent" for those same entities, selling "their" oil to independent customers at vastly higher prices.[288]

239. Yukos also controlled all aspects of the physical processing of the oil, which never occurred in the low-tax regions where the trading shells purported to operate (since they had no facilities to store the large volumes of oil and oil products which they fictitiously traded[289]), but was instead handled by the producing subsidiaries and other Yukos affiliates, including refineries. Specifically, Yukos caused the trading shells to enter into so-called "tolling" agreements, pursuant to which refineries controlled by Yukos undertook to process the oil.[290] The refined products were then shipped directly to the

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288 *See, e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92 and No. A40-54628/04-143-134 (Nov. 18, 2004), 6-7 (Exhibit RME-252): "*YUKOS was present at all stages of operations with oil and oil products, either acting as an intermediary or by engaging into the transactions* [with] *other entities that* [were] *dependent on it*; […] *The fact that one officer of* [Yukos] *represented at the same time producing companies, buyers, resellers and commission agents is evidence proving tax evasion by OAO NK YUKOS*." *See also, e.g.*, Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005), 30 (Exhibit RME-253]): "*As a result of the creation of the appearance that the sale of oil and oil products was carried out by dependent entities registered within the regions with beneficial tax treatment, it was such special purpose entities which received the earnings (profit) from the sale.* […] *However, since such entities were enjoying tax incentives unlawfully, profit tax, property tax and value added tax were not paid to the budget*."

289 *See, e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 65-67, 109 (Annex (Merits) C-175): "O*il production entities delivered the following amount of crude oil as part of raw hydrocarbon during the following periods: January 2002-August 2002, to Ratibor OOO: a total of 43,304,682 tonnes valued at RUB 48,649,272,700* […] *September 2002-December 2002, to Evoil OOO: a total of 24,512,893 tonnes valued at RUB 48,636,878,100* […] *It was also established that Ratibor OOO and Evoil OOO sold 23,909,795 tonnes and 42,829,698 tonnes of crude oil, respectively, to Fargoil OOO, an entity registered in a territory with preferential tax rates.* […] *the crude oil acquired by Fargoil OOO was sold as follows: 32,069,518 tonnes for export under Commission Agency Agreement No. YuF/1-01 dated 20 November 2001, with OAO Yukos Oil Company; 2,910,898 tonnes under Purchase and Sale Agreements No. 02/01-0041, 02/02-0042 dated 20 December 2001, with OAO Yukos Oil Company; 30,977,270 tonnes delivered as a customer-furnished raw material for refining at oil refineries of Angarsk Petrochemical Company OAO, Achinsk Oil Refinely Eastern Oil Company OAO, Kuibyshev Oil Refinery OAO, Novokuibyshevsk Oil Refinery OAO, Syzran Oil Refinery OOO* […] *148,000 tonnes under Purchase and Sale Agreement No. 02/10-0076 dated 31 October 2002, with Evoil OOO; 21,402 tonnes under Purchase and Sale Agreement No. 01/05-0001 dated 28 May 2001, with Yukos-M ZAO; 539,544 tonnes under Purchase and Sale Agreements with other entities.* […] *Fargoil OOO lacked the fixed assets necessary to purchase, store and sell oil and oil products*."

290 *See, e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (May 26, 2004), 10 (Annex (Merits) C-116), noting that "[o]*il was transferred for refining also through the agent—OAO Yukos Oil Company or under agent agreements, where entities dependent on OAO Yukos Oil Company acted as agents* […]. *Thus, Ratmir OOO entrusted Square OOO with arrangement of refining under Agent Agreement No. DU-4-054 of 31.12.99 (pp. 136–140, vol. 286).*

ultimate unrelated customer, again without coming anywhere near the low-tax regions.[291]

240. Nor did the trading shells control "their" cash, virtually all of which remained in accounts held at Yukos' captive banks that were managed as Yukos directed.[292]

241. In sum, the involvement of the trading shells in the purchase, processing, and resale of oil and oil products was limited to paperwork,[293] which was, for the most part, handled in Moscow by Yukos' affiliate OOO Yukos-Financial and Accounting Center ("Yukos-FBTs"), which at all times kept the trading shells' corporate books.[294]

All the oil was refined at Novokuibyshev Petroleum Refinery, Kuibyshev Petroleum Refinery and Syzran Petroleum Refinery—enterprises belonging to OAO Yukos Oil Company (pp. 173–178, vol. 286)." *See also* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sep. 2, 2004), 11 (Annex (Merits) C-155): "*The dependent entities transferred the crude oil for refining as customer-supplied raw materials to the subsidiaries of OAO Yukos Oil Company, including Angarsk Petrochemical Company OAO, Achinsk Eastern Oil Company Refinery ZAO, Angarsk Polymer Plant OAO, Kuibyshev Petroleum Refinery OAO, Novokuibyshevsk Petroleum Refinery OAO, Syzran Petroleum Refinery OOO and Novokuibyshevsk Lubricant and Additive Plant OOO*."

291 As a matter of fact, the trading shells "*lacked the material resources and production facilities needed for procurement and storage of oil*." *See*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004), 6 (Annex (Merits) C-104).

292 Those banks included OAO AKB "Menatep Saint-Petersbourg," KB "Trust and Investment" Bank, and AKB "Solidarnost." *See*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sep. 2, 2004), 8 (Annex (Merits) C-155).

293 The transactions between Yukos' producing subsidiaries and trading shells were themselves settled either with promissory notes or through other intercompany set-offs. *See, e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 56 (Annex (Merits) C-175).

294 Thus, for instance, the Russian courts found that "*OOO YUKOS FBTs, which was dependent on OAO NK YUKOS, was responsible for recording all transactions relating to the purchase and transfer for refining of oil, as well as the sale of oil and oil products (including the keeping of the books). OAO NK YUKOS has a 100% stake in the charter capital of OOO YUKOS-FBTs. OOO YUKOS-FBTs entered into agreements on management of production, organization of bookkeeping and provision of cash services, performance of settlements with credit institutions, preparation of all kinds of reports, including statistical and tax reports, maintenance of the customer's accounting archive, provision of information and consulting services with the following entities: OAO NK YUKOS, OOO Alta-Trade, OOO Fargoil, OOO Evoil, OOO Yu-Mordovia, ZAO YUKOS-M, OOO Ratmir, OOO Energotrade, OOO Makro-trade, OOO YUKOS-Import, OOO Export Trade.*" *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7979/05-AK (Aug. 16, 2005), 24 (Exhibit RME-251). *See also*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 3-5 (Exhibit RME-140).

242. That the trading shells were nothing but "on paper" fictions operated by Yukos is further confirmed by:

(i) the use of nominally independent entities and individuals to incorporate the most critical trading shells;[295] and

(ii) the appointment of strawmen to act as the trading shells' nominal directors, most of whom (a) were not even aware they held positions in the trading shells,[296] or (b) had a role limited to signing

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295 Thus, for instance, the putative founder and director of OOO Fargoil, M.N. Silayev, confirmed to the tax authorities that he had never heard of that trading shell, had never been to Mordovia (where OOO Fargoil was nominally registered), and had never filed any corporate paperwork there. Russian Ministry of Internal Affairs, Transcript of the Interrogation of M.N. Silayev (Aug. 11, 2004) (Exhibit RME-255).

296 These individuals were unfamiliar with the business operations of the trading shells that they were supposedly managing. *See*, *e.g.*, the testimony provided to the Russian tax authorities by:

(i) the putative director of Mars XXII (later renamed OOO Energotrade), A.V. Tsigura ("*I do not remember whether the company operated in 2000, and whether I entered into contracts as the General Director.* [...] *I cannot answer with certainty whether there were oil products; if they existed, I do not remember where they were stored.* [...] *I do not remember how long I was the General Director and who took the decision to dismiss me*"). Protocol of interrogation of A.V. Tsigura No. 19-09/26 (Feb. 19, 2004) (Exhibit RME-256);

(ii) a putative director of OOO Mega-Alians and OOO Makro Trade, G.K. Zhukova ("*I have never heard of the existence of OOO Makro-Trade [...], I did not establish it. I have never been to the Republic of Mordovia*"). Explanations of the Interregional Tax Inspectorate of the Federal Tax Service for Major Taxpayers No. 1, in response to Yukos' cassation appeal, No. 52-05-10/05354 (May 4, 2005), 15 (Exhibit RME-257); and

(iii) another putative director of OOO Makro Trade, Yu.Yu. Egorov ("[i]*n 2001, I gave my passport to Vitaly Vladimirovich Reva* [...] *for registration of a firm, with the aim to receive additional income. I did not know that I was the head of OOO Makro-Trade and never occupied a managerial position.* [...] *During the period from autumn 2001 through the end of 2002 Mr. V.V. Reva several times (approximately 5 times) brought a set of documents to me for signature; I did not look into the contents of the documents; I signed where I was asked to sign.* [...] *I never saw the seal; I do not know where it is kept. [...] I do not know what activities OOO Makro-Trade was involved in and I have nothing to do with the business activities of this company.* [...] *I am not aware of OOO Makro-Trade's entering into contracts, their performance and payments under the contracts. I do not know what documents I signed, but contracts may have been among them.* [...] *I do not know who signed and prepared accounting and tax statements. I do not know what documents I signed, but financial documents may have been among them.* [...] *I know nothing about entering into investment agreements and tax incentives for OOO Makro-Trade*"). Explanations of the Interregional Tax Inspectorate of the Federal Tax Service for Major Taxpayers No. 1, in response to Yukos' cassation appeal, No. 52-05-10/05354 (May 4, 2005), 13-14 (Exhibit RME-257).

documents pursuant to instructions received from Yukos,[297] or tolerated the forging of their signatures by other proxies for the Oligarchs.[298]

243. A fundamental part of the scheme was the concealment not just of the fact that the trading shells were operated by Yukos and other Yukos affiliates,

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297 *See*, *e.g.*, the testimony provided to the Russian tax authorities by:

(i) another putative director of OOO Mars XXII, T.G. Subbotina ("*The contract documentation was prepared by the management of OAO NK Yukos; the payments under the contracts were processed through the centralized accounting department of OAO NK Yukos; I cannot recall the counterparties in the contracts.* […] *The financial statements and tax reports were prepared by the centralized accounting department of OAO NK Yukos in the office. I signed the reports as needed.*") Witness Statement of T.G. Subbotina, Record No. 43/1a (May 18, 2004) (Exhibit RME-258); and

(ii) the putative director of OOO Yu-Mordovia, Y. V. Gavrilina ("*Between March 1, 2001 and June 26, 2003, I held the position of executive director at OOO Yu-Mordovia. I have merely a vague idea about the company's financial and business operations. My duties only included filing with the tax authorities of the tax declarations I received from Moscow by mail. I would do so on the same day the intended submissions arrived from Moscow.* […] *The financial statements and tax declarations were executed in Moscow, but I have no knowledge about the signatories*"). Explanations of the Interregional Tax Inspectorate of the Federal Tax Service for Major Taxpayers No. 1, in response to Yukos' cassation appeal, No. 52-05-10/05354 (May 4, 2005), 16 (Exhibit RME-257).

298 In this area, too, Yukos acted with reckless disregard of the fictions that it had itself created, once again confirming its contempt for tax laws and authorities. Thus, for instance:

(i) in one case, an officer's signature had been put on three sets of documents, supposedly signed in three far-flung cities (Samara, Strezhevoy and Nefteyugansk), all on the same day. *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3222-5 (June 30, 2005), 23-24 (Annex (Merits) C-184) ("*based on the results of the auction held on 18 November 2002, M.V. Yelfimov executed three contracts on the same day (19 November 2002), to sell oil to Evoil OOO at the price of RUB 1,625: contract No. 125-n with Yuganskneftegas OAO* […] *contract No. 126-n with Tomskneft Eastern Oil Company OAO* […] *and contract No. 127-n with Samaraneftegas OAO* […]. *The above agreements were allegedly executed by M.V. Yelfimov in three different towns on the same day of 19 November 2002: in Nefteyugansk (Khanty-Mansi Autonomous Region), Strezhevoy (Tomsk region), and Samara (Samara region).*");

(ii) OOO Investproekt was supposedly managed by a director who was mentally ill, had worked "*as a street sweeper*," had "*never seen the* [company's] *seal*," and "*didn't sign any documents reflecting financial and business activities of the enterprise*." *See* Explanation of S.A. Varkentin (Aug. 9, 2001) (Exhibit RME-259); and

(iii) in yet another case, the passport of a trading shell's nominal director was reported not to have ever been issued, suggesting forgery on the part of Yukos. *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sep. 2, 2004), 7 (Annex (Merits) C-155) ("*Pursuant to Letter No. 1/86 of the Smolensk Region Department of Internal Affairs of 30/04/2004, the passport with series and number indicated in the constitutional documents of Ratibor OOO in the name of S. I. Vorobyova, an executive of Ratibor OOO and, until 18/05/2001, a sole shareholder of Ratibor OOO, has never been issued.*").

but also that Yukos owned and controlled them.[299] In fact, had the authorities known that Yukos was *de facto* managing the trading shells, the risk of a tax assessment on Yukos would have been much greater. Thus, Yukos took pains to conceal its relationships with most of the trading shells, using a number of subterfuges.[300] In addition, Yukos lied to its own auditors about the extent of its *de facto* involvement in the management of the trading shells.[301]

b) The Trading Shells Engaged In Systematic Non-Arm's Length Pricing

244. The trading shells—at least "on paper"—ostensibly bought oil and oil products at heavily discounted prices from Yukos' oil producing subsidiaries (in particular, YNG, one of the largest oil-producing companies in Russia, Tomskneft, and Samaraneftegaz) and other Yukos affiliates.[302] The trading shells

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299 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 6 (Exhibit RME-140) (*see*, *e.g.*, "*Question: Do you mean to say that from the accountants you mentioned you gathered that they considered these companies to be unrelated and independent from YUKOS? Answer: This is what they said.*").

300 Among other things, Yukos resorted to "call options" to conceal control of the trading shells, while including those companies' revenues (of course, without disclosing their unlawful provenance) in Yukos' consolidated accounts. "Call options" entitled Yukos to purchase the shares of its undisclosed trading shells at any time at a "*minimum price.*" *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 8 (Exhibit RME-137) *and* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 7 (Exhibit RME-140). Thus, Yukos could maintain control over those companies while claiming that it did not own them, to the extent that ownership might be inconvenient (*e.g.*, for tax purposes). One of the attractions of the system was that even unexercised call options could suffice to consolidate the relevant trading shells' profits into Yukos for U.S. GAAP purposes. *See also* ¶¶ 1014 *infra*. *See also* Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 105 (Exhibit RME-260). Yukos also caused the Cypriot companies through which it owned some of the trading shells to be equally misleading. *See*, *e.g.*, Report and Financial Statements of Nassaubridge Limited for the Year Ended Dec. 31, 2003 (Jan. 10, 2005), 4 (Exhibit RME-273) and Report and Financial Statements of Dunsley Limited for the year ended Dec. 31, 2003 (Jan. 10, 2005), 4 (Exhibit RME-272).

301 *See*, *e.g.*, Letter from ZAO PwC Audit to E.K. Rebgun (June 15, 2007) (Annex (Merits) C-611).

302 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 4-6 (Exhibit RME-140). *See also* Decision to Hold the Taxpayer Fiscally Liable For a Tax Offence No. 14-3-05/1609-1 (Apr. 14, 2004), 1-2 (Annex (Merits) C-104): "*OAO Yukos Oil Company, in turn and at the request of the 'owners' registered in territories with beneficial tax regimes, purchased oil from production companies which were subsidiaries of OAO Yukos Oil Company (OAO Yuganskneftegaz, OAO Tomskneft, OAO Samaraneftegaz), or from the sham entities. OAO Yukos Oil Company then purchased the oil at reduced prices in demand to lower the production companies' tax base.* […] *The following also provides proof that the oil and oil products actually belonged to OAO Yukos Oil Company and that the*

would ultimately sell the oil and oil products—again "on paper"—to unrelated customers at full market price. From start to finish, the trading shells would capture the lion's share of the margin,[303] a margin that was occasionally on the order of 500%.[304] Through this aggressive technique that had no basis in economic reality, the trading shells generated huge profits that, thanks to the low-tax region program, were typically barely taxed.

245. Below is a simplified chart showing an example of the non arm's length pricing schemes operated by Yukos through its trading shells.

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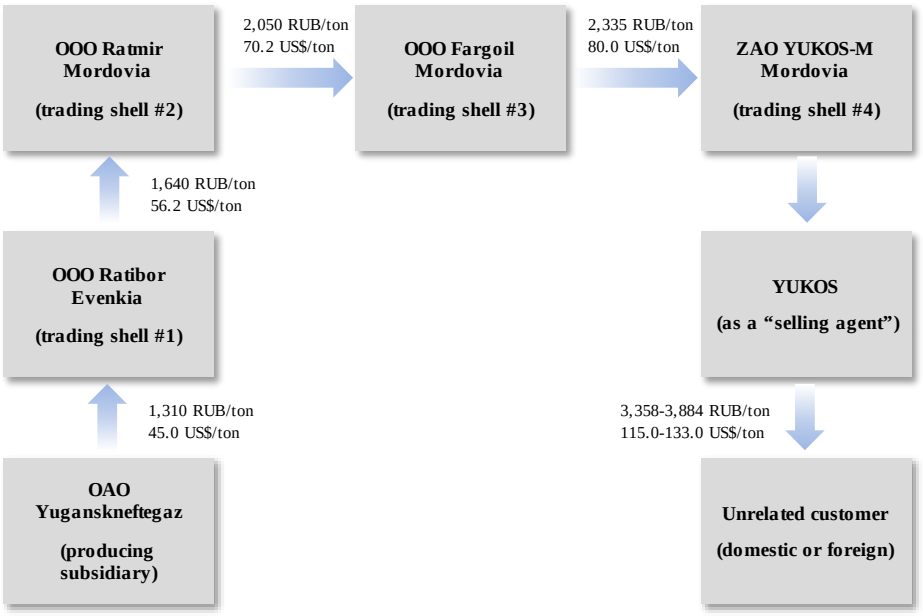
tax evasion scheme applied by them was illegal: […] *the understated prices of acquisition of oil from production entities and from other sham companies*."

303 *See, e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 13 (Exhibit RME-137).

304 *See*, *e.g.*, Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005), 18-19 (Exhibit RME-253), noting that "O*AO Samaraneftegaz sold oil to OOO Ratibor* […]; *the oil price under the agreement was RUB 670 per ton* […]; *the oil metering station belonged to OAO Samaraneftegaz. Next,* […] *OOO Ratibor "sold" oil* […] *to OOO Fargo*[i]*l at the price of RUB 755 per ton at the oil metering station of OAO Samaraneftegaz* […]. *Next, OOO Fargo*[i]*l entered into agreement* […] *with ZAO YUKOS-M to sell oil at the price of RUB 1,551 per ton* […]. *Subsequently, ZAO YUKOS-M "sold" oil out of the stock of OAO Samaraneftegaz for export to Routhenhold Holdings Limited (Cyprus). At the same time, OOO YUKOS-M entered into commission agreement* […] *with OAO NK YUKOS* […], *pursuant to which OAO NK YUKOS undertook to sell oil on the foreign market.* […] *Contract* […] *was executed by Elfimov M.V. on behalf of OAO NK YUKOS; the sale price of oil was listed as US $139.43, which converts to RUB 4,343.24 at the exchange rate effective as of the date of payment. Thus* […] *the oil remained at the oil metering stations of OAO Samaraneftegaz* […]. *As a result of such operations, the price of oil increased by RUB 3,673.24 or 6.4 times, solely by means of reselling the oil between the dependent companies.*"

CHART 6 – SIMPLIFIED NON ARM'S LENGTH PRICING SCHEME INVOLVING YUKOS' TRADING SHELLS[305]



246. As illustrated in the foregoing chart, Yukos often interposed several trading shells between the producing subsidiaries and the ultimate unrelated customer.[306] Among other things, this ruse allowed Yukos to hide from the tax inspectors the full extent of its tax abuses.[307] Whenever this form of chicanery was employed, one trading shell would resell to another one, which in turn would resell to a third one, and so forth.[308] Each trading shell would capture only a share of the total profit margin, thereby significantly reducing the

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305 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offence No. 30-3-15/3 (Sep. 2, 2004) (Annex (Merits) C-155).

306 Some transactions were routed through trading shells outside Russia (*e.g.*, Routhenhold and Pronet). *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 13.

307 It also allowed Yukos to avoid exposure to tax audits based on the application of transfer pricing rules (Article 40 of the Tax Code), the application of which was premised on the existence of sales at 20% of the market price.

308 *See*, *e.g.*, Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-4414/04-AK (Nov. 18, 2004), 14 (Exhibit RME-254), noting that "*as a result of numerous resales, the producers' selling price of crude oil, passing through a number of dependent organisations, grew from the moment of the first sale of the oil by OAO Samaraneftegas, OAO Tomskneft VNK and OAO Yuganskneftegas to dependent companies until the moment of the sale of oil or its transfer for refining from 1,001 to 2,400 roubles per ton (Quarter 1 2001), from 1,100 to more than 2,4*[illegible] *roubles per ton (Quarter 2 2001), from 1,310 to 2,340 rubles (Quarter 3 2001), and 1,290 to 1,650 roubles (Quarter 4 2001).*"

chances that the full amount of the profit margin would ever come to light during the course of an audit. This ploy also limited Yukos' outside exposure, since a single local tax inspectorate's challenge of a single trading shell's activities was unlikely to bring down the whole scheme.

247. Concealment of the artificiality of the prices paid by the trading shells was facilitated by the fact that, at the time, the domestic prices of oil were kept at levels substantially below those prevailing in the world market on which the trading shells were reselling the oil.

248. At all times, "tax optimization" – to use Yukos' euphemism, which Claimants have made their own[309] – remained the sole objective of the scheme, which otherwise served no purpose whatsoever. The producing subsidiaries minimized their taxes because their sales to the trading shells were made at such low prices that the producing subsidiaries recognized only very thin profits (if any), and therefore only paid correspondingly modest taxes. The trading shells, on the other hand, made huge profits, but they only paid significantly reduced taxes, thanks to the low-tax region program.

c) The Trading Shells Made Insignificant Investments (If Any) In The Low-Tax Regions Where They Purported To Operate

249. The trading shells had, at best, minimal local staff[310] and made, at most, insignificant investments in the low-tax regions where they were nominally registered.[311]

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309 Claimants' Memorial on the Merits, ¶ 744.

310 *See, e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 60, 96 (Annex (Merits) C-190), confirming that "[a]*ccording to the explanatory note accompanying Ratmir OOO's* [one of the trading shells that Yukos operated in the Republic of Mordovia] *accounting statements for 2003, its staff consisted of 1 person as of 31 December 2003.*" "*The entity's* [OOO Makro Trade's, another Mordovian trading shell] *actual number of employees in 2003 was 2: the General Director and the Deputy General Director.*"

311 *See, e.g.*, Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 52 (Exhibit RME-260), finding that "*in 2003 the Republic of Mordoviya received investments from the above entities* [OOO Alta Trade, OOO Fargoil, OOO Yu-Mordovia, OOO Energotrade, OOO Makro Trade, ZAO Yukos-M and OOO Ratmir] *(as confirmed by the payment orders) in the aggregate amount of RUB 619,450,000, while at the same time these entities enjoyed the incentives on profit tax and property tax* […] *in the amount of RUB 30,309,232,595. The amount of the benefits enjoyed by the entities is 49 times higher than the amount of the investments transferred.*" [emphasis added]

250. Yukos never established a true marketing or sales office in any of the low-tax regions where its trading shells purported to operate, let alone a distribution or other facility that would have created a significant number of jobs and thus satisfied the "presence" requirement of the low-tax regions legislation. To the contrary, Yukos typically limited the size of the trading shells—each handling, "on paper," billions of rubles of purchases and re-sales—to a handful of low-level employees located in the relevant low-tax region, and their fixed assets typically consisted of no more than a few computers.[312]

251. Contrary to Claimants' allegations,[313] the trading shells never made more than a symbolic contribution to the socio-economic development of the Republic of Mordovia—where the larger tax savings were generated[314]—or of any other low-tax region.[315]

252. Thus, for instance, Yukos' investments in the Republic of Mordovia relative to the tax benefits obtained by Yukos amounted to 0.8% in 2001 and to 2% in 2002-2003, as summarized in Table 3 below:

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312 *See, e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 83, 95 (Annex (Merits) C-190), noting that "[*a*]*ccording to the financial statements submitted for 2003 (Form No. 1, "Accounting Balance Sheet"; Form No. 5, "Attachment to Accounting Balance Sheet") and an explanatory note, the entity's balance sheet showed no fixed assets and did not list the average number of employees of Energotrade OOO* [another Mordovian trading shell]. […] *According to explanations received from the entity officers* [OOO Makro Trade, Mordovia]*, the only fixed assets listed on its balance sheet were a computer, a printer and office equipment, which does not enable the entity to engage in the purchase, transportation, storage and sale of crude oil.*"

313 Claimants' Memorial on the Merits, ¶ 297.

314 *Ibid.*, ¶ 296.

315 *See, e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (May 26, 2004), 17 (Annex (Merits) C-116), finding that "*sums received by the budget* [of the ZATO of Trekhgorny] *from the taxpayers* [OOO Greis, OOO Kverkus, OOO Muscron, OOO Norteks, and OOO Virtus] *are many times lower than the sums of declared benefits (the sum of investments is around 0.006 percent of the sum of benefits per taxpayer).*" [emphasis added]

TABLE 3—INVESTMENTS VS. TAX BENEFITS (REPUBLIC OF MORDOVIA)

	2001[316]	**2002**[317]	**2003**[318]
Investments[319]	RUB 114,210,000 US$ 3,789,316	RUB 434,300,000 US$ 13,665,827	RUB 619,450,000 US$ 21,033,955
Tax benefits[320]	RUB 14,846,922,600 US$ 492,598,626	RUB 21,067,038,060 US$ 662,902,393	RUB 30,309,232,595 US$ 1,029,175,979
Investments vs. tax benefits	0.8%	2%	2%

253. Chart 7 below, illustrates the huge disproportion between Yukos' investments in the Republic of Mordovia and the tax benefits received.

316 RUB/US$ conversion based on the RUB/US$ exchange rate on Dec. 31, 2001. Unless otherwise noted, all exchange rate information is based on the official exchange rate published from time to time by the Bank of Russia. For ease of reference, a chart listing the official exchange rates published by the Bank of Russia from July 1, 2003 to December 30, 2007 is enclosed as Exhibit RME-334.

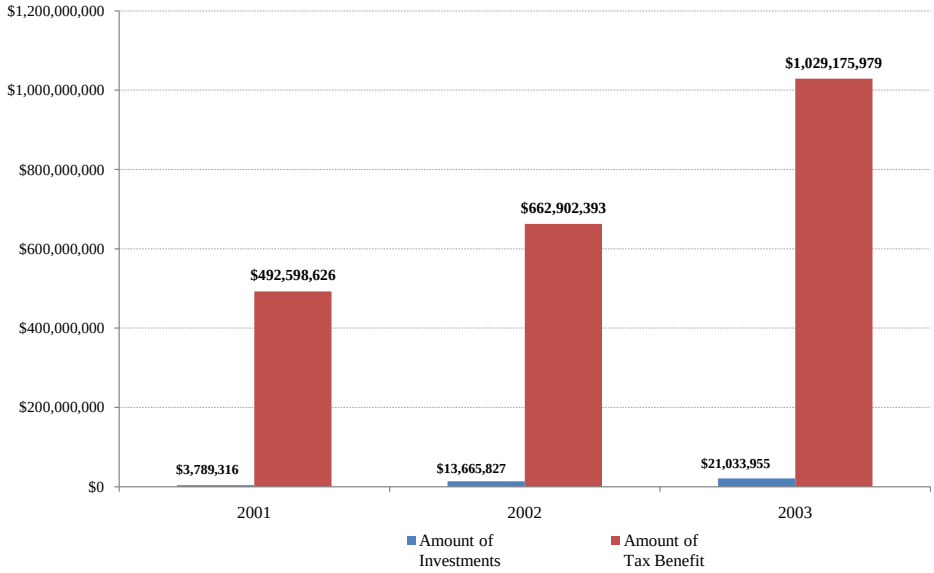
317 RUB/US$ conversion based on the RUB/US$ exchange rate on Dec. 31, 2002.

318 RUB/US$ conversion based on the RUB/US$ exchange rate on Dec. 31, 2003.

319 Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sept. 2, 2004) (Annex (Merits) C-155); Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 85 (Annex (Merits) C-175), Field Tax Audit Report No. 52/907 (Nov.19, 2004), 52 (Exhibit RME-260).

320 Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sept. 2, 2004), 42, 55, 64, 79, 110-111, 122 (Annex (Merits) C-155); Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 85 (Annex (Merits) C-175); Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 52 (Exhibit RME-260).

CHART 7—INVESTMENTS VS. TAX BENEFITS (REPUBLIC OF MORDOVIA)



254. Against this background, it is worth noting that the Oligarchs' political and economic influence in the low-tax regions where the trading shells were nominally registered was overwhelming, which allowed Yukos to reap large amounts of tax benefits while making insignificant investments in those regions. Thus, for instance, Mordovia was notoriously "*closely tied*" with Yukos:

> "In accordance with the established tradition the chair of the representative of Mordovia in the Federation Council has always been occupied by representatives of YUKOS. In 2001, immediately after a new law on a new procedure for the election of the Federation Council members was introduced, the President of the Republic of Mordovia, […] in its capacity as the representative of the Republic of Mordovia in the Federation Council, was replaced by Mr. Leonid Nevzlin, the Deputy Chairman of the Board of Directors of NK YUKOS. In March 2004, that office was 'inherited' by another YUKOS' representative, Mr. Nikolay Bychkov, the President of YUKOS-RM."[321]

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321 Andrey Eliseyev, *Mordovia Has Appointed a Tax Officer as Its Representative in the Federation Council*, Kommersant (Apr. 4, 2005) (Exhibit RME-262). *See also* Nevzlin Witness Statement, ¶ 10; Vremia (Nov. 28, 2001) (Exhibit RME-263); Stolitsa S (Nov. 28, 2001) (Exhibit RME-264); nd Anna Petrova, *YUKOS Has Changed Its Representative in the Federation Council*, Kommersant (Mar. 28, 2003) (Exhibit RME-265).

Likewise, Yukos had one of the former officers of Bank Menatep and the former Chief Executive Officer of ZAO Yukos-RM, Boris Zolotarev, appointed as the Governor of the Evenkiysky Autonomous District, another low-tax region where Yukos made massive use of its "tax optimization" scheme. Mr. Zolotarev was elected in the Spring of 2001. As pointed

255. In fact, as pointed out also by the Audit Chamber in a report published in 2004, the tax incentives granted by the Mordovian administration to the Yukos trading shells exceeded "*4.4 times the budget revenues of the Republic of Mordovia*" in 2002. The budget deficit caused to the Republic of Mordovia by the massive tax benefits reaped by Yukos required central government financial intervention.[322]

d) The Trading Shells' Profits Were Repatriated To Yukos By Artificial Means That Concealed Their Origin

256. As discussed above (*see* ¶ 235 *supra*), the fourth key component of Yukos' "tax optimization" scheme was the transfer of the barely taxed profits artificially generated by the trading shells to Yukos and its offshore affiliates.

257. This was accomplished through, *inter alia*: (i) bogus "donations" that the trading shells made to a purported "Production Development Financial Support Fund" established by Yukos (the "Fund"); (ii) sales and purchases of promissory notes issued by Yukos or its affiliates; and (iii) payments of dividends by the trading shells to their offshore nominal parent companies.

(1) The "Donations" To The Fund

258. The first technique entailed the contribution of the trading shells' earnings (*i.e.*, gross revenues, *minus* the artificially low purchase price paid for the oil and oil products, *minus* operating costs (*de minimis* as the trading shells had no operations) and taxes at the low rate assessed in the low-tax regions) in

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out by the tax authorities, "[i]*t is precisely upon the arrival of Boris Zolotarev in the Evenki Autonomous District that OAO NK YUKOS has started using shell entities in order to 'minimize' its tax liabilities, as demonstrated by Resolution No. 53 issued by the Evenki Autonomous District Administration and signed personally by the governor, Boris Zolotarev, which has extended the special taxation procedures to the operations of OOO Ratibor.* […] *The tax benefits granted to OOO Ratibor in that manner over 2001-2002 exceeded 6 billion rubles.*" *See* Explanations of the Interregional Tax Inspectorate of the Federal Tax Service for Major Taxpayers No. 1, in Response to Yukos' Cassation Appeal, No. 52-05-10/05354 (May 4, 2005), 27-28 (Exhibit RME-257).

322 Audit Chamber Report on Yukos, Lukoil and Sibneft for 2003 and Jan.-Mar. 2004, 18-19 (Exhibit RME-266).

the form of purported tax-free "donations" to the Fund, which was in fact yet another sham, devoid of any reality except on paper.[323]

259. The Achilles' heel of this technique proved to be its totally artificial nature, which had no plausible purpose other than tax evasion. Indeed, there is no logical explanation for a structure whereby purportedly independent, nominally profit-making companies would sell oil and oil products at below-market prices to purportedly unrelated entities, which would in turn "donate" all or most of their profits to the "development fund" of still another company.[324]

260. The amounts purportedly "donated" were significant. Thus, for instance, as later calculated by the tax authorities, in 2001 some of the trading shells "gifted" to Yukos amounts in excess of RUB 80 billion (approximately US$ 2.8 billion).[325]

(2) The "Promissory Notes"

261. Another technique used by Yukos to extract from the trading shells the proceeds of the scheme to evade profit taxes was the issuance of "promissory notes" by Yukos (or other Yukos affiliates) to the trading shells in consideration of the trading shells transferring to Yukos (or such other Yukos affiliate) the proceeds of Yukos' "tax optimization" scheme.[326]

262. Like the "donations" ploy described above, this technique made it possible for Yukos to repatriate the artificially inflated profits generated in the

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323 The Fund was created pursuant to a resolution of the Board of Directors of Yukos (Aug. 23, 2000) (Exhibit RME-267). The alleged purpose of the Fund was to create "*centralized financial reserves*" to finance the expenses of Yukos and its subsidiaries associated with their financial, business and investment activities. *See* Regulation on the Production Development Financial Support Fund of OAO NK YUKOS (Exhibit RME-268).

324 Yukos' management elected to ignore a confidential written warning from PwC in early 2003 questioning the legality of these "donations." *See* ZAO PricewaterhouseCoopers Audit, Written Information for the Yukos' Management on the Results of Audit Review for 2002, 9 (Exhibit RME-269). PwC's admonition provided a signal to Yukos' management that its "tax optimization" schemes were at risk. Yukos, however, ignored this and many other warnings and instead persisted with its improper practices.

325 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sept. 2, 2004), 18 (Annex (Merits) C-155).

326 *Id.*, 10 (Annex (Merits) C-155).

low-tax regions while preserving the secrecy of its affiliation with the trading shells, which would have been impossible to deny if Yukos had, for instance, received those profits in the form of dividend payments, insofar as dividends are payable only to shareholders, *i.e.*, the owners of the trading shells. In addition, like the "donations," the use of "promissory notes" allowed Yukos to further minimize its taxes, by avoiding payment of Russian dividend taxes.[327]

263. Moreover, if it ever became necessary to do so in order to protect the secrecy of the scheme, the notes, being negotiable instruments, could be instantaneously transferred from one Yukos group company to another, or even used as means of payment to third parties.[328]

264. Technically, the promissory notes represented a debt of Yukos (or of the other Yukos affiliates issuing the notes). However, because the recipients of the promissory notes were companies controlled by Yukos, Yukos could avoid (or indefinitely defer) any actual repayment obligation (or, for that matter, any obligation to pay interest), simply by causing the relevant shells not to demand payment.

265. In sum, as with the "donations" ploy, the key purpose of the "promissory notes" gambit was to conceal Yukos' "tax optimization" scheme and move cash within the group in a non-transparent manner, while additionally allowing Yukos to avoid payment of dividend taxes.

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327 In fact, it appears that "*ultimately the profit generated from the YUKOS group of companies' operations was not distributed to OAO NK YUKOS itself.*" Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 34 (Exhibit RME-137).

328 The promissory notes were sometimes also used by the trading shells to pay their limited taxes. Articles 45 and 58 of the Russian Tax Code, however, expressly prohibit the use of promissory notes to pay taxes. *See* Article 45 (Exhibit RME-270) and Article 58 (Exhibit RME-271) of the Russian Tax Code. *See*, *e.g.*, Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 72, 85, 90-91 (Annex (Merits) C-103) (confirming that at least three trading shells paid taxes using Yukos promissory notes, which were not honoured, but nonetheless obtained tax refunds).

(3) The Use Of Cypriot Shell Companies To Divert The Trading Shells' Profits Outside Russia

266. The third technique used by Yukos to exfiltrate the proceeds of its "tax optimization" scheme from the trading shells was more complex, and entailed the siphoning off of their profits into foreign tax havens. This scheme was implemented by diverting those trading shells' profits through an intricate and deeply non-transparent web of Cypriot and British Virgin Islands entities that were secretly controlled by Yukos' management.

267. Yukos' managers also took pains to maintain the secrecy of the offshore structure and, to further insulate it from scrutiny, kept most of the information relating to it outside Russia.[329]

268. Reduced to its essentials, this scheme (described here in the form it had taken in 2003) included the following key steps:

(i) the holding of shares in a few trading shells by non-transparent Cypriot holding companies with no visible affiliation with Yukos;

(ii) the holding of the Cypriot companies through a chain of non-transparent British Virgin Islands shell companies, which made it impossible for any outsider to identify their beneficial owners;

(iii) the transfer of the artificially inflated, lightly taxed and non-transparent profits generated by the trading shells in the low-tax regions to the trading shells' Cypriot holding companies in the form of dividend payments;

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329 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 13:19), 3 (Exhibit RME-17): "*Under these structures, Yukos management demonstrated that they could control the international companies (which also owned many of the domestic 'operational' companies) and that OAO NK Yukos was ultimately entitled, through a chain of ownership and control, to the profits recognized in the companies.* [A]*s I understand, most of the information about the ownership structure, including the control mechanisms, and on the companies themselves, was maintained outside of Russia.*" *See also* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 11 (Exhibit RME-140): "*We were supposed to have this information* [on the ownership structure] *during the audit. However, if someone came to the company and they were not provided with full information, it would be impossible to have a full picture of the structure.*"

(iv) the use of the dividend income received by the Cypriot companies to fund payments of further dividends to their British Virgin Islands parent companies; and

(v) the use of the dividend income received by the British Virgin Islands companies to (a) accumulate cash and/or (b) fund loans to a disclosed Luxembourg affiliate of Yukos, which would in turn make further loans to Yukos and its disclosed Russian affiliates.

269. Specifically, the artificially inflated profits generated by the trading shells through the purchases of oil and oil products at non arm's length prices would leave Russia in the form of dividends distributed by the trading shells to their nominal Cypriot parent companies. Payment of these dividends entailed the same abuses of the Russia-Cyprus Tax Treaty with respect to Russian dividend withholding tax as those perpetrated by Claimants Hulley and VPL with respect to dividends paid to them by Yukos.[330] Cyprus does not, and did not at the relevant times, levy tax on the dividends paid by the Cypriot companies to their off-shore parents. Nor do the British Virgin Islands tax dividend income. Thus, once received in Cyprus, the proceeds could be distributed tax-free in the form of dividends to the British Virgin Islands companies.[331]

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330 *See* Section II.G.2 *supra*.

331 This structure allowed Claimants to divert out of Russia the trading shells' profits in a "tax-efficient" manner, insofar as the cost for the transfer of those profits was merely the 5% tax levied on the dividends paid by the trading shells to their Cypriot holding companies under the Russia-Cyprus Tax Treaty—which was itself another abuse of that Treaty (*see also* Section II.G.2 *supra*). The resulting all-in taxation (where the trading shells paid a 6% tax thanks to the low-tax region program) was a mere 11% (in contrast to a normal rate of 39% in 2002-2003, *i.e.*, 24% in corporate profits tax *plus* 15% in dividend tax; *ibid.*). *See also*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 14, 2007), 5 (Exhibit RME-353).

A practical illustration of these abuses involved OOO Ratibor ("Ratibor") and OOO Fargoil ("Fargoil"), two of the trading shells that Yukos used in furtherance of its tax evasion scheme (*see*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 123, 146, (Annex (Merits) C-175); and Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 76 (Annex (Merits) C-190)—and their Cypriot nominal shareholders, Dunsley Limited ("Dunsley") and Nassaubridge Management Limited ("Nassaubridge") (*see*, *e.g.*: (i) Share Sale and Purchase Agreement between S. I. Vorobyova and Dunsley (May 25, 2001) (Exhibit RME–275); (ii) Decision of the Sole Participant of Ratibor

No. 7 (Jan. 24, 2002) (Exhibit RME-278); and (iii) Decision of the Sole Participant of Fargoil No. 3 (May 25, 2001) (Exhibit RME-283)).

Thus, between 2002 and 2003, Ratibor and Fargoil paid dividends to Dunsley and Nassaubridge in excess of US$ 4.4 billion (*see* Report and Financial Statements of Dunsley Limited for the Year Ended December 31, 2003 (Jan. 10, 2005), 6, Exhibit RME-272; and Report and Financial Statements of Nassaubridge Management Limited for the Year Ended December 31, 2003 (Jan. 10, 2005) 18, Exhibit RME-273). The reliance of Dunsley and Nassaubridge on the Russia-Cyprus Tax Treaty was abusive for reasons analogous to those explained in Section II.G *supra*, relating to the Russia-Cyprus Tax Treaty abuses by Claimants. In fact:

(i) neither Dunsley nor Nassaubridge was the beneficial owner of the dividends paid to it, respectively, by Ratibor and Fargoil pursuant to Article 10(4) of the Russia-Cyprus Tax Treaty (*see also* ¶¶ 159-161, 163 *supra*). As a factual matter, all of the dividends paid to Dunsley and Nassaubridge – *i.e.*, the companies' sole source of income – were passed through to their parents in the British Virgin Islands, typically shortly after their receipt from Ratibor and Fargoil (Lys Report, ¶¶ 121-141). Moreover, despite the fact that the dividends paid by Ratibor and Fargoil were substantial, the value of each of Dunsley's and Nassaubridge's assets was below US$ 200,000 – more than half of which was in fact the share capital that those companies needed in order to be at least nominally eligible for tax benefits pursuant to Article 10(2) of the Russia-Cyprus Tax Treaty (Annex (Merits) C-916) (*see also* ¶ 159 *supra*). On this basis, Professor Rosenbloom concludes that Dunsley and Nassaubridge "*were not beneficial owners of dividends received from Ratibor and Fargoil, respectively, because they did not enjoy the 'full privilege to directly benefit from the income*'." Thus, Dunsley and Nassaubridge "*were not entitled to convention based reductions of Russian tax*." (Rosenbloom Report, ¶ 116); and

(ii) in any event, both Dunsley and Nassaubridge had a permanent establishment in Russia pursuant to Article 5 of the Russia-Cyprus Tax Treaty (*see also* ¶¶ 162-163 *supra*). Thus as pointed by Professor Rosenbloom, like Hulley and VPL, Dunsley and Nassaubridge "*has permanent establishments in Russia through the activities of dependent agents*." Rosenbloom's Report, ¶ 124. The record also suggests that the dividends received by Dunsly and Nassaubridge from Ratibor and Fargoil, respectively, were attributale to that permanent establishment in Russia insofar as (a) those companies were managed by Russian individuals and residents based on powers of attorney that had been granted to them by their Cypriot-based nominal directors, and (b) their only activity entailed the holding of shares in Russian trading shells (*see* Report and Financial Statement of Dunsley Limited for the Year Ended Dec. 31, 2003 (Jan. 10, 2005), 2 (Exhibit RME-272); and Report and Financial Statements of Nassaubridge Management Limited for the Year Ended Dec. 31, 2003 (Jan. 10, 2005), 2 (Exhibit RME-273); *see also*: (i) Resolution of Dunsley's Board of Directors (May 25, 2001) (Exhibit RME–274); (ii) Share Sale and Purchase Agreement between S. I. Vorobyova and Dunsley (May 25, 2001) (Exhibit RME–275); (iii) Decision of the Sole Participant of Ratibor No. 5 (June 20, 2001) (Exhibit RME–276); (iv) Decision of the Sole Participant of Ratibor No. 6 (June 20, 2001) (Exhibit RME-277); (v) Decision of the Sole Participant of Ratibor No. 7 (Jan. 24, 2002) (Exhibit RME-278); (vi) Dunsley's Power of Attorney to O. K. Egorova (Aug. 30, 2002) (Exhibit RME-279); (vii) Decision of the Sole Participant of Ratibor No. 9 (Sep. 2, 2002) (Exhibit RME-280); (viii) Decision of the Sole Participant of Ratibor No. 10 (Sep. 1, 2003) (Exhibit RME-281); (ix) Nassaubridge's Power of Attorney to N. M. Petrosyan (Mar. 19, 2001) (Exhibit RME-282); (x) Decision of the Sole Participant of Fargoil No. 3 (May 25, 2001) (Exhibit RME-283); (xi) Decision of the Sole Participant of Fargoil No. 4 (Jan. 22, 2002) (Exhibit RME-284); and (xii) Decision of the Sole Participant of Fargoil No. 6 (May 28, 2002) (Exhibit RME-285).

270. Those entities would accumulate those funds, chiefly by investing in marketable securities.[332] If needed by Yukos, the funds could also be transferred back to Russia through a disclosed Yukos affiliate in Luxembourg in the guise of untaxed "loans."[333]

271. An especially non-transparent feature of this structure involved the insertion into each chain of British Virgin Islands companies of a trust,[334] which

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The Russia-Cyprus Tax Treaty abuses involving Dunsley and Nassaubridge resulted in substantial losses to the Russian treasury, in excess of US$ 440 million (not inclusive of interest and fines), and violated Russian and Cypriot criminal law (*see also* ¶¶ 209-224 *supra*).

332 Dunsley and Nassaubridge were owned by James Holding Venture Limited ("JHV"), and Moonstone Service Limited ("Moonstone"), respectively. Dunsley's 2003 financials disclose payment to JHV of interim dividends in the amount of US$ 800 million (February 6, 2003) and US$ 11 million (Mar. 3, 2003) (*see* Report and Financial Statements of Dunsley Limited for the Year Ended December 31, 2003 (Jan. 10, 2005), 2 (Exhibit RME-272)), while Nassaubridge's 2003 financials disclose payment to Moonstone of dividends in the amount of US$ 2.4 billion (May 8, 2003), US$ 23 million (July 2, 2003), US$ 56 million (July 7, 2003) (Report and Financial Statements of Nassaubridge Limited for the Year Ended December 31, 2003 (Jan. 10, 2005), 2 (Exhibit RME-273)) and US$ 985 million (2002) (*id*., 9). *See also* E-mail from Stanislav Zaitsev to Alexey Zubkov (June 24, 2004) with attachment "Source of funds—Structure of Funds Flow in 2003," 7 (Exhibit RME-286). In turn, JVH and Moonstone redistributed those dividends to Brill Management Limited ("Brill"), which would in turn use those funds to pay dividends to Brittany Asset Limited ("Brittany"). *See* E-mail from Zhanna Ponomarenko to Alexey Zubkov (July 14, 2004) with attachment "Detailed Balance Sheets and Income Statements "Project Victor" (Exhibit RME–350). *See also* E-mail from Chris Santis to Douglas Miller (Feb. 14, 2005) with attachment Brittany Trial Balance Sheet for six months of 2004 (Exhibit RME–351). *See* E-mail from Stanislav Zaitsev to Alexey Zubkov (June 24, 2004) with attachment "Source of funds," Structure of Funds Flow in 2003, 7 (Exhibit RME-286).

As confirmed, *e.g.*, in the Record of Interrogation of S.E. Uzornikov, former Head of the Department for International and Controlling of Yukos-Moscow (Mar. 16, 2007), 8 (Exhibit RME-348), the above-mentioned companies "*were used in the cash flow chain: dividends were paid by Fargoil and Ratibor to their parent companies, Nassaubridge and Dunsley, they passed on the dividends to their parent companies, and further up the chain. Then these funds were used to acquire Eurobonds and other securities* [...]." *See also*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 11 (Exhibit RME-140), confirming that "[t]*he overseas part of YUKOS structure was used for a number of purposes – to make financial investments so that these financial investments were carried on these companies' balance sheets*" *and* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 24-25 (Exhibit RME–137).

333 *See*, *e.g.*, Record of Interrogation of S.E. Uzornikov (Mar. 16, 2007), 7 (Exhibit RME-348): these funds were also used "*to extend loans to YUKOS production companies through Yukos Capital S.a.r.l.*" *See also*, *e.g.*, Financial statements of Yukos Capital S.a.r.l for the year 2005, 7-8 (Exhibit RME-287).

334 Namely, the Alastair Trust, the Stephen Trust, and the James Trust. *See* Letter from Chris Santis to Kelly Allin "Yukos Group Audit, Report by PwC Cyprus" (Apr. 10, 2003) (Exhibit RME-349). *See also*, *e.g.*, the "Position Paper" attached to the Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow,

allowed Yukos' managers to take diametrically inconsistent positions—depending on the audience—with regard to whether or not Yukos owned or controlled the Cyprus / British Virgin Islands structure.[335] The details of the structure were kept secret even from the Yukos personnel responsible for preparing the company's consolidated accounts.[336]

272. Another advantage of the opacity of the trusts was that they facilitated diversions by the managers of all or part of the funds flowing through

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Russia) (May 8, 2007, 13:19) (Exhibit RME-17) *and* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 12 ("*Question: So this [structure] created an appearance that Company A did not control Company B thanks to the existence of the trust, right? Answer: Yes*") (Exhibit RME-140).

335 Yukos' managers very much wanted PwC—the company's auditors—to include the assets and profits of the Cyprus / British Virgin Islands structure in Yukos' consolidated accounts, so as to boost the value of Yukos shares in the securities market. On the other hand, Yukos' management also wanted to be able to deny ownership or control of the structure, *e.g.*, for tax purposes. The trusts allowed them to have it both ways, claiming ownership and control when it suited their purposes and denying it when it did not, on the familiar pretext that the trusts were "discretionary" and that their "legal" owners were nominally independent trustees. *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 14, 2007), 11 (Exhibit RME-353): "*on the one hand company A had hidden control over company B as 90% of the shares were held by the trust and the trust provided YUKOS with the option to buy those shares.* […] *To avoid losing control over the trust, YUKOS entered into an option for the purchase of shares. One day the trustee could say that he would not follow the orders of the trust protector, although this was unlikely.*"

Mr. Misamore or another top manager of Yukos secretly stood behind each trust, whose "designated beneficiary" was one more impenetrably non-transparent British Virgin Islands company. *See* Memorandum from Nina Kazankova to Dan Walsh and Robert Langer (Sept. 20, 2002), 6, 8, 10-11 (Exhibit RME-354) indicating that the beneficiary of the Stephen Trust was Seaweed Holdings Limited (BVI) and the beneficiary of the James Trust was Starfish Venture Limited (BVI). *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 14 (Exhibit RME-140): "*Question: what sort of trusts are these: who was behind them, who managed them and who was the trustee and the trust protector? Answer: I don't know specific details, but our understanding was that an individual YUKOS executive was behind each trust. This could have been someone like Bruce Misamore, David Godfrey - someone from YUKOS' top management.*" *See also* "Position Paper" and excerpt from Form F-1 attached to the Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 13:19) (Exhibit RME-17).

336 *See. e.g.*, Record of Interrogation of S. E. Uzornikov (July, 11 2007), 7 (Exhibit RME-358): "*Question: There are units named Stichting Wellgen, Alastair Trust, Stephen Trust, James Trust in the chart. What do they mean? Answer: None of the trusts sound familiar to me, we never consolidated any trusts in YUKOS. I was never involved in the creation of YUKOS consolidation structure, and do not know the trust functionality. That is why there is nothing I can say about them, and I am not aware of why, how and who established and managed them. I have never heard about them in any conversations, and never discussed them with anyone.*"

the system (or even beneficial ownership of the structure) into the pockets of the Oligarchs or their own.[337]

273. Because the Russian authorities had no power to audit Cypriot or British Virgin Islands entities, they were unable to establish Yukos' indirect ownership of the underlying trading shells. Thus, for instance, Dunsley and Nassaubridge, the Cypriot holding companies of Ratibor and Fargoil,[338] kept confidential both the fact that they nominally owned Ratibor and Fargoil,[339] and that Yukos was their ultimate parent company.[340]

274. No business purpose has ever been claimed for this concatenation of Cyprus and redundant British Virgin Islands entities.[341]

275. Chart 8 below illustrates the scheme as it applied in 2003.

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337 *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 19 ("*Regarding the payment of dividends to foreign companies, the structure used for consolidation may have made it easier for the management to transfer money outside the structure*") (Exhibit RME-137).

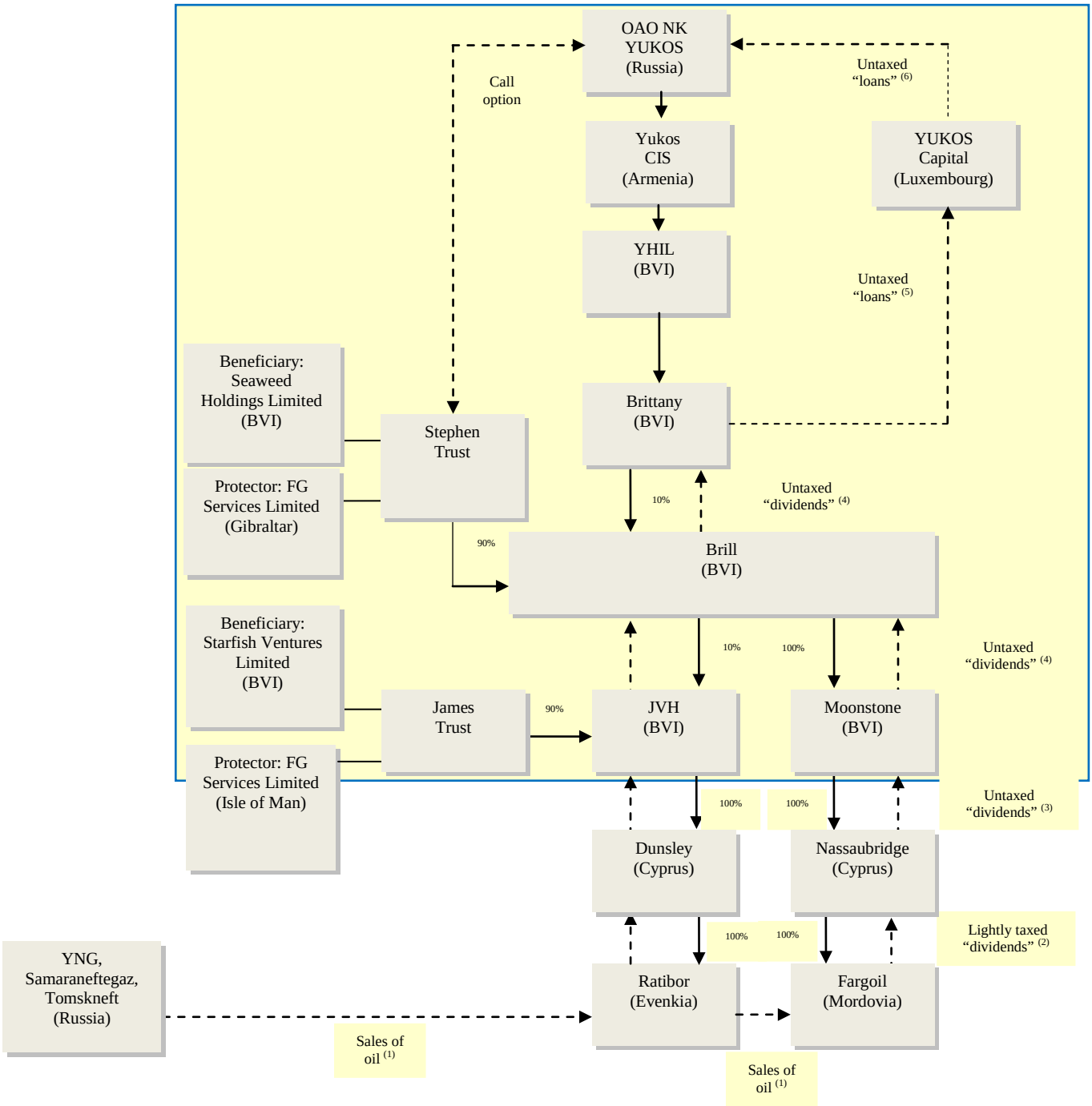
338 *See* note 331 *supra*.

339 PwC, the auditors of Dunsley and Nassaubridge, criticized this lack of disclosure based on International Accounting Standard IAS27. *See* Report and Financial Statements of Nassaubridge Limited for the Year Ended December 31, 2003 (Jan. 10, 2005), 4 (Exhibit RME-273) and Report and Financial Statements of Dunsley Limited for the year ended December 31, 2003 (Jan. 10, 2005), 4 (Exhibit RME-272): "*The financial statements do not disclose the name and details of the subsidiary undertaking as required by the International Accounting Standard IAS27 – 'Consolidated Financial Statements and Accounting for Investments in Subsidiaries.*"

340 It was not until January 10, 2005 that Dunsley and Nassaubridge admitted that they were owned by Yukos, and they do not seem to have ever disclosed that owned Ratibor and Fargoil (*see*, *e.g.*, Report and Financial Statements of Dunsley Limited for the Year Ended December 31, 2003 (Jan. 10, 2005) (Exhibit RME-272) *and* Report and Financial Statements of Nassaubridge Management Limited for the Year Ended December 31, 2003 (Jan. 10, 2005) (Exhibit RME-273), which were published on January 10, 2005). By then, of course, the Russian tax authorities had unraveled the Yukos tax evasion (*see* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sep. 2, 2004), 82, 100-101 (Annex (Merits) C-155)).

341 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 11 (Exhibit RME-140): "t*here was no reason that compelled the management to opt for these overseas companies; this was the management's choice.*"

CHART 8 – 2003 FLOWS OF FUNDS THROUGH THE YUKOS OFFSHORE STRUCTURE (SIMPLIFIED)[342]



342 (1) Fargoil and Ratibor "buy" oil and oil products at non-arm's length prices and "resell" them at vastly higher prices to third party customers thereby accumulating profits in the low-tax regions of Evenkia and Mordovia; (2) Ratibor and Fargoil distribute their inflated profits as dividends to Dunsley and Nassaubridge abusing the Russia-Cyprus Tax Treaty; (3) Dunsley and Nassaubridge redistribute those dividends to JHV and Moonstone tax-free; (4) JVH and Moonstone redistribute those dividends tax-free to their common holding company, Brill, which uses them to fund payments of further dividends, also tax-free, to Brittany; (5) Brittany does not declare dividends, but makes tax-free "loans" of its profits to Yukos Capital S.a.r.l. of Luxembourg ("Yukos Capital"); and (6) Yukos Capital makes back-to-back "loans" (also tax-free) of the funds that it had "borrowed" from Brittany.

276. The amounts flowing through these and similar structures were very significant. As explained by Professor Lys, between 2002 and 2004 these schemes generated a flow of funds out of the Russian trading shells into their British Virgin Islands "grandparent" companies totalling an amount substantially in excess of US$ 6 billion.[343]

277. Although as described above some of these funds were transferred to Yukos as "loans," a very large portion remained in the British Virgin Islands companies and was ultimately diverted by Yukos' management into a Dutch trust-like structure (*stichting*) in September 2005 for the avowed purpose of frustrating the authorities' enforcement actions relating to the tax assessments.[344]

2. The Yukos Tax Evasion Scheme Violated Russian Law

278. In other Yukos-related proceedings, Yukos and others have largely conceded the facts described above—in particular, the non-arm's length pricing at which the trading shells purported to purchase oil and oil products and trade them among themselves, the lack of any substance to the trading shells, and their insignificant investments in the low-tax regions where they purported to operate. Their defenses, instead, have been largely predicated on the claim that, because of alleged peculiarities of Russian tax law, the Yukos tax scheme was perfectly legal at the time. These claims are flatly contradicted by a large body of Russian jurisprudence, of which the cornerstones predate Yukos' first abuses of the low-tax region program.

a) The Early Development Of Russia's Anti-Avoidance Doctrines

279. The anti-avoidance doctrines relied upon by the Russian tax authorities to dismantle Yukos' "tax optimization" scheme have roots that go as far back as to the mid-1990s. As in other countries, these jurisprudential

343 *See* Lys Report, ¶ 141.

344 *See* Section II.K *infra*.

doctrines are evolutionary in nature,[345] and have been articulated in a series of decisions issued over the years by the Russian courts.

280. An often-cited ruling dates back to 1996, when the Presidium of the Supreme Arbitrazh Court upheld the tax authorities' assessment of indirect taxes based on the substance of the challenged transaction, as opposed to its form.[346] This same basic principle was restated in a number of other cases decided in that time frame,[347] and notably in a ruling of the Russian Constitutional Court handed down in 1999,[348] which reiterated the notion that when looking at the tax aspects

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345 *See* Sections VI.A.3.a and VI.C.3.c.1 *infra*.

346 *See*, *e.g.*, Resolution of the Presidium of the Russian Supreme Arbitrazh Court, No. 367/96 (Sept. 17, 1996) (Exhibit RME-288), a case involving Sibservice, an Austrian-Russian joint venture which was assessed VAT with respect to computer sale transactions that had been artificially structured as "loan agreements" pursuant to which Sibservice's customers made advance payments for the purchase of computers in the guise of "loans" to Sibservice, which in turn purported to repay the "loans" by transferring computers to the "borrowers," thereby avoiding payment of VAT on the computer sales. The Presidium of the Russian Supreme Arbitrazh Court endorsed the tax authorities' VAT assessment against Sibservice, holding that "*the relations with the customers (buyers) were actually developed that way (supply, contractor relationships) regardless of the name of the agreement*."

347 Thus, for instance, in 1997, the Presidium of the Russian Supreme Arbitrazh Court upheld a VAT assessment relating to various joint venture agreements entered into by State-owned enterprise "Yekaterinburg City Telephone Network," under which the joint venture participants made purported VAT-exempt cash contributions to finance the development of the telephone network in the city of Yekaterinburg (in Sverdlovsk Region). The tax authorities found that the State-owned enterprise in fact did not conduct any joint activity with the contributing persons, and thus levied VAT on those contributions. The Presidium of the Russian Supreme Arbitrazh Court upheld the tax authorities' assessments, holding that, "*in substance*," the sole purpose of the joint venture agreements at issue was to procure financing to the State-owned enterprise. Resolution of the Presidium of the Russian Supreme Arbitrazh Court, No. 3661/96 (Jan. 21, 1997) (Exhibit RME-289). A group of prominent Russian tax scholars has relied upon this ruling to show the existence in Russia of anti-avoidance provisions in the tax law (A.V. Bryzgalin , V.R. Bernik, A.N. Golovkin, *Collection of Economic Agreements and Documents for Companies with Legal, Arbitrazh, and Tax commentaries*, Tax and Finance Law (2004) (Exhibit RME-290), noting that "*Therefore, the arbitrazh courts as well as the tax authorities currently follow the principle of 'substance of contract over its name (form).' Thus, any attempts to conceal the real substance of an agreement by using a name of a different contract will most likely be fruitless.*"

In another early case, the Presidium of the Russian Supreme Arbitrazh Court endorsed the authorities' assessment of direct taxes against Sib-Kem, a company which was *de facto* managed in Kemerovo (Kemerovo Region), but that had been nominally registered in the Republic of Kalmykia (Elista), and had thus avoided payment of taxes in Kemerovo (*see* Resolution of the Presidium of the Russian Supreme Arbitrazh Court, No. 6957/97 (Aug. 11, 1998) (Exhibit RME-291). *See also*, *e.g.*, Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/546-98 (Mar. 30, 1998) (Exhibit RME-292).

348 Resolution of the Russian Constitutional Court, No. 14-P (Oct. 28, 1999) (Exhibit RME-293).

of a particular transaction, Russian courts should be mindful of its substance, and not merely its form.

b) The Tax Authorities Started Applying Russia's Anti-Avoidance Doctrines Against The Yukos Group As Early As In 1999 – The *Business-Oil/Lesnoy Trading Shells* Case

281. On December 9, 1999, the tax authorities of the Sverdlovsk Region (the ZATO of Lesnoy) initiated a field tax audit of three of the trading shells used by Yukos in that region to carry out its tax evasion scheme, i.e., OOO Business-Oil ("Business-Oil"), OOO Forest-Oil, and OOO Mitra. The authorities' findings, which covered 1998 and the first nine months of 1999, were summarized in an undated memorandum for the Head of the Section of the Department of the Ministry of Taxes and Levies of the Russian Federation for the Sverdlovsk Region.[349] That memorandum concluded that, while each of the audited trading shells met the formal requirements to be eligible for local tax incentives, their activities were in fact devoid of any economic substance. Specifically, the memorandum concluded that:

> "[T]he employees residing on the ZATO territory are not involved in the work related to the main activity of the company (purchase and sale of oil and oil products) and have been hired solely for the purpose of ensuring the fulfillment of the conditions allowing to receive additional tax incentives contemplated by Law of the Russian Federation No. 67—FZ of 2 April 1999."[350]

282. About one year later, after the issuance of the report that had been triggered by this memorandum, the tax authorities found that Business-Oil (i) did

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349 *See* Memorandum on the results of the audit of the legality of additional tax incentives granted to OOO Mitra, Business-Oil, and OOO Forest-Oil registered in the ZATO of Lesnoy (Sverdlovsk Region) for 1998 and nine months of 1999 (Exhibit RME-294). It appears that the audit report, whose findings were summarized in the above-mentioned undated memorandum, was issued on March 7, 2000 (*see* Statement of the tax authorities of Sverdlovsk Region on the legality of the use by Business-Oil in 1999 and 2000, of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6 (June 29, 2001), 4 (Exhibit RME-295).

350 Memorandum on the results of the audit of the legality of additional tax incentives granted to OOO Mitra, Business-Oil, and OOO Forest-Oil registered in the Closed Administrative Territorial Unit (ZATO) of Lesnoy of Sverdlovsk Region for 1998 and nine months of 1999, 3 (Exhibit RME-294).

not have any economic substance,[351] and (ii) in fact, did not even meet the formal requirements to benefit from the low-tax region's legislation.[352] As a result, Business-Oil was found to have abused the low-tax region legislation and was assessed taxes accordingly.[353]

283. Around the same time, Yukos undertook a series of totally artificial corporate restructurings, which resulted in the merger of the audited Lesnoy shells (*i.e.*, Business-Oil, OOO Forest-Oil, OOO Mitra, and OOO Vald-Oil, another Lesnoy trading shell that had been found to have abused the low-tax region program[354]) into another, new shell, OOO Perspektiva Optimum that was registered in the Aginsky Buryatsky Autonomous Okrug ("ABAO") in the Chita Region, which is located thousands of miles from the ZATO of Lesnoy.[355]

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351 *See* Statement of the tax authorities of the Sverdlovsk Region on the legality of the use by Business-Oil in 1999 and 2000, of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6 (June 29, 2001), 19 (Exhibit RME-295): "*Financial and business activities of OOO Business-Oil may not be recognized to be conducted within the territory of the closed administrative and territorial unit of Lesnoy, while executive functions, bookkeeping and preparation of accounts lie with persons who are not employed by OOO Business-Oil, not registered within the closed administrative and territorial unit of Lesnoy, while the managing organ is situated outside the closed administrative and territorial unit of Lesnoy (Moscow, Mosalsk, Krasnoyarsk), with a nominee director (also an accountant), A.V. Spirichev, residing in Moscow, with no allocation of funds left at the disposal of OOO Business-Oil as tax incentives for investing and creating jobs within the territory of the town of Lesnoy.*"

352 Specifically, the tax authorities of the Sverdlovsk Region found that "[t]*he business of OOO Business-Oil fails to comply with the requirements of the Federal Law No. 67-FZ, dated April 2, 1999, amending Acts of the Russian Federation relating to Closed Administrative and Territorial Units, pursuant to which organizations, in order to be eligible for additional incentives in respect of taxes and levies, must meet the following conditions: existence of no less than 90 percent of the fixed assets of the organization within the territory of the closed administrative and territorial unit of Lesnoy, performance of no less than 70 percent of activity of the organization within the territory of the closed administrative and territorial unit of Lesnoy, the performance by the organization of especially important orders relating to social and economic development of the territory of closed administrative and territorial unit of Lesnoy or provision of especially important services for the population of this territory.*" *Ibid.*, 19.

353 Similar findings and assessments were made with respect to the other Lesnoy trading shells used in furtherance of the Yukos tax evasion scheme, including OOO Forest-Oil (*see* Statement of the tax authorities of Sverdlovsk Region No. 7 (July 11, 2001) (Exhibit RME-296), and OOO Mitra (*see* Statement of the tax authorities of Sverdlovsk Region No. 8 (July 11, 2001) (Exhibit RME-297).

354 Statement of the tax authorities of Sverdlovsk Region No. 9 (July 11, 2001) (Exhibit RME-298).

355 *See* the corporate and administrative documents on the establishment of OOO Perspektiva Optimum: Certificate of State Registration of OOO Perspektiva Optimum in ABAO (Feb. 28, 2001); Decision of the Participant of OOO Perspektiva Optimum on reorganization No. 2 (Mar. 5, 2001); Decision of the Participant of OOO Mitra on the merger into OOO Perspektiva

284. Concurrently, a similar restructuring was carried out with respect to a number of other trading shells established in the ZATO of Trekhgorny (*i.e.*, OOO Alebra, OOO Flander, OOO Grace, OOO Kolrein, OOO Kverkus, OOO Muskron, and OOO Norteks)[356], which Yukos merged into still another, newly created shell (also registered in ABAO) by the name of OOO Trading Company Alkhanay.[357]

Optimum No. 03/1 (Mar. 5, 2001); Decision of the Participant of OOO Vald-Oil on the merger into OOO Perspektiva Optimum No. 03/1 (Mar. 5, 2001); Decision of the Participant of Business-Oil on the merger into OOO Perspektiva Optimum No. 03/1 (Mar. 5, 2001); Decision of the Participant of OOO Forest-Oil on the merger into OOO Perspektiva Optimum No. 03/1 (Mar. 5, 2001); Minutes of the general meeting of participants of OOO Mitra, OOO Forest-Oil, OOO Vald-Oil, Business Oil and OOO Perspektiva Optimum on the merger No. 1 (Mar. 5, 2001); Resolution of the Head of Administration of the Town of Lesnoy on cessation of activity of OOO Mitra due to the merger into OOO Perspektiva Optimum No. 424 (Mar. 6, 2001); Resolution of the Head of Administration of the Town of Lesnoy on cessation of activity of Business-Oil due to the merger into OOO Perspektiva Optimum No. 425 (Mar. 6, 2001); Resolution of the Head of Administration of the Town of Lesnoy on cessation of activity of OOO Vald-Oil due to the merger into OOO Perspektiva Optimum No. 426 (Mar. 6, 2001); Resolution of the Head of Administration of the Town of Lesnoy on cessation of activity of OOO Forest-Oil due to the merger into OOO Perspektiva Optimum No. 427 (Mar. 6, 2001) (Exhibit RME-299).

356 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 7-8 (Exhibit RME-137).

357 *See* the corporate and administrative documents on the establishment of OOO Trading Company Alkhanay: Resolution of the Head of Administration of Agisnkoye Municipal Unit on registration of OOO Trading Company Alkhanay in ABAO No. 55 (Feb. 28, 2001); Decision of the Participant of OOO Trading Company Alkhanay on reorganization No. 2 (Mar. 15, 2001); Minutes of the general meeting of participants of OOO Grace, OOO Kverkus, OOO Muskron, OOO Flander, OOO Kolrein, OOO Alebra, OOO Norteks and OOO Trading Company Alkhanay on the merger into OOO Trading Company Alkhanay No. 1; Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Flander from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 397 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Norteks from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 398 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Kolrein from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 399 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Kverkus from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 400 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Grace from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 401 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Muskron from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 402 (Mar. 16, 2001); Resolution of the Head of the Town of Trekhgorny on exclusion of OOO Alebra from the State register of legal entities due to the merger into OOO Trading Company Alkhanay No. 403 (Mar. 16, 2001) (Exhibit RME-300).

285. To further conceal any affiliation with Yukos, some weeks after these restructurings, Yukos caused OOO Perspektiva Optimum (the entity resulting from the merger of the Lesnoy trading shells) and OOO Trading Company Alkhanay (the entity resulting from the merger of the Trekhgorny trading shells) to merge into yet another, purportedly independent shell, OOO Investproekt,[358] which was first registered in the Kirov Region (located thousands of miles from ABAO),[359] and subsequently re-registered in the Chita Region.[360]

286. Upon completion of these restructurings, on May 21, 2001, the Lesnoy and the Trekhgorny trading shells, as well as the subsequently merged successor entities (OOO Perspektiva Optimum and OOO Trading Company Alkhanay), were liquidated.[361] At that point, the tax authorities of the District of Chernyshevsk (in the Chita Region, where OOO Investproekt had been re-registered) opened an investigation and in due course discovered that, in 2000, the Lesnoy trading shells were "*not actually conducting any activities within the territory of the Lesnoy ZATO and, consequently*" were "*not entitled to any additional tax incentives.*"[362] The entity resulting from the merger of the Lesnoy trading

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358 In accordance with Yukos' business practice (*see, e.g.*, ¶ 242 *supra*), Yukos caused Sergei Varkentin to be appointed as General Director and Chief Accountant of OOO Investproekt. However, as stated in note 298 *supra* Mr. Varkentin was mentally ill, had worked "*as a street sweeper,*" has "*never seen the* [company's] *seal,*" and "*didn't sign any documents reflecting financial and business activities of the enterprise.*" *See* Explanation of S.A. Varkentin (Aug. 9, 2001) (Exhibit RME-259).

359 Information Letter on deregistration of the taxpayer organization in connection with the change of location issued by Inspectorate for Shabalinskiy District of the Ministry of Taxes and Levies of the Russian Federation (Aug. 20, 2001) (Exhibit RME-301).

360 *Ibid*.

361 *See* the corporate and administrative documents on the establishment of OOO Investproekt: Minutes of the general participants meeting of OOO Trading Company Alkhanay on merger into OOO Investproekt No. 2 (May 20, 2001); Decision of the Participant of OOO Perspektiva Optimum on the merger into OOO Investproekt No. 6 (May 20, 2001); Minutes of the general meeting of participants of OOO Perspektiva Optimum, OOO Trading Company Alkhanay and OOO Investproekt on reorganization No. 1; Resolution of the head of Administration of Aginsloye Municipal Unit on exclusion of OOO Perspektiva Optimum, OOO Trading Company Alkhanay from the State register due to the merger into OOO Investproekt No. 127 (May 21, 2001) (Exhibit RME-302).

362 Decision of Interdistrict Inspectorate No. 4 of the Ministry of Taxes and Levies for the Chita Region No. 02-11/8/1 (Apr. 2, 2002), 3 (Exhibit RME-303). In addition, prior to this audit, the tax authorities of the Chita Region had initiated a repeat audit of OOO Investproekt with respect to the year 1999, which was completed on February 22, 2002, and resulted in the assessment of corporate income and other taxes in excess of RUB 9 billion. *See* Report on

shells (OOO Investproekt) was therefore assessed with a sizeable amount of corporate income and other taxes.[363] The tax authorities, however, were never able to collect these assessments or any of their other assessments against the Lesnoy trading shells or the entities resulting from their restructuring.[364] The reason was that the case file "*show*[s] *that neither property, nor accounts or documentation are located in* [Cherny]*shevsk District*."[365] In short, by the time these assessments became finally due, the Lesnoy and Trekhgorniy trading shells, or the entities resulting from their restructurings, had disappeared or become insolvent. It would seem that the authorities had not understood (until the later stages of the criminal investigation discussed at ¶¶ 310-313 below) that this multi-jurisdictional game of "hide and seek" had been orchestrated by Yukos.

287. The record confirms that, during their short lifetime, the Lesnoy and the Trekhgorniy trading shells generated significant profits that, also unbeknownst to the authorities, Yukos was able to siphon off into the foreign tax

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additional tax control measures against OOO Investproekt No. 04-4/11-1 (Feb. 22, 2002) (Exhibit RME-304).

363 After the restructuring of the Lesnoy trading shells, the tax authorities of the Chita Region confirmed that OOO Investproekt should have been held liable for tax offences and assessed penalties accordingly. However, because of the restructuring, the tax authorities concluded that it was not possible to make such an assessment of fines ("*upon one legal entity being merged into another* [...]*, the latter assumes all rights and obligations of the entity being merged in accordance with the deed of transfer. The tax offences committed by OOO Business-Oil, OOO Vald-Oil, OOO Forest-Oil and OOO Mitra were discovered after the completion of their reorganization. Penalties for tax law violations committed by legal entities were not included in the transfer deed, and, consequently, in accordance with clause 2 Article 50 of the Russian Tax Code, OOO Investproekt (as a successor) cannot be held responsible for payment of the amounts of the imposed fines*"). *See* Decision of Interdistrict Inspectorate No. 4 of the Ministry of Taxes and Levies for the Chita Region No. 02-11/8/1 (Apr. 2, 2002), 8 (Exhibit RME-303). On August 8, 2003, that decision was revisited by the regional tax authorities, which ultimately assessed against OOO Investproekt fines for violation of federal tax law in excess of RUB 2 billion. *See* Decision of the Department of the Ministry of Taxes and Levies of the Russian Federation for the Chita Region to Hold Taxpayer OOO Investproekt Liable for a Tax Offense No. 2.6-23 (Aug. 8, 2003) (Exhibit RME-305).

364 *See, e.g.*, Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 27 (Annex (Merits) C-121).

365 Letter from the Department of the Ministry of Justice of the Chita Region to the Head of the Interdistrict Inspectorate No. 4 for Chernyshevsk District of the Ministry of Taxes and Levies No. 31-2051 (Exhibit RME-306).

haven companies. The amounts in question for years 2000-2001 totalled US$ 1.7 billion.[366]

c) In The Meantime, The Russian Constitutional Court Formalized The "Bad-Faith Taxpayer" Doctrine

288. In 2001, around the same time as the fruitless assessments against the Lesnoy trading shells, the Russian Constitutional Court formalized—in a well-known Ruling 138-O[367]—the so-called "bad-faith taxpayer" doctrine, pursuant to which a taxpayer abusively invoking a provision of the tax law is a "bad faith-taxpayer" and, as such, is ineligible to use the tax benefits at issue.

289. In commenting on this important ruling, Mr. S.G. Pepelyaev, a Russian tax lawyer who served on Yukos' defense team, has written as follows:

> "In this Ruling [138-O dated July 25, 2001] the court considers the issue of limitations on tax planning, which implies the recognition of the right of each taxpayer to use the means, ways and methods permitted by law to reduce such taxpayers' tax liabilities to the maximum extent possible. However, sometimes tax planning goes beyond the permitted limits and results in tax evasion. […] The Constitutional Court of the Russian Federation in the Ruling proceeds from the premise that the civil relations giving rise to the tax consequences must comply with the principles of reasonableness and good faith. […] If it appears that parties act both unreasonably and not in good faith, then this constitutes a ground for reassessment of the parties' tax liabilities, for which various mechanisms can be used. Upon a claim brought by the tax authorities the actual relations between the parties may be assessed by court."[368]

290. In the years following the Constitutional Court's Ruling 138-O, the Russian tax authorities brought literally thousands of "bad-faith taxpayer"

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366 *See*, *e.g.*, E-mail from Stanislav Zaitsev to Alexey Zubkov (June 24, 2004) with attachment "Source of funds—Structure of Funds Flow in 2000 and 2001," 4-5 (Exhibit RME-286).

367 Ruling of the Russian Constitutional Court No. 138-O (July 25, 2001) (Exhibit RME-307). The conclusions of the Russian Constitutional Court in this ruling were confirmed in a number of later rulings of the same Court. *See*, *e.g.*, Rulings of the Constitutional Court No. 4-O (Jan. 10, 2002) (Exhibit RME-308) and No. 108-O (May 14, 2002) (Exhibit RME-309).

368 S.G. Pepelyaev, *Commentary to Ruling of the Constitutional Court of the Russian Federation No. 138-O dated July 25, 2001*, Your Tax Attorney, No. 1, First Quarter of 2002 [emphasis added] (Exhibit RME-352).

doctrine cases to deny tax benefits to taxpayers who, while complying "on paper" with the letter of the law, had acted abusively.[369] As discussed below, several of these cases involved abuses of the low-tax regions similar to those that are at issue in these proceedings.[370]

d) The "Bad-Faith Taxpayer" Doctrine Was Applied Against The Yukos Group Before The Issue Of The December 2003 Tax Audit Report – The *Sibirskaya* Case

291. One of the many "bad-faith taxpayer" cases in which Russian courts have denied low-tax regions benefits involved another trading shell that Yukos had been using in furtherance of its tax evasion scheme, Sibirskaya Transportnaya Kompaniya ("Sibirskaya")[371]—although the tax authorities did not realize the connection of that company with Yukos at the time.[372]

292. The *Sibirskaya* case involved a tax audit conducted by the Russian Ministry of Taxes and Levies for the City of Elista (Republic of Kalmykia) in 2001[373] that was upheld by the Federal Arbitrazh Court for the North-Caucasian District in 2002.[374]

293. Specifically, the Federal Arbitrazh Court found that Sibirskaya had obtained tax benefits highly disproportionate to the nominal investments it had made in the low-tax region where it purported to operate. Thus, on the basis of the bad-faith taxpayer doctrine, the court denied those benefits. In the Federal Arbitrazh Court's own words:

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369 Thus, for instance, as noted by another Russian tax lawyer who served on Yukos' defense team, S.V. Savseris, in 2001 there were at least 262 court cases where the "bad faith" criterion was applied; that figure increased to 644 in 2002, and almost doubled to 1,189 in 2003, and increased further to 2,235 in 2004. *See* S.V. Savseris, *Bad faith category in tax law* (Statut, 2007), 47 (Exhibit RME-310).

370 *See* ¶¶ 291-296, 992-1002.

371 *See*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004), 5 (Annex (Merits) C-104).

372 *See* Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1678/2002-614A (May 20, 2002) (Exhibit RME-311).

373 Tax Ministry's Resolution No. 01-24/2261 (Sept. 25, 2001) and claim No. 01-23/2261 (Sept. 25, 2001).

374 *See* Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1678/2002-614A (May 20, 2002) (Exhibit RME-311).

> "The Ruling of the Constitutional Court […] No. 138-O of July 25, 2001 sets out the presumption of a good-faith taxpayer in the tax relations. […] [T]he good-faith attitude of a person in any of its legal relationships should be measured by the consistency of its conduct with the rules determined by the respective industry standards and general basics and the meaning of this industry law. […] Based on the contents and the meaning of the Law of the Republic of Kalmykia […], it follows that their [tax incentives] purpose is to attract financing from various investors to procure the development of the regional and local economies due to a lack of sufficient funds in the regional and local budgets and the need for their replenishment to ensure the activities of the Republic of Kalmykia and the City of Elista. […] [T]he amount of investments made by the claimant comprises 0.4% of the amount of [taxes that would have otherwise been payable by it]. […] Therefore, being aware of a clear disproportion between the amount of investment and the amount of the tax incentives applied, the claimant has abused its right, *i.e.*, the claimant acted in bad faith."[375]

294. Yukos fully understood that this decision meant that its "tax optimization" scheme would be condemned whenever and wherever it was discovered.[376] The tax authorities, in contrast, remained unaware that Sibirskaya had ties to Yukos.

e) Other Pre-2004 Rulings Condemning Abuses Of The Low-Tax Region Program

295. The *Sibirskaya* case was not unique in applying the "bad faith-taxpayer" doctrine to abuses of the low-tax region program, or in otherwise condemning such abuses.

296. Several other similar rulings handed down against other taxpayers who abused the low-tax region program re-emphasized the requirement that, in order to benefit from the low-tax region program, a taxpayer needed to have made local investments "proportionate" to the tax benefits received by it.[377]

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375 *Ibid*.

376 *See* ¶¶ 281-287 *supra*.

377 *See*, *e.g.*, Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A41/6270-03 (Oct. 10, 2003) (Exhibit RME-319), in which the Federal Arbitrazh Court for the

f) Lukoil's Abandonment Of Similar Abuses As Of December 31, 2001

297. It is a matter of public record that, around the same time as the Russian tax authorities and courts were developing their anti-avoidance arsenal

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Moscow District overruled a lower court's ruling rendered by the Arbitrazh Court for the Moscow Region that had invalidated a 2002 tax assessment. Upon overruling the judgment, the Federal Arbitrazh Court for the Moscow District sent the case back to the lower court for further investigation as to whether the taxpayer had received tax incentives in Baikonur in accordance with the rationale underlying the low-tax region legislation: "[i]*t does not follow from the judicial act whether the court had considered the* [significance] *of the activities of* [the taxpayer] *for the population of the town. However, this circumstance is essential for assessing the lawfulness of concluding the agreement for the granting of tax incentives.*" Eventually, the tax authorities were successful in challenging the scheme. *See* Decision of the Arbitrazh Court of the Moscow Region, Case No. A41-K2-10055/02 (Nov. 17, 2004) (Exhibit RME-320).

See, *also*, Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-270/2003-91A (Feb. 20, 2003) (Exhibit RME-315), in which the Federal Arbitrazh Court overruled the lower court's decision that—contrary to a 2001 tax assessment from the Tax Ministry—had upheld the tax benefits granted to a taxpayer on the basis of the following reasoning: "[T]*he* [lower] *court admitted that the* [taxpayer that had sought to annul the tax authorities' tax assessment] *had complied with necessary terms and conditions of the use of the* [tax] *benefit since it was registered at the Ministry of the Investment Policy of the Kalmyk Republic as a company making investments in the economy of the republic* [...]. *However, the court failed to appraise the extent of a good-faith attitude in the acts of the taxpayer as applied to requirements set by Ruling No. 138-O of July 25, 2001 by the Constitutional Court* [...]. *In* [examining] *the case, the court failed to study the actual facts pointing to the compliance of* [the taxpayer] *with the terms and conditions of the use of* [tax] *benefits.* [...] *No evidence of actual investment made by the* [taxpayer] *is attached to the case file.* [...] *The court also failed to determine whether the taxpayer acted in good faith if viewed from the viewpoint of commensurability of the tax benefits obtained with its investment contribution to the economy of the Kalmyk Republic since pursuant to the Tax Code the bad-faith taxpayer may not use the same legal remedies as a good-faith one.*" On this basis, the Federal Arbitrazh Court upheld the tax assessments. *See also* Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1793/2002 (May 28, 2002) (Exhibit RME-316), in which the Federal Arbitrazh Court overruled the lower court's ruling, thereby upholding a 2001 tax assessment, because that court had "*made a poorly reasoned finding that the* [taxpayer] *acted in good faith.*" In returning the case to the first instance court for further investigation on the facts of the case, the Federal Arbitrazh Court instructed the lower court, "*to find out the proportion between the investments made by the* [taxpayer] *and the amount of tax that did not come to the budget. Upon clarifying those facts, the court will be able to resolve the issue of the good-faith attitude of the plaintiff and its abuse of its rights.*"

See also Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1368/2002-506A (Apr. 29, 2002) (Exhibit RME-318), with respect to a tax assessment issued on October 12, 2001; Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1679/2002-622A (May 21, 2002) (Exhibit RME-312), with respect to a tax assessment issued on October 4, 2001; Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1682/2002-623A (May 21, 2002) (Exhibit RME-313), with respect to a tax assessment issued on September 19, 2001; Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1674/2002-627A (May 21, 2002) (Exhibit RME-314), with respect to a tax assessment issued on September 27, 2001; Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-3949/2002-1374A (Oct. 22, 2002) (Exhibit RME-317), with respect to a tax assessment issued on October 9, 2001.

to combat tax abuses similar to Yukos', other oil companies backed away from tax minimization schemes that they had used in the past (although to a much lesser extent than Yukos).

298. Thus, for instance, Lukoil—Yukos' main private sector competitor—publicly acknowledged as early as mid-2002, the year for which Yukos was assessed approximately RUR 193.8 billion (US$ 6.8 billion),[378] that it had abandoned the use of low-tax regions to minimize its taxes effective from December 31, 2001. Specifically, in its financial statements for the year 2001, Lukoil reported that:

> "[i]n the past, the Group has been able to establish strategies which have reduced its overall cost of taxation. It may not be possible to establish other arrangements which facilitate similar tax efficiencies in the future to replace the arrangements which have reduced the cost of taxation in the years ended December 31, 2001, 2000 and 1999."[379]

299. Lukoil made a similar announcement in its November 2002 offering circular for a bond placement, in which it disclosed that:

> "[i]n 2002 substantially all of the tax-planning initiatives that we formerly used were phased out, and we expect to pay higher taxes in 2002 and thereafter. Accordingly, our results of operations may be adversely affected."[380]

300. Yukos' management was undoubtedly aware of these public statements by its main rival.

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378 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004) (Annex (Merits) C-175).

379 OAO Lukoil, Annual Report for 2001, 93 (Exhibit RME-321).

380 OAO Lukoil, Securities Filing, Offering Circular (Nov. 26, 2002), 36 (Exhibit RME-322). Lukoil was ultimately assessed taxes for US$ 103 million for year 2002, which it voluntarily paid (*see* Alexander Tutushkin, *Pay Taxes and Live a Calm Life*, Vedomosti (Jan. 14, 2004) (Exhibit RME-361).

301. Thus, Lukoil aligned itself with oil companies that had never engaged in abuses of the low-tax region program, including Rosneft,[381] Surgutneftegaz,[382] and Tatneft.

302. In contrast, despite the publicity surrounding Lukoil's abandonment of its practices, Yukos persisted with its abuses, which in fact grew in size in 2002.[383] Indeed, more than two-thirds of the overall 2000-2004 tax assessments against Yukos relate to abuses after January 1, 2002, *i.e.*, after Lukoil's abandonment of analoguous practices.[384]

g) Cancellation Of Plans To List Yukos Shares On The New York Stock Exchange For Fear Of Disclosure Of The "Tax Optimization" Scheme

303. In the summer of 2002, Yukos' owners and managers explored the feasibility of listing Yukos shares—including Claimants' shares—on the New York Stock Exchange. The project was ultimately abandoned, for reasons that included the express concern that, as a result of the disclosures required by the U.S. Securities and Exchange Commission, the secrecy of Yukos' "tax

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381 As stated by Sergey Bogdanchikov, Rosneft's former CEO, "[t]*here are transfer prices, which oil companies use in order to consolidate their revenues. This, however, does not reduce the aggregate revenues, and, consequently, the taxes. However, various off-shore schemes, Baikonur schemes,* [ZATOs] *or disabled companies are sometimes used along with transfer pricing. We have never used these schemes. We have been using only the first element, i.e. transfer prices, in order to centralize the management*." Interview of Sergey Bogdanchikov to AU92 Information Agency (Feb. 5, 2004) (Exhibit RME-324).

382 In the words of one research report, Surgutneftegaz always maintained a "*simple legal structure,*" "*did not engage in transfer pricing to avoid revenue-based production taxes*," and "*shunned the aggressive tax optimization*." Surgutneftegaz: Drilling Power, Renaissance Capital (Mar. 2005), 41 (Exhibit RME-323).

383 Specifically, thanks to its abuses, Yukos was assessed taxes, penalties and interest in excess of approximately US$ 3.5 billion for 2000, US$ 4.1 billion for 2001 and US$ 6.8 billion for 2002. *See*, *e.g.*, Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1610-8 (Apr. 14, 2004) (Annex (Merits) C-104), Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sept. 2, 2004), 156-159 (Annex (Merits) C-155); Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 165-167 (Annex (Merits) C-175).

384 Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004), 90-91 (Annex (Merits) C-104); Decision to Hold the Taxpayer Fiscally Responsible Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 165-167 (Annex (Merits) C-175); Decision No. 30-3-15/3 to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 143-146 (Annex (Merits) C-190); Decisions to Hold the Taxpaer Fiscally Liabele for a Tax Offense No. 52/292 (Mar. 17, 2006), 129-131 (Exhibit RME-1539).

optimization" scheme, which Yukos had always strived to protect, would be jeopardized, with the result that, in the words of a Yukos manager:

> "We understand that the Company has set up a complex structure of subsidiaries in various jurisdictions primarily with the purpose of maximizing tax efficiency. This structure enables the Company to exploit inconsistencies between legal regimes and treat certain entities differently for the purposes of Russian legal and tax regime and, say, US accounting rules. There is a risk (whose extent we are now trying to ascertain) that the filings with the SEC and publicly available materials would have to disclose the names of such entities and their affiliation with the Company. Such information may be used by the Russian tax authorities to challenge our approach to certain transactions and, consequently, will result in substantial tax claims against the Company."[385]

304. Other Yukos internal communications confirm that it was an ongoing "*headache*" for Yukos' employees to ensure that the transactions among the trading shells were structured in a way that would prevent detection of the scheme by Russian tax authorities.[386] The failed listing on the New York Stock Exchange is discussed in greater detail at ¶¶ 1019-1026 *infra*.

h) The 2002 Audit Of Yukos

305. Yukos was subject to a tax audit for the 2000 and 2001 tax years that began on October 13, 2002. The findings of this audit are summarized in a 35-page report issued on April 28, 2003[387] and a corresponding decision to hold Yukos liable for a tax offense and order it to pay approximately US$ 300,000 in taxes, default interest and fines.[388]

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385 Memorandum from P.N. Maliy of Yukos to O.V. Sheyko of Yukos re: Risks Associated with the Listing on the New-York Stock Exchange/Public Offering of Securities in the USA (Apr. 22, 2002) [emphasis added] (Exhibit RME-184). Thus, fear of the tax consequences of disclosure of the Yukos tax evasion scheme had been a long standing concern of Yukos' management.

386 *See*, *e.g.*, E-mail dated by A.V. Brazhkov to A.P Kuchusheva (Oct. 9, 2001) (Exhibit RME-325).

387 *See* Field Tax Audit Report No. 66 (Apr. 28, 2003) (Annex (Merits) C-100).

388 *See* Resolution to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 289 (June 9, 2003) (Annex (Merits) C-101).

306. As is made clear by the audit report itself, the audit's scope was limited to the review of a few accounting documents,[389] which had been provided to the auditors by Yukos itself.[390]

307. The audit was conducted by the tax inspectorate of the City of Nefteyugansk, a Yukos "company town" whose mayor had been assassinated in 1998 shortly after organizing a public protest against Yukos' failure to pay local taxes.[391]

308. Neither the report, nor the audit itself, addressed any of the issues that were raised in the subsequent December 2003 audit leading to the assessment for tax yer 2000. In particular, nowhere in the report do the auditors consider the transfer pricing issue, or question whether any of Yukos' affiliates were mere shams, or whether the "proportionality of the investment" standard articulated in Sibirskaya and other court decisions had been satisfied. In fact, the uncovering of Yukos' abuses would have been possible only if Yukos had disclosed them—whereas Yukos was at the time focused on continuing to conceal them—or if the auditors had launched an aggressive, invasive audit targeted at uncovering those abuses despite the precautions that Yukos had taken to obviate just such a risk.[392] Instead, the 2002 audit came and went without uncovering any of those abuses: the auditors did not ask, and Yukos—naturally—did not tell.

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389 *See*, *e.g.*, Field Tax Audit Report No. 66 (Apr. 28, 2003), 4 (Annex (Merits) C-100).

390 *See*, *e.g.*, *ibid.*, 1-4.

391 *See* Section II.E *supra*.

392 In contrast, in parallel to the commencement of the December 2003 tax audit against Yukos leading to the 2000 tax assessment, the Tax Ministry launched several cross-audits on a number of Yukos' disclosed affiliates (*e.g.*, production subsidiaries and related refineries) in order to have a full understanding of the magnitude of the Yukos tax evasion scheme, including the full picture of the interrelations between Yukos and its undisclosed affiliates. *See*, *e.g.*, Report on the cross-audit of Open Joint Stock Company Tomskneft VNK (Dec. 24, 2003) (Exhibit RME-326); Demand to submit documents of the Interdistrict Inspectorate for Major Taxpayers of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 9, 2003) (Exhibit RME-327); Demand to submit documents of the Interdistrict Inspectorate for Major Taxpayers of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 17, 2003) (Exhibit RME-328); Interview Report of I.A. Karmakova (Dec. 18, 2003) (Exhibit RME-329). *See also* Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 5-7 (Annex (Merits) C-103).

i) The Criminal Investigations Of Messrs. Lebedev And Khodorkovsky

309. In this context, it can hardly be surprising that by the beginning of 2003, senior Yukos managers, including Messrs. Khodorkovsky and Lebedev, were coming under increasing scrutiny from the Russian criminal authorities. In June and July 2003, the investigative efforts had come to focus on the use of fraudulent tax schemes in Lesnoy, to which were also joined investigations of the Apatit fraud and the fraudulent acquisition by Menatep of its stake in NIYIF in 1995 (described in Section II.C. *supra*). The implication in Claimants' recitation is that these investigations sprouted from thin air "in June 2003"[393] and that, before certain interactions with President Putin earlier that year, Messrs. Khodorkovsky and Lebedev were held in high regard and were above reproach.[394] That is simply wrong, as the investigations predated any of the supposed "critical events."

j) The Criminal Tax Investigation Of The Lesnoy Shells

310. The shell game in which the Lesnoy shells were moved to distant jurisdictions and placed under other shells, and then all were dissolved before unpaid taxes were collected, is discussed at Section II.H.2(b) *supra*. An investigation of suspected tax evasion by the four Lesnoy sham companies (Business-Oil, Forest-Oil, Vald-Oil, Mitra) in the tax years 1999-2000 had been opened by the Urals District tax police on September 3, 2001.[395] The criminal investigation related, initially, to the payment of taxes by the four companies in

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393 Claimants allege that, "[s]tarting in June 2003, the Office of the Prosecutor General of the Russian Federation [...] launched a series of criminal investigations." Claimants' Memorial on the Merits, ¶ 108.

394 This is implicit from Claimants' references to the February 2003 Meeting at the Union of Industrialists and Entrepreneurs, *see* Claimants' Memorial on the Merits, 86-91, as well as an alleged meeting between President Putin and Mr. Khodorkovsky at the former's dacha in late April 2003, *see* Claimants' Memorial on the Merits, ¶ 93, which are both described as "key events" which "exacerbated the position of Yukos." *See* Claimants' Memorial on the Merits, ¶ 85.

395 *See* Tax Police Investigator, District department of Internal Affairs, decree on Instituion of Criminal Proceedings (Sep. 3, 2001) at (Exhibit RME-376). This differs from the efforts of the tax authorities, at roughly the same time in Lesnoy (Sverdlovksk region) and Chernyshevsky (Chita region) to assess the unpaid taxes in respect of the same companies and their successors in title. *See* Section II.H.2(b) *supra*.

non-monetary form, *i.e.*, in the form of promissory notes issued by Yukos, and also to the fact that the four companies had claimed tax refunds in respect of over-payments made in this way.[396]

311. The history of the 2001 Lesnoy investigation reveals the difficulties the investigative authorities were facing in relation to Yukos' corrupt activities. The investigators were also based locally, in the Urals region, rather than in Moscow.[397] This contributes to explain why, at least initially, the investigators were unable to make much progress, as the following chronology shows.

312. First, on January 16, 2002 the investigation was terminated, on the basis that the administration of the City of Lesnoy had in fact allowed the companies to pay taxes by using Yukos bills of exchange (and to claim refunds of excess tax paid in this way).[398] Then, on February 1, 2002 the case was re-opened, on the basis that the payment scheme through promissory notes, as well as intentional overpayments made in order to claim refunds, was clearly illegal, and that the investigation had not been sufficiently thorough.[399] The same investigator took over the case again. Then, on March 4, 2002, he suspended (although he did not terminate) the investigation, on the ground that, even if the facts constituting a crime were present, no actual suspects could be identified.[400] He also directed the local tax police to establish the identity of the possible suspects.[401]

313. Thus, by March 2002, the investigation had started, stopped, re-started, and been suspended pending identification of the suspects.

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396 *See ibid.*

397 *See ibid.*

398 *See* Investigation Committee of the Russian Federation, Decree on Termination of a Criminal Case in Part, Case No.135070 (Jan. 16, 2002) (Exhibit RME-377).

399 *See* Decree on the Reversal of the Decree to Discontinue the Criminal Case No. 135070 (Feb. 1, 2002) (Exhibit RME-381).

400 *See* Investigation Committee of the Russian Federation, Decree on Suspension of a Preliminary Investigation Due to Failure to establish an Individual to be Accused (Mar. 4, 2002) (Exhibit RME-378).

401 *See ibid.*

k) Apatit

314. The underlying facts relating to Apatit have already been described in Section I. C above. In November 2002 a settlement agreement between the State privatization authority and Volna, the Menatep company that had failed to fulfil its obligations under the privatization contract, was concluded.[402] Under the terms of the settlement agreement, Volna paid RUB 478,914,197 (equal to US$ 15,130,000) into the State budget.[403] That amount was intended to reflect the value of the 20% stake in Apatit that was supposed to have been returned in accordance with a court order dated February 12, 1998.[404]

315. The settlement was viewed suspiciously by certain regional political leaders, including the Governor of the Novgorord region.[405] The regional leaders were unhappy that the settlement consolidated Menatep's position as the majority owner of Apatit, because in their view Apatit was being used by Messrs. Khodorkovsky and Lebedev to carry out abusive practices that hurt fertilizer producers in their regions.[406] The regional leaders wrote letters to the Prosecutor General and to the President of the Russian Federation in February and December 2002[407] complaining about Apatit's activities and seeking the return to the State of the 20% block of shares that was still owned by Menatep. They argued that the amount paid by Volna under the settlement was far less than the actual value of the shares.[408]

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402 *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 28 (Exhibit RME-379).

403 *Ibid. See also* Letter from the Governor of the Novgorod Region to President V.V. Putin (Dec. 3, 2002) (Exhibit RME-372).

404 *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 23 (Exhibit RME-379).

405 *See* Letter from the Governor of the Novgorod Region to President V.V. Putin (Dec. 3, 2002) (Exhibit RME-372).

406 *See* Letter from the Head of the Administration of the Smolensk Region, the Governor of the Tula Region, and the Head of the Administration of the Tambov Region to the General Prosecutor of the Russian Federation (Feb. 1, 2002) (Exhibit RME-371).

407 *See* Letter from the Head of the Administration of the Smolensk Region, the Governor of the Tula Region, and the Head of the Administration of the Tambov Region to the General Prosecutor of the Russian Federation, V.V. Ustinov (Feb. 1, 2002) (Exhibit RME-371); Letter from the Governor of the Novgorod Region to President Putin (Dec. 3, 2002) (Exhibit RME-372).

408 *Ibid.* (Exhibit RME-371); (Exhibit RME-372).

316. On December 16, 2002, President Putin ordered the Prime Minister and the Prosecutor General of the Russian Federation to examine the facts about which the Governors complained.[409] In January 2003, the Prosecutor General gave a preliminary response to the President, in which he stated that "*facts can testify to deliberate acts of a group of interested persons aimed at the deliberate misappropriation of a block of shares of OAO Apatit and committing monopolistic acts.*"[410] He also stated that he had sent requests to various other Government agencies, including the Ministry of the Interior and the Tax Ministry, to investigate further.[411]

317. On April 28, 2003, the Prosecutor General wrote a second letter to the President, stating that some of the arguments advanced by the Governor of the Novgorod Region, namely those relating to the alleged breach of anti-monopoly and tax laws by Apatit, could not then be corroborated, at least on the basis of reports provided by other government agencies.[412] However, a field inspection of Apatit by the local Tax Ministry representatives and tax police was taking place, and "*in case violations of the legislation are identified there will be taken measures stipulated by the law.*"[413]

l) The Arrests And Criminal Convictions Of Messrs. Khodorkovsky and Lebedev

318. These criminal investigations led to the arrest of Mr. Lebedev on July 3, 2003 and of Mr. Khodorkovsky on October 25, 2003.[414] The Russian Federation reserves for later discussion other events surrounding their arrest, detention, and subsequent trial—particularly Claimants' allegations of breaches

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409 "*Attn. M.M. Kasyanov: assign to investigate. Safeguard the reasons of the state; attn. V.V. Ustinov: please make arrangements for the investigation and take decisions to safeguard the interests of the state*" (Exhibit RME-373).

410 *See* Letter from the Prosecutor General of the Russian Federation to President V.V. Putin (Jan. 2003) (Exhibit RME-374).

411 *Ibid.*

412 In fact, Messrs. Khodorkovsky and Lebedev were never charged with these offences. *Ibid.*

413 Letter from the Prosecutor General of the Russian Federation to President Putin (Apr. 28, 2003) (Exhibit RME-375).

414 *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 57 (Exhibit RME-379).

of due process.[415] For present purposes, the important facts are the subjects of the criminal convictions of Mr. Khodorkovsky and Mr. Lebedev in 2005, about which Claimants have been remarkably silent in their Memorial – perhaps not surprisingly, as the facts underlying those convictions, in particular the tax evasion by the Lesnoy companies were confirmed by the evidence, and, indeed, have not been denied by Claimants.[416]

319. First, Messrs. Khodorkovsky and Lebedev were convicted on several charges of corporate tax evasion relating to the four Lesnoy sham companies.[417] The court found that they had withheld documents and made fraudulent declarations to the tax authorities regarding the companies' business activities in the region.[418] They were also convicted of fraudulently receiving refunds of supposed tax overpayments made by those companies, despite the fact that the taxes had been paid with promissory notes issued by Yukos, not cash.[419]

320. Further, the court found that Messrs. Khodorkovsky and Lebedev diverted profits from Apatit to intermediary companies, through transfer pricing schemes implemented from 1995 to 2002,[420] and had evaded paying taxes by use

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415 *See* Sections II and III *supra*.

416 *See* Meschansky District Court of Moscow, Judgment (May 16, 2005) (Exhibit RME-379).

417 Although Messrs. Khodorkovsky and Lebedev denied controlling the sham companies, the court determined that they were controlled *de facto* by Yukos. *Ibid.*

418 In fact, there were no business activities conducted in that region, mirroring Yukos' use of sham companies in other low-tax regions as part of its "tax optimization" scheme. *Ibid.*

419 The four Lesnoy companies, as well as other Yukos sham companies, used promissory notes to pay taxes which were higher in value than their tax debt. *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 42 (Exhibit RME-379).As with Yukos' other shell companies, discussed at length at Section II.C., the companies then underwent extensive corporate restructuring. The right to claim the tax refund was reassigned to the new companies, but tax claims against the original four Lesnoy companies never resulted in any recovery, because they had disappeared.

420 On this count, the court considered extensive documentary evidence proving that the activities of Apatit, as well as of the intermediary selling companies, were controlled directly by Messrs. Khodorkovsky and Lebedev. *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 14, 15 (Exhibit RME-379).

of promissory note payment schemes. They were also found guilty of several additional charges.[421] In total, they were sentenced to nine years imprisonment.

321. Messrs. Khodorkovsky and Lebedev pursued appeals in which their convictions of other offenses were overturned,[422] but their convictions relating to the tax fraud were in most respects upheld.[423] As a result, the appellate court reduced their sentences to eight years imprisonment.[424]

m) The Russian Federation Did Not Seek the Break-up of the Yukos-Sibneft Merger

322. The break-up of the Yukos-Sibneft merger was the result of actions taken by Sibneft's controlling shareholders (the "Sibneft Group") in the pursuit of their own legitimate commercial interests.[425] Contrary to Claimants' assertions, the Russian Federation did not intervene in the merger and the Russian court decisions invalidating the exchange of Yukos shares for Sibneft shares held by the Sibneft Group were correctly decided.

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421 For Menatep's acquisition of 44% of the shares in NIYIF, Messrs. Khodorkovsky and Lebedev were found guilty of fraud. They were also convicted of failure to comply with court decisions and evading personal taxes, and Mr. Khodorkovsky was convicted of embezzling RUB 2,649,906,620 (roughly US$ 90 million) from the Yukos group between 1999 and 2000. *See* Meschansky District Court of Moscow, Judgment (May 16, 2005), 50 (Exhibit RME-379).

422 *See* Appeal Decision of the Moscow City Court, Case No. 22-9971 (Sept. 22, 2005) (Exhibit RME-370).

423 The court held that criminal liability for payment of taxes in non-monetary form was only possible up to December 11, 2003; therefore, the aspect of the offense relating to payment of taxes by promissory notes was overturned. However, the convictions for providing fraudulent information on tax forms, and for receiving fraudulent refunds, were upheld. *Ibid.*

424 *Ibid.*

425 Claimants repeatedly refer to the combining of the two companies' businesses as a "merger," a usage adopted here as well for ease of reference. While it is possible that the parties contemplated a full-blown merger (in which all of the assets of the two companies would have been combined in a single surviving entity), Claimants' account of the unwinding of the "merger" refers only to Yukos' acquisition of 92% of Sibneft's shares and does not address the treatment of the remaining shares, held by Sibneft's minority investors. If, as would appear to be the case, those shares remained outstanding, then Yukos and Sibneft were never in fact "merged," as both companies continued to have separate corporate identities. What is clear from Claimants' account is that the two companies' business operations were never fully integrated. *See* Claimants' Memorial on the Merits, ¶ 207.

Claimants have not produced copies of any of the underlying share purchase or share exchange agreements, let alone a "merger" agreement. Respondent is thus unable to reconstruct the entirety of the parties' agreements or dealings. Respondent's account is instead based principally on the description of events contained in the Russian judicial decisions adjudicating the validity of the "merger," discussed below.

(1) The Break-up of the Merger Was the Result of Actions Taken By the Sibneft Group in Its Own Self-Interest, and the Russian Federation Did Not Interfere With the Merger

323. On April 8, 2003, Yukos' controlling shareholders led by Mr. Khodorkovsky, and the Sibneft Group, holding approximately 92% of Sibneft's shares and led by Mr. Abramovich, signed a Memorandum of Understanding providing for the combination of the two businesses. The memorandum also set out how the two groups of principal shareholders would jointly manage the companies' affairs pending completion of the merger.

324. On April 30, 2003, Yukos and the Sibneft Group signed a share exchange agreement pursuant to which Yukos agreed to exchange 26% of its shares for 72% of Sibneft's shares, held by the Sibneft Group. The exchange was to be implemented in two tranches: 57.5% of Sibneft's shares, would be exchanged for newly issued Yukos shares (representing 17.2% of the company's shares), and 14.5% of Sibneft's shares would be exchanged for previously issued Yukos shares (representing 8.8% of the company's shares).

325. That same day, the same parties also signed an agreement providing for Yukos to purchase an additional 20% (less one) of Sibneft's shares from the Sibneft Group for a total purchase price of US$ 3 billion. Under the combined terms of the two agreements, Yukos would thus acquire in total 92% of Sibneft's shares, held by the Sibneft Group. Both the share exchange (72% of Sibneft's shares) and the share purchase (20% of Sibneft's shares) were eventually consummated, though on dates not known to Respondent.

326. On November 28, 2003, Sibneft announced that it was putting the merger on hold. That announcement was not at all surprising, as Messrs. Khodorkovsky and Lebedev, Yukos' two leading Directors, had recently been arrested and charged with various criminal acts, including fraud in connection with Yukos' (and their own) tax filings. Messrs. Khodorkovsky's and Lebedev's future leadership of the company was thus in serious doubt, and any proposed partner would have understandably been concerned about handing over

management of the combined company to a team headed by two individuals recently charged with tax evasion and other crimes.

327. Claimants would have the Tribunal believe that Sibneft's decision to halt and, subsequently, unwind the merger was taken with the "approval" and "at the behest of the Kremlin."[426] The only evidence in support of this claim is a press report of a meeting supposedly held by Mr. Putin and Mr. Abramovich several days before Sibneft's announcement, at which "Abramovich is understood to have raised the prospect of changing the management team of the combined company with Putin, who welcomed the idea."[427]

328. The reported conversation, assuming it ever happened, does not remotely support Claimants' position. The only plausible interpretation of the report is that, rather than opposing the merger, as Claimants allege, Mr. Putin supported the merger, but welcomed Mr. Abramovich's suggestion of a change in management. That Mr. Putin may have *"welcomed"* the possible change is not surprising given the serious fraud charges pending against Messrs. Khodorkovsky and Lebedev. What is surprising, and not reasonable, is Yukos' subsequent refusal even to consider Sibneft's proposal. As reported at the time, "*The breaking point came when Yukos was not ready to hand over management of the company.*"[428]

329. In December 2003, Mr. Abramovich specifically proposed that Eugene Shvidler, the head of Sibneft, serve as the chief executive of the new company. Yukos' principal shareholders rejected that proposal outright.[429] Leonid Nevzlin, Mr. Khodorkovsky's right-hand man and Yukos' Deputy Chairman, confirms that Sibneft wanted the merger to go forward, but walked away from the deal because Yukos was unwilling to appoint Sibneft executives to

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426 Claimants' Memorial on the Merits, ¶¶ 211, 805. Claimants are uncharacteristically cautious in claiming that the Russian Federation actually intervened in the merger process. It was, according to Claimants, only "reportedly" the case that Sibneft's actions were taken "at the behest of the Kremlin." *Ibid.* ¶ 805.

427 Claimants' Memorial on the Merits, ¶ 211 [emphasis added].

428 *Yukos-Sibneft merger called off*, BBC News (Nov. 28, 2003) (Exhibit RME-397).

429 *Kremlin seen as a deep well of influence*, Financial Times (Nov. 29-30, 2003) (Annex (Merits) C-668).

top management positions at the new company. According to Mr. Nevzlin, he discussed the merger with Mr. Abramovich in Israel in late 2003:

> "The general idea from Roman Abramovich was that YukosSibneft could be saved if the management of the merged company was transferred to his team. Roman Abramovich said that YukosSibneft had to be preserved and this was the only way of doing that. However, he said it would not be possible to secure the release of Mikhail Khodorkovsky and Platon Lebedev, at least in the short term."[430]

330. Even though the proposed change in management teams would have had no effect on the Yukos principal shareholders' ownership interest in the new company, Mr. Nevzlin refused to go along. He instead apparently suggested that Sibneft's proposal might be differently received if Mr. Abramovich were able to secure Messrs. Khodorkovsky's and Lebedev's release from prison — something Mr. Abramovich manifestly had no power to accomplish and no legitimate reason to advocate.[431] It was thus Yukos' stubborn refusal to consider Sibneft's change-in-management proposal — and not any action on the part of the Russian Federation — that ultimately doomed the Yukos-Sibneft merger.

(2) The Judicial Decisions Concerning the Merger Were Correctly Decided

331. In 2004, private-party litigation was initiated by two minority Yukos shareholders to invalidate Yukos' previously consummated exchange of 26% of its shares for 72% of Sibneft's shares. The first action was brought by two Yukos shareholders in Moscow, the second action by one of those shareholders in Russia's Far East. After due consideration of the evidence and arguments, the courts in Moscow invalidated Yukos' share issuance and the courts in the Far East invalidated Yukos' exchange of existing Yukos shares. Yukos' purchase of the remaining 20% of Sibneft's shares held by the Sibneft Group, while also at risk of being unwound, was apparently never legally challenged in Russian

430 Witness Statement of Leonid Nevzlin, Sept. 15, 2010 ("Nevzlin Witness Statement"), ¶ 35.

431 *See ibid*.

courts, and those shares were ultimately purchased from Yukos' bankruptcy estate, as discussed below at ¶¶ 643-647.

(a) Moscow Proceedings

332. On January 19, 2004, NP Gemini Holdings Limited ("Gemini Holdings") and Nimegan Trading Limited ("Nimegan Trading") filed a joint application in Moscow to invalidate Yukos' prior exchange of 17.2% of Yukos' shares for 57.5% of Sibneft's shares, held by the Sibneft Group. That share issuance had been the subject of a shareholder vote at a general meeting of Yukos' shareholders held on May 27, 2003. Shareholders holding at least 75% of Yukos' shares represented at that meeting voted in favor of the share issuance. [432]

333. The Moscow applicants argued that the issuance of the shares in favor of the Sibneft Group was invalid under Russian law, because the issuance had not been approved as an "interested party transaction" ("IPT"), as required by the Joint Stock Company Law. This argument was undeniably correct, as the Moscow court properly found.

334. IPTs are regulated under Articles 81-84 of the Joint Stock Company Law. An IPT is there defined as a transaction between a Russian joint stock

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[432] The consent of 75% of Yukos' shareholders was required because the shares were issued by way of a "closed subscription," meaning that they were issued directly to an identified group of investors, and not to the public generally. *See* Art. 39, Russian Joint Stock Company Law (Exhibit RME-398). The high consent threshold apparently created problems for Yukos. As explained by the Moscow applicants: "YUKOS' Principal Shareholders did not have the required 75% of the votes: all they had was just 62% of YUKOS' shares, while those held by minority shareholders or were outstanding at the time totaled up to 38%. For this reason, if all of the 100% of YUKOS shareholders attended the general meeting, with many of them potentially voting against it, it could result in the failure to pass the resolutions required by YUKOS' Principal Shareholders and, consequently, nonperformance under the arrangements that had been reached. Therefore, it was necessary that the maximum possible number of votes for shares beyond the control of YUKOS' Principal Shareholders be excluded from the participation in the process of resolution passing." Appeal Resolution of the Moscow Arbitrazh Court, Case No. A 40-2352/04/92/35 (May 31, 2004), 13 (Annex (Merits) C-72) According to the Moscow applicants, Yukos' principal shareholders deliberately delayed the mailing of ballots in order to ensure the required level of consent. Plaintiffs' Petition to Declare the FCSM Decision to Register the Issuance of Securities Unlawful, and to Declare as Null and Void the Issuance of the Securities (Jan. 19, 2004) (Annex (Merits C-71) Yukos' principal shareholders were apparently successful in their low-attendance strategy: "*At the May 27 2003 general meeting, about 27% of the voting shares either did not attend or voted against.*" Appeal Resolution of the Moscow Arbitrazh Court, Case No. A 40-2352/04/92/35 (May 31, 2004), 13 (Annex (Merits) C-72).

company (such as Yukos) and any person or persons deemed to be "interested" in the conclusion of that transaction.[433] A person is deemed to be an "interested" person in respect of a transaction if, *inter alia*, that person or any of that person's "affiliated persons" is a party to the transaction.[434] "Affiliated persons" are in turn defined under Russian law to include one or more persons or legal entities who, individually or jointly, (i) have the right to control, directly or indirectly, more than 50% of the voting shares of another legal entity, or (ii) have the ability, by contract or otherwise, to determine the decisions taken by another legal entity.[435]

335. Under Article 83 of the Joint Stock Company Law, an IPT must be approved by a majority of a company's disinterested shareholders if, *inter alia*, the IPT involves the issuance or sale of more than 2% of the company's shares. The Yukos shares issued to the Sibneft Group obviously satisfied this test. Under Article 84 of the Joint Stock Company Law, any shareholder of a company may challenge an IPT to which that company is a party if the IPT was not approved in accordance with the Joint Stock Company Law.[436]

336. The Moscow Arbitrazh Court held that Yukos' and Sibneft's principal shareholders each controlled more than 50% of their company's shares, and thus each constituted a group of "affiliated persons" in respect of the company they controlled. The court further held that Yukos was an "affiliated person" in respect of Sibneft by virtue of the rights granted to Yukos in the April 30, 2003 share exchange agreement, including the right to determine Sibneft's business activities. As a result, according to the court, the two groups of shareholders and the two companies together constituted a single group of "affiliated persons." Yukos' controlling shareholders were thus "interested" persons in respect of Yukos' share issuance in favor of the Sibneft Group, and

433 Art. 81, Russian Joint Stock Company Law (Exhibit RME-93).

434 *Ibid.*

435 Art. 4, Law of the RSFSR of March 22, 1991 on Competition and Restriction of Monopoly Activity of Commodity Markets (Exhibit RME-399).

436 Art. 84, Russian Joint Stock Company Law (Exhibit RME-398).

that share issuance was accordingly an IPT requiring the consent of a majority of the disinterested shareholders of Yukos.

337. While the court found that Yukos' share issuance had been approved by the requisite consent of the company's shareholders as a "closed subscription," the court correctly ruled that the share issuance had not been approved as an IPT by a majority of the disinterested shareholders of Yukos. Under the circumstances, the Moscow Arbitrazh Court properly invalidated the share issuance.

338. The Moscow applicants also argued that the prospectus for the shares and the report on the results of the share issuance were misleading in material respects (including in failing to disclose that the share issuance constituted an IPT requiring the approval of Yukos' disinterested shareholders) and that the price of the shares had not been determined in accordance with Russian law. These arguments were also upheld by the Moscow court. The court, however, rejected the applicants' claims (i) that the record date for determining the shareholders entitled to vote on the issuance of the shares had been incorrectly fixed, and (ii) that inadequate notice had been given of the general shareholders' meeting called to approve the share issuance.

339. The Moscow Arbitrazh Court's ruling was upheld on appeal by the Appellate Division of the Moscow Arbitrazh Court in a 21-page opinion detailing both sides' arguments and the court's own reasoning, and on further appeal by the Federal Arbitrazh Court for the Moscow District.[437]

[437] Appeal Resolution of the Moscow Arbitrazh Court, Case No. A 40-2352/04/92/35 (May 31, 2004) (Annex (Merits) C-72), Resolution of the Federal Arbitrazh Court for the Moscow Region, Case No. KG-A40/7182-04 (Aug. 19, 2004) (Annex (Merits) C-73).

(b) Far East Proceedings

340. In July 2004, Nimegan Trading brought another action challenging the merger, this one to invalidate Yukos' exchange of 8.8% of its shares for 14.5% of Sibneft's shares.[438]

341. The Far East court invalidated Yukos' share exchange on the same grounds as the Moscow court had previously invalidated Yukos' share issuance -- because it had not been approved as an IPT by a majority of Yukos' disinterested shareholders -- after finding that Yukos, Sibneft, and their respective controlling shareholders constituted a single group of "affiliated persons" by virtue of the Memorandum of Understanding of April 8, 2003.[439]

342. Following a series of appeals, the Federal Arbitrazh Court of the Far-Eastern District overturned the lower court's decision and remanded the case for retrial. On retrial, the share exchange agreement was again ruled invalid, and the decision was upheld on appeal by the Federal Arbitrazh Court of the Far-Eastern District.[440]

(c) Claimants' Attack on the Russian Judicial Proceedings Is Unavailing

343. Claimants' attack on the Moscow and Far East judicial proceedings amounts to nothing more than innuendo, ungrounded speculation and a series of frivolous objections:

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438 According to Claimants, this action was brought in Chukotka, where Mr. Abramovich was the Governor. While the first and second instance courts that heard this case are located in Chukotka, their decisions were ultimately appealed to the Federal Arbitrazh Court of the Far-Eastern District, and that court is not located in Chukotka, but in Khabarovsk, where Mr. Abramovich was not the Governor. Both Khabarovsk and Chukotka are located in the Far-Eastern District.

439 The Federal Arbitrazh Court of the Far-Eastern District held in its second hearing of this matter that the Memorandum of Understanding "enabled the group of persons in question to determine conditions for the conduct of business by OAO Sibneft and OAO NK Yukos [...] [and] has also laid down basic procedures for the contemplated share sale and exchange [and] principles for the governance of the projected company." Resolution of the Federal Arbitrazh Court for the Far-East District, Case No. F03-A80/06-1/3 (Apr. 25, 2006), 7 (Annex (Merits) C-78).

440 Resolution of the Federal Arbitrazh Court for the Far-East District, Case No. F03-A80/06-1/3 (Apr. 25, 2006), 16 (Annex (Merits) C-78).

(i) The fact that the share exchange agreement was governed by English law is irrelevant because the IPT rules are applicable to all Russian companies regardless of the law governing the challenged agreement and, in any event, Russian courts, like courts the world over, are competent to interpret agreements governed by foreign law.[441]

(ii) The fact that the applicants, who were undeniably Yukos shareholders, may also have had links to Sibneft is equally irrelevant, especially insofar as the Russian Federation is concerned.[442] Claimants do not seriously question the applicants' legal right to challenge the merger.

(iii) The fact that one of the applicants had a very small shareholding is irrelevant to the validity of an IPT, which, as provided for in the Joint Stock Company Law, may be challenged by any shareholder.[443]

(iv) The fact that the share exchange agreement contained an arbitration clause is likewise irrelevant (i) to Nimegan Trading's Far East challenge because that challenge was based on the April 8, 2003 Memorandum of Understanding and Nimegan Trading was, in any event, not a party to the share exchange agreement, and (ii) to the Moscow applicants' challenge because they challenged Yukos' share issuance (not the share exchange agreement) and did not raise the arbitration issue.

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441 Claimants' Memorial on the Merits, ¶ 220.

442 As the Appellate Division of the Moscow Arbitrazh Court explained: "*[Gemini Holding] is a party to the disputed legal relations and participated directly in the securities issues, acquired the newly issued shares in the process of placement, and transferred its property in payment for the shares. The violations of the Russian Federation laws committed by the Issuer in the course of securities issue may result in the rights attached to the additional shares being contested and, as such, go against the lawful interests of the Claimant N.P. Gemini Holdings Limited as the owner of the shares.*" Appeal Resolution of the Moscow Arbitrazh Court, Case No. A 40-2352/04/92/35 (May 31, 2004), 26 (Annex (Merits) C-72).

443 Art. 84, Russian Joint Stock Company Law (Exhibit RME-398).

(v) Yukos can hardly complain if one of the Far East parties (it was in fact one of the defendants) borrowed a page out of Yukos' own play book, and opened a local bank account in order to confer jurisdiction on the court.[444] And while Claimants complain about the manner in which jurisdiction was obtained, they do not challenge the court's ruling that jurisdiction was properly obtained.[445]

344. Claimants' suggestion that Yukos' share issuance had previously been cleared for all purposes by the Russian authorities because the shares were registered with Russia's Federal Commission for the Securities Market is also unavailing. Like securities commissions everywhere, Russia's Federal Commission for the Securities Market does not purport to enforce any law other than the securities laws (and certainly not the rules governing IPTs), and as a matter of Russian law the Commission is expressly not responsible for the accuracy of a company's securities filings.[446]

345. The most telling point of all is that Claimants do not even attempt to show that the Moscow and Far East actions were wrongly decided. They instead fall back on snide but unsupported innuendo -- "*[n]ot surprisingly,*" the Russian courts found in Sibneft's favor and "*[p]redictably,*" the Moscow Arbitrazh Court annulled Yukos' share issue.[447] There is likewise no allegation, much less any evidence, that any of the judges who heard any of the Sibneft-related cases was subjected to improper pressure or acted inappropriately.

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444 *See* ¶¶ 497-501 *infra*.

445 Claimants' Memorial on the Merits, ¶ 227.

446 *See* Claimants' Memorial on the Merits ¶¶ 214-215 *and* Resolution No. 16/ps of the Federal Commission for the Securities Market of April 30, 2002, "On Issuance of Shares and Obligations Convertible into Shares," §9.10 (Exhibit RME-395).

447 Claimants' Memorial on the Merits, ¶¶ 214, 217. While Claimants do assert that the Russian courts "*colluded in the break-up of YukosSibneft,*" that claim is likewise entirely unsubstantiated.

(3) The Unwinding of the Merger Was Not Part of a Plan for Gazprom to Acquire Sibneft

346. Claimants argue that the unwinding of the merger was the first step in a carefully planned strategy that culminated in Gazprom's acquisition of a 73% stake in Sibneft in September 2005.[448]

347. This is an assertion snatched out of the air. While Gazprom did purchase a stake in Sibneft in September 2005, that was almost a year after the Yukos-Sibneft merger fell through, and is hardly evidence that the purchase had been planned a year earlier. The Sibneft shareholders were in fact in discussions in the first half of 2004 with several possible buyers, none of them Gazprom. In March 2004, for example, Mr. Abramovich was reported to have held discussions with Royal Dutch/Shell (whose Russian representative confirmed that the company was negotiating to purchase a stake in Sibneft), with Chevron Texaco (which stated that it was interested in buying a controlling stake) and with Total.[449] In May 2004, Total was reported to have received the Kremlin's approval for the purchase of 25% of Sibneft.[450] At around the same time, analysts saw Sibneft as a likely acquisition target and expected "*the arrival of a large foreign strategic investor.*"[451] At no point during this period was there any press speculation about a possible bid by Gazprom.

(4) Claimants Realized a Substantial Gain from the Unwinding of the Merger

348. Yukos in reality realized a substantial gain on the only portion of its dealings with the Sibneft Group that can be measured with any certainty. As discussed above at ¶ 325, Yukos purchased 20% of Sibneft's shares for US$ 3 billion. These shares were not part of the unwinding of the merger, and were thus included in Yukos' bankruptcy estate. On April 4, 2007, the shares were purchased for RUB 151,536,328,088 (then equivalent to US$ 5.83 billion) by

448 Claimants' Memorial on the Merits, ¶ 230.

449 *Sibneft is for sale*, Nezavisimaya (Mar. 15, 2004) (Exhibit RME-400).

450 *Total promised to buy Sibneft*, Kommersant (May 11, 2004) (Exhibit RME-401).

451 Aton Capital Flashnote on Sibneft (June 8, 2004) (Exhibit RME-402).

EniNeftegaz[452] as part of Lot No. 2, which comprised both the Sibneft shares and certain Siberian gas assets.[453] While the auction price was not allocated between the Sibneft shares and the Siberian gas assets, the independent valuation expert retained by Yukos' receiver had previously valued the shares on a stand-alone basis at RUB 111,349,299,000 (equivalent to US$ 4.25 billion).[454] The shares were subsequently purchased by Gazprom from EniNeftegaz in April, 2009 for RUB 138 billion (equivalent to US$ 4.1 billion).[455] If the portion of the purchase price paid by EniNeftegaz that was allocable to the Sibneft shares is (conservatively) assumed to be on the order of US$ 4 billion, then Yukos realized close to a US$ 1 billion gain on its US$ 3 billion investment in the Sibneft shares, and that gain, together with the balance of the proceeds of Lot No. 2, was applied by Yukos' receiver in reduction of the company's liabilities (*see* ¶¶ 650-656).

n) Yukos Paid The Largest Dividend In Its History To Siphon Off From Russia, And Secure With Claimants, Their Affiliates, And/Or The Oligarchs, An Amount Of Approximately US$ 1.4 Billion. In Parallel, The Oligarchs Shielded Their Holdings In GML Into The Guernsey Trusts

349. Claimants assert that because of the gathering investigation, which they allege had been focused on taxation matters, Mr. Illarionov warned Mr. Khodorkovsky to leave the country in September 2003.[456] If that is so, while they claim Mr. Khodorkovsky elected not to follow this warning, Claimants moved quickly to move as much more money out of Russia as possible to enrich themselves and make the funds unavailable to pay taxes.

350. Only few weeks after the alleged Illarionov-Khodorkovsky meeting, on September 25, 2003, a decision to convene an extraordinary general meeting of Yukos shareholders was taken, at which the company's majority shareholders—*i.e.*, the shell companies appearing as Claimants in these

452 Claimants' Memorial on the Merits, ¶¶ 236, 483.

453 *Ibid.*, ¶ 483.

454 Minutes No. 5 of the meeting of the Creditors' Committee of OAO NK Yukos (Feb. 21, 2007) (Exhibit RME-394).

455 Claimants' Memorial on the Merits, ¶ 237.

456 *Ibid*, ¶ 111.

proceedings—approved the payment of an interim dividend for 2003 of RUB 59.9 billion, or approximately US$ 2 billion.[457] This was by far the largest dividend ever paid by Yukos in its corporate history and, indeed, "'[u]*nprecedented' for a Russian Company*."[458] Also unprecedented was the haste with which this giga-dividend was declared. Previously, Yukos had paid only comparatively small interim dividends, waiting until the close of the fiscal year to make major distributions of profits.[459] The Fall 2003 interim dividend betrays an unusual sense of urgency on the part of those who proposed it—Claimants and the managers whom they had appointed—who evidently sensed the gathering storm, wanted to get as much money as possible, as quickly as possible, out of the company, and out of Russia, and into their pockets.

351. Although Claimants may have thought it clever at the time to extract such a huge sum out of Yukos at the eleventh hour, the long-term cost to the company (and other shareholders) was enormous, because the Fall 2003 dividend—especially when viewed in the light of Yukos' subsequent claims that it did not have the means to pay its tax bills[460]—sent an unambiguous message to the authorities that Yukos' management, in confronting the tax crisis, would not hesitate to play foul. From this perspective, the US$ 2 billion dividend was the first in a series of momentous, self-destructive decisions by Yukos' management that ultimately led to the company's demise.[461]

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457 *See* OAO NK Yukos, Quarterly Report for Fourth Quarter of 2003 (Exhibit RME-330). *See also, e.g., On November 28, 2003 Shareholders of Yukos Oil Company Will Take a Decision on Payment of Dividends*, SKRIN, (Sept. 26, 2003) (Exhibit RME-355); *Yukos Oil Company Shareholders' Meeting Approves Dividend of About $2 Billion*, Yukos Website (Nov. 28, 2003), 8 (Exhibit RME-331).

458 *See, e.g., Yukos Is Planning to Pay Dividends, Which Are 'Unprecedented' for a Russian Company*, Vsluh.ru (Oct. 30, 2003) (Exhibit RME-332). *See also* YUKOS: Investor Relations, Yukos Website, 9 (Annex (Merits) C-4).

459 Lys Report, Exhibit 18.

460 *See* ¶¶ 1384-1387 *infra*.

461 As detailed *infra*, the other critical misjudgments included: (i) the failure to take advantage in early 2004 of the opportunities afforded by Russian law to dramatically reduce Yukos tax exposure (¶¶ 366-372 *infra*); (ii) the decision on April 16, 2004 not to pay the 2000 tax assessment when it became due, on manifestly specious pretexts (¶¶ 381-386 *infra*); (iii) the attempts in Spring-Summer 2004 to trick the authorities into accepting tainted Sibneft shares that Yukos knew to be subject to third party claims (¶¶ 420-430 *infra*); and (iv) the attempt in November and December 2004 to sabotage the YNG auction, including by initiating spurious

352. In fact, as shown by Professor Lys in his report, Claimants Hulley, VPL, and YUL received an amount of approximately US$ 1.4 billion[462] out of that unprecedented US$ 2 billion dividend.[463] The record suggests that, after receipt of that money by Claimants, it was paid out to the Oligarchs.[464] Concurrently, on or around October 25, 2003—*i.e.,* the day of Mr. Khodorkovsky's arrest—each of the Oligarchs transferred his shareholding in GML into the Guernsey Trusts.[465]

o) The December 29, 2003 Tax Audit Report And The April 14, 2004 Tax Assessment For The Year 2000

353. On December 8, 2003, the Tax Ministry issued a resolution calling for a supervisory level audit of Yukos.[466]

354. Upon the conclusion of this audit, on December 29, 2003, the Tax Ministry handed down a detailed, 106-page report describing Yukos' tax evasion scheme, as summarized above,[467] with respect to the 2000 tax year.[468]

355. Yukos had sought to obstruct the conduct of this audit, by refusing to provide documents and information that would have shown the extent of its

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bankruptcy proceedings in the United States (¶¶ 497-506 *infra*).

462 *See* Lys Report, Exhibit 19.

463 Specifically, Hulley received payment of approx. US$ 1.2 billion, while VPL received payment of US$ 179 million and YUL received payment of US$ 63 (Lys Report, Exhibit 19).

464 *See, e.g.*, Annual Report and Financial Statements of Hulley Enterprises Limited for the Year Ended December 31, 2003 (Exhibit RME-190), disclosing that the company had, for that year, "*announced the payment of an interim dividend of US$ 3,002,536 thousand of which US$ 2,991,636 thousand was paid during the years and it proposes the payment of US$ 588,806 thousand as a final dividend for the year*."

465 *See* ¶¶ 127-129 *supra*.

466 *See* Resolution of the Ministry of Taxes and Levies, No. 14-3-05/3239-1 (Dec. 8, 2003) (Exhibit RME-333). As it is clear from the December 8, 2003 resolution, the Tax Ministry justified the audit based on the "*availability of materials showing signs of failure to pay taxes, which facts lead to the necessity to conduct another field tax audit as a measure of overseeing the activity of a subordinate tax agency.*" This audit was a "supervisory" or a "repeat" audit launched by the Tax Ministry to review the audit conducted between October 13, 2002 and March 4, 2003 for the 2000 and 2001 tax years by the local tax inspectorate of Nefteyugansk, which gave rise to a 35-page report (Apr. 28, 2003) (*see* ¶¶ 305-308 *supra*). Russian tax law explicitly provides for The Tax Ministry's power to conduct "supervisory" or "repeat" audits (*see* Article 87 of the Russian Tax Code, (Exhibit RME-356) and Konnov Report, ¶¶ 65-70.

467 *See* Section II.H. 1. *supra*.

468 *See generally* Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003) (Annex (Merits) C-103).

abuses and by causing a number of its subsidiaries to do the same.[469] As pointed out by the Tax Ministry:

> "[d]uring the tax audit, OAO Yukos Oil Company did not provide route orders for deliveries of oil and oil products. In addition, the OAO Yukos Oil Company subsidiaries, which participated in the unlawful scheme of tax evasion, deliberately failed to provide the initial documents required for third party control audits arranged during the tax audit of OAO Yukos Oil Company."[470]

356. The December 2003 tax audit report provided detailed illustrations of the tax evasion scheme used by Yukos in 2000, and concluded that Yukos had set up a network of trading shells through which it had willfully and in bad faith reduced or eliminated its tax obligations.[471]

357. Specifically, the December 2003 audit report found that:

> "registration of sham companies in territories with preferential tax rates, with the exclusive aim of evading tax, and which […] did not actually trade or engage in any activity in those territories or indeed anywhere else, or invest any money in the economies of the relevant constituent entities of the Russian Federation, and which, therefore, illegally applied the additional tax benefits, indicates that OAO Yukos Oil Company acted in bad faith."[472]

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469 *See*, *e.g.*, Report on the cross-audit of Open Joint Stock Company Tomskneft VNK (Dec. 24, 2003) (Exhibit RME-326), confirming that OAO Tomskneft VNK refused to provide the tax authorities with any document "*evidencing* [its] *financial and business relationships with*" 38 companies (several of which were later found to be Yukos' affiliated entities) "*in the period from January 1, 2000 to December 31, 2000*": "*OAO Tomskneft VNK gave a written reply No. 04-42/6-831, dated December 15, 2003, refusing to submit the documents pursuant to the demand issued. As of today (December 24, 2003), the documents have not been submitted.*" *See also* Demand to submit documents of the Interdistrict Inspectorate for Major Taxpayers of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 9, 2003) (Exhibit RME-327); Demand to submit documents of the Interdistrict Inspectorate for Major Taxpayers of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 17, 2003) (Exhibit RME-328); Interview Report of I.A. Karmakova (Dec. 18, 2003) (Exhibit RME-329); Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 5-7 (Annex (Merits) C-103).

470 Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 7 (Annex (Merits) C-103).

471 *Ibid.*, 7-15.

472 *Ibid.*, 14.

358. By relying on the Constitutional Court ruling No. 138-O of July 25, 2001 and the arbitrazh court rulings discussed above,[473] the tax authorities concluded that:

> "OAO Yukos Oil Company carrying out operations involving the purchase and sale of oil and oil products, indicate Yukos Oil Company's [...] bad faith, which evidences its deliberate actions in evading payment of taxes through the application of illegal schemes."[474]

359. Thus, for instance, with respect to Business-Oil, one of the trading shells that had been audited in 1999,[475] the tax authorities found that:

> "[c]ircumstances established in the course of conducting control measures show that RUB 17,455,322.64 was received from Business-Oil […] to develop the regional and local economy[,] but the local budget directly connected with the said economy did not receive the RUB 1,549,359,853. Thus, the investments made by the claimant amount to 1.12 per cent of the unpaid amount of tax. They do not affect the development of the economy, do not cover those budgetary losses which are connected with the granting of tax benefits to taxpayers, but on the contrary, have consequences in the form of unjustified enrichment (saving) on account of budget funds. Consequently, with a clear disparity between the sums of investments made and the benefits applied, the taxpayer abused its right, that is it acted in bad faith which evidences the absence of the right to the benefit."[476]

360. In sum, the tax authorities simply applied to Yukos, on a company-wide basis, the anti-avoidance rules that the courts had been developing since the

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473 *See* ¶¶ 288-296 *supra*.

474 *See* Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 14 (Annex (Merits) C-103).

475 *See* ¶¶ 281-287 *supra*.

476 Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 73 (Annex (Merits) C-103). *See also, e.g.*, with respect to Nortex, a trading shell in the ZATO of Trekhgorny, "*the entity made investment payments of RUB 199,071* […] *as a result of which it subsequently enjoyed tax benefits of RUB 3,152,537,572* […], *given the obvious incommensurability between the amounts invested and the benefits granted, the tax payer has abused the law*" (*Id.*, 28); with respect to Vald Oil, another trading shell in the ZATO of Lesnoy, "*RUB 73,130,225.25 was received from Vald-Oil OOO to develop the regional and local economy but the local budget directly connected with the said economy did not receive the RUB 1,244,413,717. Thus, the investments made by the claimant amount to 5.9 percent of the unpaid amount of tax.* […] *Consequently, with a clear disparity between the sums of investments made and the benefits applied, the taxpayer abused its right*" (*Id.*, 91).

mid-1990s,[477] including the principles articulated in the *Sibirskaya* case and other cases.[478] The audit report was delivered to Yukos on December 29, 2003. It concluded that Yukos owed approximately RUB 98.5 billion in taxes, default interest and fines.[479]

361. On January 12, 2004, Yukos exercised its rights to file written objections to the Tax Ministry's 2003 audit report.[480] Two weeks later, on January 26, 2004, Yukos made a number of arguments that were frivolous on their face, including the bizarre claim that "*the issue of qualifying the actions of a taxpayer as 'illegal' and 'aimed at tax evasion' is out of the scope of the Ministry's competence, cannot be settled by the Ministry during a tax audit and accepted as a basis of proprietary claims to the taxpayer*'."[481]

362. On January 27, 2004, the Tax Ministry met with Yukos' counsel for a discussion of those objections.[482] As a result of this meeting, on January 28, 2004, the Tax Ministry decided to conduct additional control measures on the issues relating to (i) Yukos' affiliations with the trading shells, and (ii) tax calculations, inviting Yukos to provide documents to support its position.[483] Yukos, however, refused to provide any such documents.[484]

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477 Konnov Report, ¶¶ 39-52.

478 *See* ¶¶ 291-296 *supra*.

479 Approximately US$ 3.4 billion based on the RUB/US$ exchange rate on Dec. 29, 2003.

480 *See* Yukos Objections to the Audit Report for Tax Year 2000 (Jan. 12, 2004) (Exhibit RME-335).

481 *See* Letter from Yukos to Deputy Minister of Taxes and Levies of the Russian Federation, I. F. Golikov, No. 243/2-130 (Jan. 26, 2004) (Exhibit RME-336). *See also* Letter of Bruce Misamore to M.M. Kasyanov (Jan. 12, 2004) (Exhibit RME-357), containing equally frivolous statements to the effect that the tax authorities actions are "*a clear 'tax racket'*" and that "[w]*orld practice has no examples when tax reporting duties and tax liabilities were imposed on such a number of unaffiliated persons and, in general, when such unprecedented unfounded tax claims were raised.*" [emphasis added]

482 Minutes of Consideration of Objections to Tax Audit Report No. 08-1/1 of December 29, 2003 (Jan. 27, 2004) (Exhibit RME-337).

483 Ministry of Taxes and Levies of the Russian Federation, Decision No. 14-0-05/300 to Conduct Additional Tax Control Measures (Jan. 28, 2004), 36 (Exhibit RME-338).

484 Comments of Yukos' Representative, D.V. Gololobov, to Minutes of Consideration of Objections to Tax Audit Report No. 08-1/1 (Dec. 29, 2003) (Exhibit RME-339).

363. On April 8, 2004, Yukos confirmed its view in a letter to the Tax Ministry that there were "unresolved controversies" with respect to the content of the Audit Report for Tax Year 2000, and that Yukos did not intend to pay its tax bill.[485]

364. On April 14, 2004, the Tax Ministry issued the 2000 tax assessment in the form of a comprehensive 102-page resolution upholding the findings of December 29, 2003 audit report, and providing a detailed response to all of the objections and counter-arguments raised by Yukos.[486] The 2000 tax assessment affirmed the initial findings of the Tax Ministry and concluded that Yukos owed a total of approximately RUB 99.4 billion,[487] a figure closely corresponding (with minor adjustments) to the still unpaid RUB 98.5 billion[488] assessment in the December 2003 report.[489]

365. As discussed in greater detail at paragraphs 381 to 394 below, for nearly three months, Yukos refused to pay any part of the tax bill.

p) Early 2004: What Yukos Did Vs. What It Could Have Done

366. Yukos' interference with the authorities' December 2003 audit, its frivolous objections to the tax audit report, and then its failure to pay the 2000 tax assessment when it became due were consistent with a broader "die-hard" strategy of confrontation that included extensive domestic and international propaganda campaigns in which Yukos claimed that the tax assessment had no basis in Russian law, and depicted itself, and Messrs. Khodorkovsky and

485 Letter from Yukos to the Deputy Minister of Taxes and Levies of the Russian Federation, S. N. Shulgin, No. 243/2-435 (Apr. 8, 2004) (Exhibit RME-340).

486 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004) (Annex (Merits) C-104).

487 Approximately US$ 3.5 billion based on the RUB/US$ exchange rate on Apr. 14, 2004.

488 Approximately US$3.4 billion based on the RUB/US$ exchange rate on Apr. 14, 2004.

489 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004) (Annex (Merits) C-104).

Lebedev, as victims of political persecution.[490] Those campaigns were built around two major falsehoods.

367. First, a factual matter, during this early period, Yukos continued to deny—in the face of abundant evidence—its control of most of the trading shells. Thus, for example, it denied that it had ever owned or controlled companies such as Sibirskaya (which had been assessed in 2001), and the Lesnoy trading shells (which had been audited in 1999).[491]

368. The second key fabrication was the claim that Yukos' "tax optimization" scheme had been legal at the time when it had been carried out, and that it had become unlawful only for tax years starting after December 31, 2003. This lie took advantage of the fact that the Duma had indeed passed a law (Federal Law No. 163-FZ of December 8, 2003)[492] that amended the low-tax region program effective as of January 1, 2004, significantly limiting (though not

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490 *See* Section III. *infra*.

491 Thus, for instance, in its Objections to the Audit Report for Tax Year 2000 (Jan. 12, 2004), 3-4 (Exhibit RME-335) Yukos complained that the tax inspectors had established Yukos' interdependence with the trading shells "*arbitrarily*," arguing—in the face of overwhelming evidence to the contrary—that "*YUKOS is not an interdependent company and does not have information about their constituent documents, replacement of managers of these companies and their tax liabilities*." *See also* Transcript of the court hearing held on June 18, 2004 in the appellate instance of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 13-16 (Exhibit RME-342), at which Yukos-Moscow (Yukos' managing company) maintained, *inter alia*, that: (i) the tax authorities had made "*groundless assertions as to the interdependency of a number of entities with OAO NK YUKOS;*" (ii) "*OAO NK YUKOS didn't influence the Russian entities referenced in the decision*" of the tax authorities; (iii) "[s]*hareholders of OOO Mitra were natural persons who didn't have anything to do with OAO NK YUKOS;*" and (iv) "[t]*he findings relating to OOO Vald-Oil* […] *are also groundless and were made without taking into account the fact that OOO Vald-Oil was liquidated in September 2000*." At the same hearing, "[*a*] *representative of OAO NK YUKOS stated as follows: We support the arguments of OOO YUKOS-Moscow as to the absence of grounds for establishing interdependency.*"

Only in 2005 did Yukos acknowledge its relationship with Nassaubridge and Dunsley, but continued to hide its control through them of Fargoil and Ratibor. *See*, *e.g.*, the disclosures made by Dunsley and Nassaubridge in their 2003 financial statements (published on January 10, 2005), (Report and Financial Statements of Dunsley Limited for the Year Ended December 31, 2003 (Jan. 10, 2005) (Exhibit RME-272) *and* Report and Financial Statements of Nassaubridge Management Limited for the Year Ended December 31, 2003 (Jan. 10, 2005) (Exhibit RME-273)).

492 Federal Law No. 163-FZ "On Amending Certain Legislative Acts of the Russian Federation on Taxes and Levies (Dec. 8, 2003) (Exhibit RME-343).

eliminating) the benefits that taxpayers could thereafter derive from it.[493] That law, however, left completely undisturbed the jurisprudential doctrines underpinning the authorities' December 29, 2003 audit report and subsequent assessment, and in fact did not mention those doctrines. Federal Law No. 163-FZ thus neither limited nor expanded the anti-abuse arsenal upon which the authorities could rely to combat Yukos' scheme before or after December 31, 2003. The suggestion that December 31, 2003 was some kind of watershed was therefore baseless.[494]

369. It is around this same time—in the early months of 2004—that Yukos management made its second critical misjudgments, which had devastating consequences for the company and, more than other, precipitated its demise.

370. Under a very indulgent provision of Russian law, taxpayers who have filed fraudulent returns can avoid all fines by paying their overdue taxes and interest, and filing proper amended returns for the relevant tax years, before receipt of a formal notice that the authorities are about to audit those years.[495] By early 2004, Yukos could no longer invoke this remedy for tax year 2000 (which had already been audited), but it remained available for several months with

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493 Specifically, Article 3 of Federal Law No. 163-FZ (Exhibit RME-343) provides that "*additional tax incentives stipulated by Article 6(9) with respect to certain categories of taxpayers implementing investment projects under agreements on investment activity and established by the legislative (representative) bodies of the sub-federal units of the Russian Federation and by the representative bodies of local administration as of July 1, 2001, shall be effective until the expiration of the period for which they were granted but no later than January 1, 2004.*"

494 The argument based on Federal Law No. 163-FZ is picked up by Mr. Kasyanov in the attachments to his witness statement, but does not seem to be one that Claimants are pursuing in these proceedings. *See also* ¶¶ 1055-1060 *infra*.

495 Article 81(4) of the Russian Tax Code (Exhibit RME-344). *See also* Konnov Report, ¶¶ 83-85. The management of Yukos was indeed under the fiduciary obligation to take such mitigating actions *vis-à-vis* the company and the company's stakeholders. *See*, *e.g.*, Article 71 of the Russian Federal Law No. 208-FZ "On Joint Stock Companies" (Dec. 26, 1995), requiring that a company's directors, its Chief Executive Officer (or management company), and the members of the executive body must act in the best interest of the company when exercising their rights and performing their duties, and act reasonably and in good faith (Exhibit RME-347). *See*, *e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A41-K1-20186/04 (Dec. 16, 2004) (Exhibit RME-359) *and* Ruling of the Supreme Court No. 14-V01-31 (May 30, 2002) (Exhibit RME-360).

respect to the later tax years (2001 and 2002).[496] Inexplicably, however, Yukos' management, which had access to some of Russia's best tax lawyers, let this opportunity slip away. Worse still, when the time came to file Yukos' annual profit tax return for tax year 2003—on March 28, 2004[497]—Yukos filed that report on the basis that its "tax optimization" scheme had been legal, even though by then—*i.e.*, more than three months after receipt of the December 29, 2003 audit report—Yukos was alone in pretending to believe this. Recklessly (although consistently with this contrarian position), Yukos also continued to file VAT returns for 2004 on this basis. *Errare humanum est, perseverare diabolicum*.

371. Well over one half of the total assessments on Yukos for the five year period 2000-2004 (including most of the VAT assessments for those years and fines)[498] could have been avoided if Yukos' managers had simply paid their overdue profit and other direct taxes and ceased, in early 2004, to file returns as though they—and they alone—understood the requirements of Russian tax law.[499]

372. At the time, Yukos had full unrestricted access to resources, both inside and outside Russia, which would have allowed it to discharge its overdue tax liabilities.[500] If these simple steps had been taken, Yukos would certainly

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496 The audits for years 2001 and 2002 commenced on March 23, 2004, and August 9, 2004, respectively (Field Tax Audit Report No. 30-3-14/1 (June 30, 2004), 3 (Exhibit RME-345) and Field Tax Audit Report No. 52/852 (Oct. 29, 2004), 3 (Exhibit RME-346).

497 Konnov Report, ¶ 84(b).

498 Yukos would have avoided any of the VAT assessments for 2001-2003 (totaling RUB 118.4 billion or approximately US$ 4.2 billion), the 2001-2003 fines (totaling RUB 181.6 billion or approximately US$ 6.4 billion) and almost all 2004 tax assessment, *i.e.*, the 2004 taxes (totaling RUB 51.1 billion or approximately US$ 1.8 billion), all of the assessed 2004 default interest (totaling RUB 11.8 billion or approximately US$ 0.4 billion), and fines (totaling RUB 40.8 billion or approximately US$ 1.5 billion). In sum, Yukos would have saved RUB 403.6 billion (approximately US$ 14.2 billion) of the overall amount of the complained-of assessments, which totaled RUB 691.9 billion (approximately US$ 24.3 billion), *i.e.*, a reduction of approximately 58%. *See also* Konnov Report, ¶ 84.

499 Konnov Report, ¶¶ 83-85.

500 Thus, for instance, in addition to the US$ 2 billion that was used to pay the "gigadividend" to Claimants and other shareholders, Yukos had vast resources available in its Cypriot/British Virgin Islands structure (in excess of US$ 6.8 billion; *see* note 878 *supra* and ¶ 1389 *infra*), other foreign assets, such as, *e.g.*, a 53.7% interest in Mazeikiu Nafta (a Lithuanian refinery) which Yukos' management itself valued at US$ 1.45 billion, and a 49% interest in Transpetrol a.s. (a

have avoided bankruptcy, and could undoubtedly have avoided the sale of YNG as well. Management's failure to do so may have been its single most catastrophic misjudgment.[501]

I. The Russian Tax Authorities' Enforcement Of Yukos' Tax Payment Obligations And Yukos' Continued And Unjustified Refusals To Pay What It Owed, Leading Ultimately To Its Self-Inflicted Insolvency

373. Throughout 2004, while the Russian tax authorities acted properly and with consistent judicial approval to enforce Yukos' tax payment obligations, Yukos steadfastly refused to mitigate or discharge its liabilities, instead continuing to dissipate assets to obstruct the authorities' enforcement efforts, raising spurious objections to those efforts, and making bad faith settlement proposals. Throughout this period, Yukos failed to pay its tax bills when due despite having ample resources to do so, ultimately causing its own self-inflicted and fatal insolvency.

1. Yukos Had Ample Time To Pay The 2000 Tax Assessment, But Resisted Payment

374. In the Russian system, the critical procedural step that puts the taxpayer on notice that it will need to pay a specified amount is the issuance of the audit report for the relevant tax year, which sets forth in detail the basis for the assessments and the amount payable (inclusive of fines, if any), and always precedes the formal payment demand by a significant period of time.[502]

375. For tax year 2000, the audit report was issued to Yukos on December 29, 2003. By the time the actual assessment was issued by the Tax

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Slovakian company) worth US$ 100 million, and other Russian assets. *See* Yukos' Outline of Proposed Financial Rehabilitation Plan, 5 (Annex (Merits) C-312).

501 As noted *supra*, the others having been: (i) the payment of the Fall 2003 dividend (¶¶ 349-352 *supra*); (ii) the decision on April 16, 2004 not to pay the 2000 assessment when it became due, on manifestly specious pretexts (¶¶ 385-394 *infra*); (iii) the attempts in Spring-Summer 2004 to trick the authorities into accepting Sibneft shares that Yukos knew to be subject to third party claims (¶¶ 420-430 *infra*); and (iv) the attempt in November-December 2004 to sabotage the YNG auction by initiating spurious bankruptcy proceeding in the United States (¶¶ 497-506 *infra*).

502 In cases such as this one involving fraud, the taxpayer, of course, knows far better and far sooner than the authorities the amount of the taxes evaded, the only open question being whether the authorities will be able to uncover the full extent of the evasion, or only part of it.

Ministry on April 14, 2004,[503] Yukos had already had 107 days (*i.e.*, from December 29, 2003, to April 14, 2004) -- and not "less than one day"[504] -- within which to pay, or at least to prepare to do so, using its abundant resources. This was an entirely reasonable interval, consistent with international practice.[505] As shown below, however, Yukos did the exact opposite of preparing to make payment, and instead further dissipated its assets and set plans afoot to obstruct the authorities' efforts to enforce Yukos' tax debts.

2. Yukos' Asset Dissipation And Stated Refusal To Pay The 2000 Tax Assessment Prompted The April Injunction, Which Did Not Prevent Yukos From Paying Its Overdue Taxes

376. In the more than three months during which the Tax Ministry was reviewing the December 29, 2003 audit report, Yukos gave no reason to believe that it would pay amounts that were due. To the contrary, as late as April 8, 2004, Yukos made crystal clear to the tax authorities that there were "*unresolved controversies*" with respect to the content of the audit report and that it did not have any intention to pay its overdue taxes.[506] The amounts due were finalized a few days later, on April 14, 2004, when the Tax Ministry issued the 2000 tax assessment, holding that Yukos owed RUB 99.4 billion (approximately US$ 3.5 billion)[507] for tax year 2000 and giving Yukos until April 16, 2004 to voluntarily pay the amounts due.[508]

377. Given Yukos' resistance to making any payment and its continued insistence on "*unresolved controversies*," the tax authorities began to take the precautionary steps contemplated by Russian law[509] to ensure enforcement of the

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503 *See* Tax Payment Demand No. 14-3-05/1610-8 (Apr. 14, 2004) (Annex (Merits) C-105); Tax Penalty Payment Demand No. 14-3-05/1611-1 (Apr. 14, 2004) (Annex (Merits) C-106).

504 Claimants' Memorial on the Merits, ¶ 338.

505 *See* ¶¶ 1414-1416 *infra.*

506 Letter from Yukos to the Deputy Minister of Taxes and Levies of the Russian Federation, S. N. Shulgin, No. 243/2-435 (Apr. 8, 2004) (Exhibit RME-340). *See* ¶ 363 *supra*.

507 Based on the RUB/US$ exchange rate on April 14, 2004.

508 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004) (Annex (Merits) C-104).

509 *See* Art. 90(1) of the Russian Arbitrazh Procedure Code (Exhibit RME-449). Under Russian law, the Tax Ministry is entitled to file an application seeking enforcement of its payment

assessment, with a view to preventing further asset dissipation and securing collection. On April 15, 2004, the Tax Ministry commenced civil proceedings to enforce the 2000 tax assessment[510] by seeking and obtaining from the Moscow Arbitrazh Court an injunction (the "April Injunction") prohibiting Yukos from selling, transferring, or encumbering specified types of assets (in particular, shares or other interests in the capital of its subsidiaries and other entities).[511]

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demand prior to the expiration of the time limit provided for voluntary payment if there are "*unresolved controversies*" with the taxpayer. *See* Resolution of the Plenum of the Supreme Arbitrazh Court No. 5 (Feb. 28, 2001), ¶ 11 (Exhibit RME–450). *A fortiori*, the Tax Ministry is also entitled to file an application for interim relief for purposes of securing its claim on the merits.

510 Claimants' contention that "*Article 104 of the Russian Tax Code prohibits filing a tax claim with a court before the voluntary payment period has elapsed*" (Claimants' Memorial on the Merits, ¶ 247) is contradicted by the very wording of Article 104, which entitles the tax authorities to apply to a court to enforce their claims not only if the "*taxpayer* […] *did not make the payment within the time limit stated in the payment demand*" (in Yukos' case, April 16, 2004), but also "*if the taxpayer refused to pay*" in advance of the due date for the payment (Annex (Merits) C-401). As noted, in the circumstances, Yukos had made it crystal clear to the tax authorities before April 16, 2004 that it had no intention to pay its overdue taxes since there were "*unresolved controversies*" with respect thereto. Yukos raised the same objection before Russian courts as Claimants. The courts confirmed the legality of the tax authorities' application, holding that the tax authorities were authorized to apply to the court prior to the expiration of the deadline for voluntary payment given Yukos' stated refusal to pay the assessed amounts and the existence of "*unresolved controversies*" with Yukos. *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121) ("*Given that failure to meet the Applicant's demand for voluntary payment of the amount due is one of the independent conditions for filing a claim with a court together with the failure to meet the deadline for payment, the RF Tax Ministry had the right to file its application with the Court prior to the due date indicated in the demand, provided that the taxpayer did not meet the demand by the time the claim was submitted. The case file also confirms the existence of unresolved disagreements between the tax authority and the taxpayer with respect to the justness of the Applicant's demands (OAO Yukos Oil Company letters No. 243/2-27 of 12.01.2004, No. 220-24 of 12.01.2004, No. 243/2-130 of 26.01.2004, telegram of 12.01.2004, objections to the field tax audit report No. 243/2-28 of 12.04.2004, protocol of review of objections to the field tax audit report dated 27.01.2004, letter No. 243/2-435 of 08.04.2004), which confirms the Applicant's right to file an application for collection with the Court prior to the expiry of the established deadlines* […]. *Furthermore, the RF Tax Ministry's demands have not yet been fulfilled by the Respondent.*"); upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/6914-I,B (Sept. 17, 2004) (Exhibit RME-1549) and Resolution of the Supreme Arbitrazh Court, Case No. 8665/04 (Oct. 4, 2005) (Exhibit RME-1552). Claimants also contend that the Tax Ministry filed its application with respect to fines for tax year 2001 before the expiration of the deadline for voluntary payment (Claimants' Memorial on the Merits, ¶ 256). This allegation is incorrect. The Tax Ministry applied to the court on September 7, 2004, after the expiration of the due date, and not on September 3, 2004, as alleged by Claimants. *See* Tax Ministry's petition to collect tax penalties (Sept. 3, 2004; stamped filed Sept. 7, 2004) (Exhibit RME-1694) and (Annex (Merits) C-158).

511 *See* Order of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 15, 2004) (Annex (Merits) C-108).

The April Injunction also prohibited the Yukos subsidiaries' stock registrars from making any changes to their registers in violation of the April Injunction.[512]

378. The April Injunction was limited in scope.[513] It specifically excluded (i) oil and oil products, thereby allowing Yukos to continue its operations,[514] (ii) cash and cash revenues,[515] thereby allowing Yukos to voluntarily pay the overdue taxes, and (iii) Yukos' non-Russian assets,[516] which the company remained free to sell, as later acknowledged by Yukos' own counsel: "*Yukos has assets outside Russia free from the Russian Court's freezing order which could have been, and which could be, exploited to raise money.*"[517] As discussed below, Yukos' management and core shareholders brazenly stripped these assets away from the company and shielded any relevant sales proceeds from the tax authorities.[518] Because of its limited scope, the April Injunction did not affect the business activities of Yukos, as confirmed by the company's own managers,[519] nor its operating results.[520]

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512 *Ibid.*

513 The April Injunction prevented Yukos "*from alienation and encumbrance in any way of its assets, including shares (including prohibition from the transfer of securities to a nominee holder and in trust management), interests in the charter capital of other legal entities, securities, excluding main types of products manufactured by* […] *Yukos.*" Order of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 15, 2004) (Annex (Merits) C-108).

514 The Moscow Arbitrazh Court found that the April Injunction did not cover "*any of YUKOS Oil Company's operations related to sales of petroleum and oil products and thus* [did] *not prevent either YUKOS Oil Company or any other parties from going about their business as normal.*" Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (July 2, 2004), 2 (Exhibit RME-451).

515 By Order of April 23, 2004, Case No. A40-17669/04-109-241, the Moscow Arbitrazh Court confirmed that the April Injunction did not cover, *inter alia*, "*deferred tax assets, inventory, including raw materials, materials, finished goods, goods delivered, input VAT credit, current non-delinquent accounts receivable, cash.*" (Exhibit RME-452).

516 Under Article 16(1) of the Russian Arbitrazh Procedure Code (Exhibit RME-454), judicial rulings, including interim measures, are effective in the territory of the Russian Federation.

517 The submission by Yukos' English counsel is quoted in a judgment of the High Court of England and Wales (June 17 and 24, 2005), ¶ 15 (Exhibit RME-455).

518 *See* ¶¶ 528-539, 588, 592 *infra.*

519 For instance, on April 19, 2004, Yukos' Chief Financial Officer Bruce Misamore publicly stated that the April Injunction "*wouldn't have a significant effect on the company's operations.*" Gregory L. White, Guy Chazan, *Yukos Is Further Squeezed by Ban - Russian Court Bars Sales of Assets, as Authorities Seek Back Taxes and Fines*, Wall St. J. (Apr. 19, 2004), A8 (Exhibit RME-456). On June 21, 2004, Mr. Misamore further stated that Yukos' "*export operations and debt service continue*[d]

379. Interim *ex parte* measures,[521] such as the April Injunction, are routinely granted by Russian courts -- as well as by courts in many other jurisdictions[522] -- if failure to take these measures "*may impede or preclude the execution of the court ruling.*"[523] The tax authorities explained that their application was prompted, *inter alia*, by "*the real risk of OAO NK YUKOS dissipating its assets and subsequently making it impossible to collect the required amount of taxes, fines and default interest.*"[524] Considering that only a few weeks earlier Yukos had completed payment of an unprecedented US$ 2 billion dividend, primarily to Claimants,[525] and that Yukos had expressly stated its

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as normal" and "*Yukos ha*[d] *well in excess of US$ 1 billion in cash and cash equivalents.*" Bruce K. Misamore, *Presentation for Renaissance Capital Annual Investor Conference* (June 21, 2004), 6, 8 (Exhibit RME-457). During the court hearing relating to Yukos' challenge of the April Injunction that took place on July 2, 2004, in response to a question by the court, Yukos' representative confirmed that he was "*not aware of any adverse effect of the* [April Injunction] *on this activity* [operations with oil and oil products]." Record of the Court Hearing in the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (July 2, 2004), 4 (Exhibit RME-458).

520 *See* Yukos' preliminary consolidated operating results for the second quarter of 2004, confirming that the company's "*production was 21.3 million metric tons (156 million barrels) of crude oil and gas condensate, including 0.4 million metric tons (3.2 million barrels) of Yukos' interest in production of equity affiliates in the second quarter of 2004, which is 8.0% more than in the corresponding period of 2003* [...]. *In the second quarter of 2004 international sales of crude oil were 11.8 million metric tons (86 million barrels), an increase of 3.1% over the corresponding period of 2003* [while] *exports of crude oil outside the territory of the Russian Federation* [...] *were 13.3 million metric tons (97 million barrels), an increase of 7.5% over the second quarter of 2003.*" (Exhibit RME-459).

521 *See* Article 93(1) of the Arbitrazh Procedure Code, which provides that applications for interim measures must be decided (i) within one day from the date the application is filed, and (ii) "*without notifying the parties*" (*i.e., ex parte*) (Exhibit RME-449). Yukos had full opportunity to challenge the April Injunction, as it did, and to seek its amendment, as it also did.

522 *See* ¶¶ 1417-1421 *infra*.

523 *See* Art. 90(2) of Russian Arbitrazh Procedure Code (Exhibit RME-449). *See also* Gregory L. White, Guy Chazan, *Yukos Is Further Squeezed by Ban – Russian Court Bars Sales of Assets, as Authorities Seek Back Taxes and Fines*, Wall St. J. (Apr. 19, 2004), A8 (Exhibit RME-456) ("*Russian tax authorities often go to court seeking asset freezes to keep alleged tax evaders from shifting assets to other entities.*"). In any event, under Russian law, Yukos could have had the April Injunction lifted simply by providing adequate counter-security, a route which Yukos also failed to pursue. *See* Art. 96(3) of the Russian Arbitrazh Procedure Code (Exhibit RME-460), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7691-04 (Aug. 31, 2004) (Exhibit RME-461) and Resolution of the Federal Arbitrazh Court of the North Western District, Case No. A56-34850/03 (May 20, 2004) (Exhibit RME-462).

524 *See* Application for interim relief measures of the Ministry of Taxes and Levies of the Russian Federation (Apr. 15, 2004) (Exhibit RME-463).

525 *See* ¶¶ 349-352 *supra*.

intention not to pay the taxes due, the authorities had good reasons to take steps to prevent further asset dissipation.

380. Yukos availed itself of the opportunity to challenge the April Injunction before the courts which upheld it at two levels in well-reasoned judgments, rendered after full hearings of Yukos' objections.[526]

3. Yukos Failed To Pay The 2000 Tax Assessment Due On April 16, 2004, Even Though It Had The Ability To Do So

381. As the tax authorities feared and as the April Injunction was intended to protect against, Yukos failed to pay the amounts due pursuant to the 2000 tax assessment when they became due on April 16, 2004.

382. This was the third momentous misstep in Yukos' self-destructive strategy, after the decision in the fall of 2003 to "empty the coffers" through the giga-dividend (*see* ¶¶ 349-352 above), and the decision in early 2004 to forgo the opportunities to mitigate the company's tax liabilities (*see* ¶¶ 369-371 above).

383. Yukos' non-payment of its 2000 tax bill was indeed deliberate.

384. At that time, even without considering the vast wealth accumulated and concealed by Yukos and its controlling Oligarchs in off-shore entities, Yukos possessed unencumbered resources far exceeding the amount of

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526 *See* Order of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 15, 2004) (Annex (Merits) C-108) and Resolution of the Appellate Division of the Moscow Arbitrazh Court on Yukos' challenge of the April Injunction, Case No. A40-17669/04-109-241 (July 2, 2004) (Exhibit RME-451). As discussed in greater detail at ¶¶ 420-421 *infra*, Russian courts also rejected Yukos' bad faith attempt to lift the April Injunction by proffering the impaired 57.5% stake in Sibneft. *See* Order of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 23, 2004) (Exhibit RME-452) and Resolution of the Appellate Division of the Moscow Arbitrazh Court on Yukos' application for substitution of the April Injunction, Case No. A40-17669/04-109-241 (July 2, 2004) (Exhibit RME-453). Article 95 of the Arbitrazh Procedure Code (Exhibit RME-1674) provides that "*upon application of the claimant or the respondent one interim measure may be substituted with another.*" [emphasis added]. It is well established under Russian law that the decision to substitute an interim measure with another rests within the court's discretion, which in the circumstances was reasonably exercised, considering that the alternative security offered by Yukos consisted of shares encumbered by a prior court order.

the overdue taxes[527]. Mr. Steven Theede recently confirmed as much: "*in April 2004* […] *Yukos had substantial assets to repay its alleged tax liabilities*."[528]

385. As noted, by April 14, 2004, Yukos had had 107 days after it was notified of the tax audit report for year 2000 on December 29, 2003[529] –- not the "less than one day" Claimants allege –- during which it was free "to sell or leverage any of its assets"[530] in order to generate the necessary cash, as no restrictions at all were in place during that period. And Yukos well knew that it needed to do so, if in fact it planned to pay voluntarily, because as a matter of Russian law, once an assessment is made, the taxpayer will have a maximum of 10 days within which to make payment.[531] If Yukos' management and controlling shareholders had wished to pay voluntarily the company's 2000 tax liabilities, they would thus not have waited until April 14, 2004 to generate and set aside the necessary cash.

386. Instead, as also noted, only a few weeks beforehand, the company had completed payment to its shareholders of an enormous, eleventh-hour distribution of dividends, following the arrest of the mastermind of the Yukos tax evasion scheme -- the biggest ever in Yukos' history, totaling US$ 2 billion, most of which had been pocketed by the Claimants in these proceedings.[532] The timing of the decision-making process leading to the distribution of these dividends makes it clear that the intent of Yukos' management (and Claimants)

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527 *See* ¶¶ 1387-1389 *infra.*

528 Witness Statement of Steven Theede (Aug. 26, 2010) ("Theede Witness Statement"), ¶ 9. *See also ibid.*, ¶ 10, where Mr. Theede further confirms that "*Yukos had the means* […] *to pay its alleged tax liabilities*."

529 *See* ¶ 375 *supra.*

530 Claimants' Memorial on the Merits, ¶ 338.

531 Russian law at the time did not include a statutory requirement regarding the minimum time limit to be granted to a taxpayer for the voluntary performance of a tax payment demand (*see, e.g.*, Art. 69 of the Tax Code (Exhibit RME-579)). To the contrary, the standard procedure at the time expressly required that this period would not exceed 10 calendar days from the date of the delivery of the demand (*see, e.g.*, Tax Ministry Order No. BG-3-29/159 (Apr. 2, 2003) (Exhibit RME-580), and it was in the Tax Ministry's discretion to establish, within this maximum 10-day time limit, the deadline for the voluntary performance of any specific payment demand.

532 *See* ¶¶ 349-352 *supra.*

was precisely to put this sum beyond the tax authorities' ability to collect, given that Yukos would soon be subject to major tax assessments.[533] If Yukos' management had simply refrained from taking this aggressive step, Yukos' cash reserves as of the due date for the 2000 tax assessment (April 16, 2004) would have been US$ 2 billion higher, an amount representing approximately 60% of the tax bill that Claimants say "*Yukos was prevented from discharging*."[534]

4. Yukos' Continued Failure To Pay Its Overdue Taxes For Year 2000, While Proceeding With Further Asset Dissipation, Caused The Authorities To Commence Enforcement Proceedings And Adopt Enforcement Measures

387. On June 29, 2004, the Appellate Division of the Moscow Arbitrazh Court delivered its ruling affirming in all material respects the 2000 tax assessment.[535] The following day, the Moscow Arbitrazh Court issued a writ of enforcement authorizing the First Interdistrict Department of the Court Bailiff Service for the Central Administrative District of Moscow (the "bailiffs") to commence enforcement of the 2000 tax assessment.[536]

a) Yukos Willfully Resisted Payment Of Its Overdue Taxes

388. By June 29, 2004, Yukos had had 77 additional days to pay its tax debt -- which was due and payable regardless of the pending challenges before courts[537] -- for a total of 184 days following the delivery of the tax audit report for the year 2000 (December 29, 2003). During this additional period, the April

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533 *See* ¶ 350 *supra*.

534 Claimants' Memorial on the Merits, ¶ 338.

535 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court upholding the first instance judgment, which had confirmed the Assessment for Tax Year 2000 (Annex (Merits) C-116 and Annex (Merits) C-121).

536 *See* Writ of Execution No. 383729 (June 30, 2004) (Annex (Merits) C-122).

537 Under Russian law, the tax authorities were required to apply to a court only for collection of the assessed fines, while the overdue taxes and default interest were enforceable even before confirmation by court. Pursuant to Article 46 of the Tax Code (in force at the relevant time), the tax authorities could collect taxes and default interest "*by way of sending a collection order to the bank in which the accounts of the taxpayer* [...] *have been opened* for *debiting and tranferring the amount of tax from the accounts of the taxpayer* […] *to appropriate budgets/non-budget funds*." (Exhibit RME-541).

Injunction -- which did not cover, *inter alia*, Yukos' cash and foreign assets[538] -- was the only limitation on Yukos's ability to dispose of its resources.

389. At that time, Yukos' resources were still abundant despite the US$ 2 billion dividend, as confirmed by Yukos' own managers who publicly declared that Yukos' "*export operations and debt service continue*[d] *as normal*" and that "*Yukos ha*[d] *well in excess of US$ 1 billion in cash and cash equivalents*."[539]

390. During the additional 77 days, instead of paying its taxes, Yukos' managers dissipated its assets, *inter alia* by making "*prepayments*" to Moravel, a wholly-owned subsidiary of GML (the Oligarchs' holding company through which they owned Claimants), in the aggregate principal amount of US$ 225 million,[540] under the US$ 1.6 billion loan entered into between Société Générale S.A. and Yukos on September 30, 2003 and assigned by Société Générale S.A. to Moravel on May 25, 2004.[541] Yukos' payments to Moravel continued into early 2005 through Yukos' indirect subsidiaries, out of the proceeds from exports of crude oil and oil products, totaling approximately US$ 944 million (plus interest accrued).[542]

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538 *See* ¶¶ 378 *supra*.

539 Bruce K. Misamore, *renaissance capital Annual Investor Conference* (June 21, 2004), 6, 8 (Exhibit RME-457). *See also* Yukos Oil Company, Statement regarding the current financial situation (July 22, 2004) (Exhibit RME-464). *See also* Isabel Gorst, *Yukos Looks for Help From Putin After Setback in Court on Back Taxes*, Platts Oilgram News (July 1, 2004), 1 (Exhibit RME-465) (noting that Yukos had US$ 1 billion in cash on hand it could use towards payment of its tax liabilities as of the end of June 2004). Yukos consolidated turnover for nine months of 2003 was more than US$ 12 billion, an average of US$ 1 billion per month. *See* Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements (Sept. 30, 2003) (Annex (Merits) C-31).

540 The payments were made on May 28, 2004 and June 28, 2004. *See Moravel Investments Limited v. Yukos Oil Company*, LCIA, Award (Sept. 16, 2005), ¶¶ 21-30 (Exhibit RME-1818 /466). Pursuant to Article 9.1 of the Moravel loan agreement, "[t]*he Borrower* [Yukos] *may, if he gives the facility agent no less than three (3) Business Days* [...] *prior notice, prepay all or any part of any Advance*." US$ 1.6 billion Loan Agreement between Yukos and Société Générale S.A. and others (Sept. 30, 2003), Art. 9.1 (Exhibit RME-468).

541 *See* Transfer Certificate between Société Générale S.A. and UBS AG (May 4, 2004) (Exhibit RME-469); Transfer Certificate between UBS AG and Pecunia Universal Limited (May 4-6, 2004) (Exhibit RME-470); and Transfer Certificate between Pecunia Universal Limited and Moravel Investments Limited (May 24, 2004) (Exhibit RME-471).

542 *See Moravel Investments Limited v. Yukos Oil Company*, LCIA, Award (Sept. 16, 2005), ¶ 27 (Exhibit RME-1818). *See also* Definition of "Security Documents" in US$ 1.6 billion Loan

391. Also, during this period, the management of Yukos foisted upon YNG US$ 5 billion in upstream guarantees for the debts of Yukos.[543] Of these guarantees, US$ 3 billion were in favor of Moravel, including a guarantee of the US$ 1.6 billion loan from Moravel to Yukos, which both Russian courts and an LCIA arbitration panel subsequently declared invalid as having been improperly imposed by Yukos to favor its majority shareholders.[544]

392. Thus, from April 16 to June 29, 2004, Yukos used its accounts for every purpose other than discharging its overdue taxes. Tellingly, Yukos' managers even failed to make a provision for the company's tax liabilities in Yukos' financial statements, even though they were clearly required to do so.[545] As a result, as of June 29, 2004, six months after the initial audit report, the tax authorities had still not received a kopek.

Agreement between Yukos and Société Générale S.A. and others (Sept. 30, 2003) (Exhibit RME-468). Payments under such Security Documents were due upon the occurrence of an event of default. *See Moravel Investments Limited v. Yukos Oil Company*, LCIA, Award (Sept. 16, 2005), ¶ 27 (Exhibit RME-1818). Société Générale S.A., as agent for Moravel, notified Yukos and its guarantors of the occurrence of an event of default under the US$ 1.6 billion loan agreement on August 6, 2004. *See* Valeria Korchagina, *Menatep Says Yukos in Default*, Moscow Times (Aug. 12, 2004) (Exhibit RME-473). Eventually, Moravel's claim under the US$ 1.6 billion loan was fully satisfied through the proceeds from the sale of the most valuable asset controlled by the Dutch *Stichting*, the Lithuanian refinery AB Maizeikiu Nafta. *See* ¶¶ 592 *infra*.

543 *See* Financial and Performance Guarantee between YNG and Société Générale (May 24, 2004) (Exhibit RME-581) and Financial and Performance Guarantee between YNG and Société Générale (May 25, 2004) (Exhibit RME-582).

544 YNG's guarantee of the Moravel loan was annulled by a Russian court decision which held that, by causing YNG to guarantee its parent's indebtedness, Yukos had exceeded its corporate powers. *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7419-06 (Sept. 7, 2006) (Exhibit RME-583). Thereafter, it was reported that an LCIA arbitration panel dismissed a claim brought in arbitration by Moravel to enforce a guarantee. *See* "Moravel Investments vs. OAO Yuganskneftegaz" *Law.com - Arbitration Scorecard 2007: Top 50 Contract Disputes* (June 13, 2007), 12 (Exhibit RME-584).

545 *See* PricewaterhouseCooopers, Auditor's Opinion on 2003 Financial (Accounting) Statements of Yukos under Russian Accounting Standards (June 23, 2004), 4 (Exhibit RME-474) ("*the Company failed to make a provision for the amount of taxes specified by the tax authorities as due for the financial year ending on December 31, 2000 in the Report on tax audit dated December 30, 2003. The duty to pay this sum was confirmed in the decision of the Moscow Arbitrazh Court dated May 26, 2004, in the amount of 99.375 billion rubles. In our opinion, the Bookkeeping Regulations 'Events since the accounting date' (PBU 7/98) require that the said amount is reported in the financial (accounting) statements of the Company for the year ending on December 31, 2003. Should the amount assessed by the tax authorities have been reported, the tax indebtedness and current liabilities of the Company would have increased by 99.375 billion rubles and the net profit would have decreased by the same amount.*") [emphasis added].

393. As the only excuse for its delinquency, Yukos publicly claimed (as Claimants do in these proceedings)[546] that the measures taken by the Russian authorities to try to secure payment, notably the April Injunction, deprived it of the ability to discharge the amounts due.[547] These statements were (and remain) false.

394. As noted, despite the April Injunction (which had a limited scope), Yukos was able to and did discharge obligations (some, as discussed above, prior to when they were due) but chose not to pay its taxes. And when Yukos' managers finally decided to pay the 2000 tax assessment in early July 2004, they were able to effect full payment in a period of only 134 days (between July 6 and November 16, 2004),[548] and without any of Yukos' considerable foreign assets and funds.[549] Therefore, contrary to Claimants' contention, neither the April Injunction nor any of the enforcement measures subsequently levied on Yukos'

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546 *See* Claimants' Memorial on the Merits, ¶ 338. *See also* Theede Witness Statement, ¶¶ 10-11 ("*Yukos worked diligently and in good faith to discharge* […] *the tax liabilities arbitrarily assessed against the company*" but "*it was simply not allowed to pay its alleged tax liabilities*") and Witness Statement of Bruce Misamore (July 28, 2010) ("Misamore Witness Statement"), ¶ 41.

547 *See* Greg Walters, *Yukos Warns It May Go Bankrupt,* Moscow Times (May 28, 2004) (Exhibit RME-475), citing statement by Yukos that the "*court-ordered freeze on the company's property means Yukos cannot sell assets, including stocks, to help pay the tax bill*" and that, "[u]*nless the court ban is lifted, the sale of assets is impossible.* […] *If the tax authorities continue their actions, we can forecast with high probability that we will go bankrupt before the end of 2004.*" When challenging the April Injunction, Yukos also argued before the courts that the injunction would be harmful to the company's ability to continue to operate smoothly. *See, e.g.*, Yukos' application on alteration of interim relief measures before the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 22, 2004) (Exhibit RME-476) and Yukos' addition to application on alteration of interim relief measures before the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (stamped received Apr. 23, 2004) (Exhibit RME-477). As noted above, this is at odds with contemporaneous statements made by Yukos' own managers.

548 *See* Statements on payments made by Yukos to discharge its tax debts from June 30, 2004 through November 16, 2004 (Annexes (Merits) C-212 to C-234).

549 Claimants contend that because of the restrictions on Yukos' assets, "*in order to meet its alleged tax liabilities, Yukos had to seek an inter-company loan from Yukos Capital, its Luxembourg subsidiary, for an amount of US$ 355 million.*" Claimants' Memorial on the Merits, ¶ 351. In reality, as discussed in greater detail at ¶ 1530 *infra*, the US$ 355 million that Yukos Capital S.a.r.l. loaned to Yukos originated from the sale of a Russian asset of Yukos, an indirect stake in a Russian oil and gas company, CJSC Rospan International (owned through the Yukos Cypriot subsidiary Hedgerow Limited), and therefore came from Yukos' own funds. The proceeds resulting from this sale were channeled to Yukos via a loan from Hedgerow Limited to Yukos Capital S.a.r.l., which had no evident business purpose other than further avoidance of taxes and fabrication of a sham claim against Yukos.

assets by the Russian authorities "*prevented* [Yukos] *from discharging or settling*" its tax debt.[550]

b) Due To Yukos' Willful Delinquency, The Authorities Commenced Enforcement Proceedings For Tax Year 2000 And Adopted Enforcement Measures Securing Collection

395. As a result of Yukos' continued default, the Russian tax authorities -- whose duties include prompt collection of budget revenues from tax offenders[551] -- expeditiously proceeded to enforce Yukos' tax debt.[552] They did so in a manner that was, if anything, less aggressive than was warranted given Yukos' history of obstructionism and deceit.[553]

396. On June 30, 2004, the bailiffs formally instituted enforcement proceedings against Yukos, granting Yukos a further five-day grace period until July 8, 2004, for voluntary payment of the full amount due[554] -- the maximum period the bailiffs were authorized to allow under the law.[555]

397. Yukos once again willfully failed to pay the amounts due. Consequently, the bailiffs levied a statutory 7% enforcement fee, which was fully

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550 Claimants' Memorial on the Merits, ¶ 338.

551 *See* Art. 30(1) of the Russian Tax Code (Exhibit RME-597).

552 Apparently without irony, Claimants suggest that the tax authorities could have merely patiently waited "*three years*" before enforcing their tax claim, during which they could have "*negotiate*[d] *with Yukos how the Company would pay the alleged liability*." Claimants' Memorial on the Merits, ¶ 339.

553 *See* ¶¶ 349-352, 355 *supra* .

554 *See* Resolution of Bailiff I.D. Solovyova to initiate enforcement proceedings No. 10249/21/04 (June 30, 2004) (Annex (Merits) C-123). Yukos challenged this resolution, complaining, *inter alia,* about the five-day deadline for voluntary payment. Russian courts dismissed Yukos' challenge, upholding the legality of this deadline. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-33821/04-92-266 (July 30, 2004), 2 (Exhibit RME-487), and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-33821/04-92-266 (Nov. 10, 2004) (Exhibit RME-488).

555 Pursuant to Article 319(3) of the Russian Arbitrazh Procedure Code, upon entry into force of a court judgment, the arbitrazh court is empowered to issue a writ of execution, which is then submitted to the bailiff for initiation of enforcement proceedings (Exhibit RME-1675). When initiating enforcement proceedings, a bailiff must establish a time limit for voluntary performance of claims which "*may not exceed five days from the date of institution of the enforcement proceedings*." *See* Art. 9 of Federal Law No. 119-FZ (July 21, 1997) "On Enforcement Proceedings" (the "1997 Enforcement Law") (Exhibit RME-478).

compliant with Russian law and practice.[556] In the meantime, the bailiffs adopted a number of enforcement measures aimed at securing collection of the overdue taxes.

398. As discussed in Section VI.D.4(b) and (c) all of these measures were not only valid and appropriate under Russian law and practice, but also consistent with the law and practice of many other countries. At each step of the enforcement proceedings, Yukos was given the opportunity to appeal the decisions of the bailiffs and of the courts, and generally did so.[557]

c) The Cash Freeze Orders Were Appropriate And Did Not Prevent Yukos From Paying Its Overdue Taxes

399. On June 30, 2004, the bailiffs issued orders to freeze cash in 16 Yukos bank accounts up to the total amount of taxes then due and in need of

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556 *See* Resolution of Bailiff I.D. Solovyova (July 9, 2004) to collect an enforcement fee (Annex (Merits) C-132). Pursuant to Article 81(1) of the 1997 Enforcement Law, "[*i*]*f the enforcement document is not executed without any valid reasons within the term fixed for the voluntary performance of the document, the bailiff issues a resolution, under which an enforcement fee shall be imposed on the debtor, in the amount of seven per cent of the claimed amount or the value of the debtor's assets.*" (Exhibit RME-478). Russian courts confirmed that the 7% enforcement fee was fully compliant with Russian law, holding that no "*force-majeure, reasonably unavoidable and other unexpected, insurmountable obstacles beyond the Debtor's control*" could be invoked to excuse Yukos' failure to voluntarily satisfy the enforced claims and consequently exempt it from the imposition of an enforcement fee. *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09-AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479), and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-11135-04 (Dec. 6, 2004) (Annex (Merits) C-148). These decisions were in full accord with existing court practice. *See, e.g.*, Resolution of the Federal Arbitrazh Court of the Western-Siberia District, Case No. F04-5245/2004(A03-3205-32) (July 28, 2004), upholding the imposition of an enforcement fee, despite the fact that the debtor's assets were seized, on the ground that the "*the financial and economic position of the debtor*" may not be considered as a valid excuse for failing to satisfy the enforced claims voluntarily (Exhibit RME-480); and Resolution of the Federal Arbitrazh Court of the Far Eastern District, Case No. F03-A73/06-1/3291 (Oct. 3, 2006), upholding the imposition of an enforcement fee on the ground that no extraordinary circumstances prevented the debtor from discharging its debt, despite the fact that the debtor's cash was frozen simultaneously with the initiation of the enforcement proceedings and that the debtor was enjoined from disposing of its real property (Exhibit RME-481).

557 *See* ¶¶ 1427-1429 *infra*. In some cases, there is no evidence that Yukos exercised its right to appeal. For instance, there is no evidence that Yukos appealed the July 2, 2004 ruling of the Appellate Court that upheld the April Injunction as reasonable and not interfering with the company's operations. There is also no evidence that Yukos appealed the August 17, 2004 order of the Moscow Arbitrazh Court upholding the bailiffs' decision to reject Yukos' offers of tainted Sibneft shares.

being forcibly collected, *i.e.,* RUB 99,333,936,391 (the "Cash Freeze Orders").[558] These orders were valid and appropriate under Russian law, which provides that a debtor's cash can be frozen in any amount to secure collection of a claim.[559] These orders were also consistent with international practice.[560]

400. Like the April Injunction, the Cash Freeze Orders did not in any way prevent Yukos from discharging its overdue tax obligations.[561] To the

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558 *See* Resolutions of Bailiff I.D. Solovyova Nos. 10249/21/04-01, 10249/21/04-02, 10249/21/04-03, 10249/21/04-04, 10249/21/04-05, 10249/21/04-06, 10249/21/04-07, 10249/21/04-08, 10249/21/04-09, 10249/21/04-10, 10249/21/04-11, 10249/21/04-12, 10249/21/04-13, 10249/21/04-14, 10249/21/04-15, and 10249/21/04-16 (June 30, 2004) (Annex (Merits) C-124).

559 Pursuant to Article 9(5) of the 1997 Enforcement Law (Exhibit RME-478), the bailiff had the right to freeze any of the debtor's assets to secure enforcement simultaneously with the initiation of the enforcement proceedings. Article 46(2) of the same law (Exhibit RME-482) provided that "[e]*xecution under enforcement documents shall be, in the first priority, levied on the debtor's monetary funds in rubles and in foreign currency, and on other valuables, including those kept in banks and other credit institutions.*" As a matter of practice, bailiffs normally start enforcement by freezing the cash (which is then used to satisfy a creditor's claim if the debtor fails to pay the amounts voluntarily). Russian courts have repeatedly confirmed such practice to be in compliance with the law. *See, e.g.,* Resolution of the Federal Arbitrazh Court of the Far East District, Case No. F03-A73/01-2/1483 (Aug. 7, 2001) ("[w]*hen a debtor holds accounts in various banks, a court bailiff may issue resolutions on the attachment of the funds of the debtor in these banks in full. Such actions are not prohibited by legislation on enforcement proceedings.*") (Exhibit RME-483); Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4691-06 (June 5, 2006) ("*Article 9(5) of the Federal Law No. 119-FZ of July 21, 1997 'On Enforcement Proceedings' provides for the possibility to seize debtor's assets simultaneously with the initiation of the proceedings if there is an application from the creditor to that effect. It has been established that the creditor has submitted such an application to the bailiff, due to which fact a seizure was imposed on the debtor's assets (cash) in the amount to be collected*") (Exhibit RME-484); Resolution of the Federal Arbitrazh Court of the Far Eastern District, Case No. F03-A73/06-1/3291 (Oct. 3, 2006) (Exhibit RME-481). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7573-01 (Dec. 25, 2001) (Exhibit RME-485); and Ruling of the Supreme Court, Case No. 5-V02-209 (Nov. 29, 2002) (Exhibit RME-486).]

560 *See* ¶¶ 1417-1421 *infra.*

561 Russian courts dismissed Yukos' objection that the Cash Freeze Orders prevented it from discharging its tax debt, confirming the legality of these orders. *See, e.g.,* Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9 and A-40-7780/05-98-90 (Apr. 28, 2005), 59 (Annex (Merits) C-196) ("*The court does not accept this argument since, despite the taxpayer's documents submitted to the case file about freezing of money, it did not submit evidence that there is a causal link between the impossibility of paying the arrears and the existence of freezes. In addition, in the court's proceedings, the tax authority presented certificates from* [Yukos] *about the voluntary payments of tax arrears under writs of execution during the period of freezing of money, which indicates the lack of the impossibility for it to pay the arrears due to freezing of its property*"). This court decision was definitively upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7979/05-AK (Aug. 16, 2005), 60-61 (Exhibit RME-251) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/11321-05 (Dec. 5, 2005), 21 (Annex (Merits) C-197). S*ee also* Decision of the Moscow Arbitrazh Court, Case No. A40-33821/04-92-266 (July 30, 2004), 3 (Exhibit RME-487), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-33821/04-92-266 (Nov. 10, 2004)

contrary, they ensured for the first time that Yukos' cash would be applied to pay its overdue taxes: promptly after issuance of the orders, the cash thus frozen was withdrawn from the relevant Yukos bank accounts through collection orders issued by the bailiffs[562] and directly transferred to the tax authorities in satisfaction of the company's tax debts.[563]

401. Soon after the issuance of the Cash Freeze Orders on June 30, 2004, Yukos' CEO, Mr. Steven Theede, publicly acknowledged that the company "*still ha*[*d*] *free cash*."[564] The bulk of that "*free cash*" was not held by Yukos itself, but by subsidiaries of Yukos whose bank accounts were never subjected to any freeze or other encumbrance. [565]

(Exhibit RME-488); Resolution of the Ninth Appellate Arbitrazh Court, Case No. 09-AP-1595/04-AK (Aug. 27, 2004), 6 (Exhibit RME-479), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-11135-04 (Dec. 6, 2004) (Annex (Merits) C-148); and Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004), 2 (Exhibit RME-543), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005), 3 (Exhibit RME-544).

562 Under Russian law in effect at the relevant time, measures such as the Cash Freeze Orders only covered cash existing in a bank account as of the date of their issuance. As a result, the debtor was free to dispose of any excess subsequently deposited in such accounts, and Yukos was able to take advantage of this right notwithstanding the Cash Freeze Orders. *See* Information Letter of the Supreme Arbitrazh Court, No. 6 (July 25, 1996) (the arrest of cash may not be imposed on the "*account of the defendant*" and on the "*sums that will be transferred to this account in the future*") (Exhibit RME-489); Resolution of the Plenum of the Supreme Arbitrazh Court, No. 11 (Dec. 9, 2002) ("[*a*]*rrest on cash owned by the debtor shall be imposed not on its accounts in credit institution but on cash that is in the accounts, within the limits of the monetary claims*") (Exhibit RME-585); and Letter of the First Interdistrict Department of the Bailiffs' Service for the Central Administrative District of Moscow to Yukos (Aug. 3, 2004) (Exhibit RME-490). Furthermore, the Cash Freeze Orders were only in effect for five business days, after which the freezes were removed and the frozen cash was collected to discharge Yukos' tax debt. When Yukos' management belatedly resolved to have the company voluntarily discharge its debt for tax year 2000, Yukos made its voluntary payments from the very same bank accounts that were previously subject to the Cash Freeze Orders, a confirmation that Yukos maintained the ability to dispose of the funds flowing into these bank accounts. *See* Statements on payments made by Yukos to discharge its tax debts (from June 30, 2004 through May 30, 2005) (Annexes (Merits) C-212 to C-238).

563 *See, e.g.,* Note of the First Interdistrict Department of the Court Bailiff Service for the Central Administrative District of Moscow (Jan. 18, 2005), 24 *et seq.* (Exhibit RME-491); and Note of the Federal Bailiffs' Service on Enforcement Activities and Developments (Oct. 31, 2005) (Exhibit RME-492).

564 *See* Erin E. Arvedlund, *Russian Court Upholds Tax Claim Against Yukos*, N.Y. Times (June 30, 2004) (Exhibit RME-508).

565 *See* ¶¶ 528-539 *infra.*

d) The Seizures Of Yukos' Shareholdings Were Appropriate And Did Not Prevent Yukos From Paying Its Overdue Taxes

402. Because the funds frozen in Yukos' bank accounts pursuant to the Cash Freeze Orders were not sufficient to secure collection of Yukos' tax debt,[566] the bailiffs seized Yukos' holdings of shares in a number of Russian subsidiaries, including in YNG. This was done in July 2004.[567]

403. Indicative of its willful failure to pay its taxes, Yukos had anticipated and taken steps to obstruct the bailiffs' seizures, and was in part successful. Immediately after commencement of the enforcement proceedings on June 30, 2004, Yukos caused its main production subsidiaries (YNG, Tomskneft, and Samaranefegaz) to terminate their contracts with their common share register company (ZAO "M-Reestr"), instructing it to send the share registers by ordinary post from a central location in Moscow to remote locations around the country, with a view to preventing, or at least delaying, the effectiveness of the seizures, which under Russian law needed to be recorded in the relevant share registers.[568] Not only did these steps obstruct the seizure orders, but they also stood to frustrate the April Injunction, which prohibited the registrars from registering any change of Yukos' ownership interests in its subsidiaries.[569]

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566 *See, e.g.,* Note of the First Interdistrict Department of the Court Bailiff Service for the Central Administrative District of Moscow (Jan. 18, 2005), 24 *et seq.* (Exhibit RME-491).

567 *See* Resolutions of Bailiff I.D. Solovyova to restrict the rights of the securities owner of July 1, 2004 (Annex (Merits) C-125), July 5, 2004 (Annex (Merits) C-127), July 7, 2004 (Annex (Merits) C-130), July 8, 2004 (Annex (Merits) C-131), July 14, 2004 (Annex (Merits) C-134); Report of Bailiff I.V. Kochergin on inventory and seizure of securities (July 14, 2004) (Annex (Merits) C-135); Report of Bailiff A.V. Reydik on inventory and seizure of securities (July 14, 2004) (Annex (Merits) C-136).

568 *See* Catherine Belton, *Ustinov Sees More Tax Bills for Yukos*, Moscow Times (July 7, 2004), (Exhibit RME-494). Under Russian law, securities owned by the debtor are the kind of assets that may be seized and then sold in the first priority. *See* Art. 59 of the 1997 Enforcement Law (Exhibit RME-495). *See, e.g.,* Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005), 6 (Exhibit RME-496). Yukos' egregious behavior prompted the authorities to open a criminal obstruction of justice investigation into the purposeful hiding of the share registries. *See* Gregory L. White, *Yukos Assets Aren't Seized, as Tax Talks Continue*, Wall St. J. (July 9, 2004), A7 (Exhibit RME-497).

569 *See supra* ¶ 377 .

404. Claimants contend that "[d]ue to the continuous effect of the seizures, Yukos was precluded from selling any of its assets in order to use the corresponding proceeds to pay off the Russian Federation's massive payment demands for 2000."[570] This claim is demonstrably false.

405. First, the seizures never covered Yukos' shareholdings in its foreign subsidiaries, let alone the underlying foreign assets, which were out of the reach of the Russian authorities and which Yukos thus remained free to sell[571] (as it eventually did, using the relevant proceeds to the exclusive satisfaction of claims from Yukos Hydrocarbons and Moravel,[572] the latter being owned by the Oligarchs through GML). Second, the seizures were limited to Yukos' shares in a number (but not all) of its Russian subsidiaries. For example, in February 2005, Yukos was able to sell its shares in Western-Malobalykskoe, an oil and gas production company located in the Khanty-Mansiysky Autonomous Region.[573] Tellingly, Yukos structured this transaction so as to ensure that the relevant sales proceeds never reached its bank accounts, where they would have been subject to collection in discharge of Yukos' tax debt.[574] Third, none of the seizures ever

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570 Claimants' Memorial on the Merits, ¶ 351. *See also ibid.*, ¶ 358; Misamore Witness Statement, ¶ 41; and Theede Witness Statement, ¶ 11.

571 This was admitted by Yukos' own counsel in the proceedings brought by the syndicate of Western banks led by Société Générale S.A. against Yukos before the High Court of England and Wales in 2005. *See* Judgment of the High Court of England and Wales (June 17 and 24, 2005), ¶ 15 (Exhibit RME-455). *See* ¶ 553 *infra* .

572 *See* ¶¶ 592 *infra.*

573 *See* Agreement for the sale and purchase of shares (Feb. 14, 2005) between International Business Company Rosenborg Alliance Corp and Yukos (Exhibit RME-498); Agreement for the sale and purchase of shares (Feb. 14, 2005) between International Business Company Skylany Systems Inc. and Yukos (Exhibit RME-499); and Agreement for the sale and purchase of shares (Feb. 14, 2005) between International Business Company AEF Group Corp. and Yukos (Exhibit RME-500).

574 Settlements between Yukos and the purchaser, AEF Group Corp., were structured through a series of assignments and a set-off in order to ensure that the purchase price did not reach Yukos' bank accounts (where it would be subject to collection to discharge Yukos' tax debt), but was instead channeled to Yukos' affiliates, including one of Yukos' Trading Shells, OOO Makro-Trade. *See* Application for termination of obligations by way of mutual claims set off (Apr. 22, 2005) sent from AEF Group Corp. to Yukos (Exhibit RME-501).

covered any of the assets which Yukos owned indirectly and which remained at its full disposal, a capability that Yukos exercised during this period.[575]

406. While the seizures of Yukos' shares in certain Russian subsidiaries prevented Yukos from disposing of those shares, those seizures did not in any way restrict the ability of those subsidiaries to conduct their business operations in the ordinary course and to continue to generate income that Yukos' management effectively controlled.[576] Yukos' management publicly acknowledged as much.[577] In fact, as previously noted, Yukos was able, despite

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575 For example, in 2004 and 2005, Yukos sold its shareholding in the following indirect subsidiaries: Sakhaneftegaz, a company holding licenses for oil exploration and production located in the Republic of Yakutia; Alnas, a unique manufacturer of pumping machines used in oil production; Geoilbent, a company producing oil located in the Yamalo-Nenets Autonomous District; and CJSC Rospan International, as oil and gas company located in the Yamalo-Nenets Autonomous District. *See* E. Kiseleva, A. Vasiliev, *Yukos Left Yakutia. Sakhaneftegaz Is Sold to Mikhail Gitseriev's Structures,* Kommersant (Nov. 3, 2005) (Exhibit RME-502); Denis Skorobogatko, *Russneft Crossed Lukoil's Road,* Kommersant (June 21, 2005) (Exhibit RME-503); A. Skornyakova, I. Sviriz, *Lukoil and Russneft Exchange Production Assets,* Kommersant (Jan. 21, 2006) (Exhibit RME-504). *See also* Annual Report of TNK-BP Holding for 2006, 39 (Exhibit RME-505). *See also* Letter from the Federal Bailiffs' Service to the Federal Tax Service (Feb. 15, 2006) No. 12/05-1344-IV (Exhibit RME-506). As discussed in detail at ¶¶ 1530 *infra*, the proceeds from the sale of CJSC Rospan International were funneled back to Yukos by way of a US$ 355 million intercompany loan from Yukos Capital S.a.r.l. in August 2004, rather than being provided directly to Yukos to repay the company's overdue taxes. *See also* Claimants' Memorial on the Merits, ¶ 351.

576 *See* Resolutions of the bailiffs *sub* Annexes (Merits) C-125, C-127, C-130, C-131, C-134, C-135, C-136. To the extent possible, the bailiffs avoided imposing enforcement measures that could hinder Yukos' business operations. Thus, for example, the bailiffs promptly cancelled the demands prohibiting YNG, Samaraneftegaz, and Tomskneft from disposing of their assets, after they learned that these demands may threaten oil sales by Yukos. *See, e.g.*, Letters from bailiff Solovyova to Samaraneftegaz and YNG withdrawing demands of July 21, 2004 (July 28, 2004) (Exhibit RME-507). *See also* Letter from Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), 4 (Annex (Merits) C-140).

577 *See* Erin E. Arvedlund, *Russian Court Upholds Tax Claim Against Yukos*, N.Y. Times (June 30, 2004) (Exhibit RME-508), quoting Yukos CEO Steven Theede as confirming that "[o]*perationally, Yukos's goals remain intact: production targets for 2004 stand at 90 million tons of crude oil, up from 81 million to 82 million in 2003*." *See also* Erin E. Arvedlund, *Despite Its Troubles, Yukos Keeps Pumping,* Inter. Her. Trib. *(*Aug. 2, 2004), (Exhibit RME-493) ("*But none of that drama in Moscow appears to have touched Yukos's oil operations in the field* […]. *Yukos is still pumping nearly 1.7 million barrels of oil every day, or 2 percent of the world's supply, still contributing its share to Russia's congested export pipelines and rail lines.*") *See also Russia's Yukos says interim oil output up 5.3% on year in 2004*, Prime-TASS Energy Service (Russia) (Mar. 21, 2005) (Exhibit RME-509) ("*Yukos said that despite persecution from the Russian authorities, the company was able to retain its leading position among Russian oil companies in terms of oil output in 2004.* […] *'Despite a stringent savings program and a decrease in capital expenditures of more than 50%, our performance in 2004 was extremely healthy.' Yukos' CEO Steven Theede said, as quoted in the press release*"). In June 2006, Yukos' management estimated that, based on the company's

the freezes and seizures, to discharge in full its tax liabilities for the year 2000 once it finally decided to do so, starting in July 2004.[578]

407. Claimants further contend that the seizures imposed on some of Yukos' shareholdings in July 2004 were "*grossly disproportionate*" in value to the tax claims then pending against Yukos.[579] This argument does not accurately portray the relevant situation.

408. As a threshold issue, Yukos itself never raised this objection in the numerous proceedings in which it sought judicial review of the enforcement measures taken by the Russian authorities. The reason may have been the fact that Yukos suffered no harm whatsoever as a result of the alleged disproportion, which merely prevented it from selling subsidiaries that it had no desire to sell.

409. In any event, at that time, there was no requirement of proportionality in Russian law. The 1997 Enforcement Law simply required that execution be levied against the debtor's property "*in such amount and such scope as is required to ensure the satisfaction of claims set out in the enforcement document*."[580] Thus, the primary statutory aim was to ensure satisfaction of the claim, regardless of proportionality. A requirement of proportionality between the sums to be recovered and the enforcement measure was introduced only in 2007.[581] The scope of the enforcement measures was -- in compliance with the

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2005 EBITDA, Yukos' core assets would generate a cash flow "*in the range of US$ 3 - US$ 3.5 billion per year*." *See* Yukos' Outline of Proposed Financial Rehabilitation Plan, 4 (Annex (Merits) C-312). The financial statements of Yukos' production subsidiaries (OAO Tomskneft and OAO Samaraneftegaz) confirm that, in 2005, production and sales of oil continued unhindered and generated substantial cash. *See* Quarterly Report of OAO Samaraneftegaz for the 1st Quarter of 2006 (Exhibit RME-510) *and* Annual Report of OAO Tomskneft VNK for the year 2006 (Exhibit RME-511).

578 *See* Statements on payments made by Yukos to discharge its tax debts from June 30, 2004 through November 16, 2004 (Annexes (Merits) C-212 to C-234).

579 *See* Claimants' Memorial on the Merits, ¶ 342. *See also* Misamore Witness Statement, ¶ 41.

580 *See* Art. 46(6) of the 1997 Enforcement Law (Exhibit RME-482). The definition of "*amount of debt*" was specified only in 2007 by Article 69(2) of the Federal Law "On Enforcement Proceedings" No. 229-FZ (Oct. 2, 2007) (Exhibit RME-512).

581 Federal Law "On Enforcement Proceedings" No. 229-FZ (Oct. 2, 2007) which provided (Art. 4): "*an enforcement proceeding shall be carried out on the principles of* [...] *correlation between the scope of claims of a claimant and enforced execution measures.*" (Exhibit RME-512).

law in effect at the time and in accordance with general practice -- determined by the bailiffs at their discretion on a case-by-case basis, depending on the particular circumstances and with a view to making sure that these measures would result in full collection of the debtor's liabilities.[582] Russian courts have repeatedly held that the bailiffs' exercise of their discretion (even where it resulted in seizures of assets for an amount exceeding that of the enforced claims) is not an infringement of the debtor's rights or a violation of the enforcement procedure under the 1997 Enforcement Law,[583] thus upholding the validity of the seizures.[584] A similar approach is commonplace in international practice.[585]

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582 Also, when the bailiffs impose a seizure on the debtor's property, an expert is not normally retained to evaluate the seized assets, nor is any appraisal required at that stage. *See* Art. 51 and Art. 52 of the 1997 Enforcement Law (Exhibit RME-513).

583 *See, e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A40-15482/05-92-139 (June 1, 2005) ("*In these circumstances the court is of the opinion that in issuing the challenged resolution the bailiff M. did not violate the requirements of the Federal Law 'On Enforcement Proceedings' and the applicant failed to prove the infringement of its rights thereby, since a restriction of rights of a holder of securities constitutes a stage in the enforcement proceedings where execution is levied against shares as set out in paragraph 1 Article 46 of the said Law, and if the value of shares exceeds the amount of debt due to the collector, it does not mean that the amount equal to full value of such shares will be recovered from the debtor.*") (Exhibit RME-514). *See also* Resolution of the Federal Arbitrazh Court of the Western-Siberia District, Case No. F04/491-19/A70-2003 (Feb. 10, 2003) (Exhibit RME-515); Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7018/06-AK (July 11, 2006) (Exhibit RME-517); Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2832/03-GK (Oct. 6, 2003) (Exhibit RME-518); Resolution of the Tenth Arbitrazh Appellate Court, Case No. A41-K1-8606/06 (July 7, 2006) (Exhibit RME-519).

584 Russian courts upheld the July 2004 seizures as legal and appropriate, dismissing the numerous challenges made by Yukos on grounds other than proportionality. Specifically:

(i) The July 1, 2004 seizure of Yukos' shares in 24 subsidiaries (Annex (Merits) C-125) was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37946/04-12-398 (Sept. 20, 2004) (Exhibit RME-520) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521). Yukos did not challenge the seizures of shares in 12 other subsidiaries under the July 1, 2004 bailiff's resolution.

(ii) The July 5, 2004 seizure of Yukos' shares in three subsidiaries (NPF Geofit, Tomskneftegeofizika, and Khantymansiysknefteproduct (Annex C (Merits) C-127)) and the July 8, 2004 seizure of Yukos' shares in an oil products retailer OAO Novosibirsk Entity for the Provision of Oil Products of the Eastern Oil Company (Annex (Merits) C-131) were upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12602-04 (Jan. 20, 2005) (Exhibit RME-523). Yukos did not challenge the seizures of shares in 17 other subsidiaries under the July 5, 2004 bailiff's resolution.

(iii) The July 14, 2004 seizure of Yukos' shares in YNG was upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-

5. Yukos Resisted Payment Of Its Overdue Taxes For Years 2001-2003, Thereby Prompting Further Enforcement Proceedings And Measures

410. In the months following the December 2003 tax audit report, and in defiance of overwhelming evidence to the contrary, Yukos continued to maintain, in court filings as well as in public pronouncements, that Yukos' tax scheme was legal, that the company could not and would not pay any assessment, and that the tax authorities' claims were "*politically motivated*."[586]

411. It was only on June 9, 2004 that a Yukos executive, Deputy Chief Executive Officer Yuri Beilin, in a letter to Mikhail Fradkov, Russia's Prime Minister at the time, finally conceded that Yukos' tax schemes in 2000 and

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A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525).

(iv) The July 14, 2004 seizures of Yukos' shares in Samaraneftegaz was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527).

(v) The July 14, 2004 seizure of Yukos' shares in Tomskneft was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529).

When considering Yukos' challenges, Russian courts found that the seizures were imposed in compliance with the procedures established by Russian law and did not violate Yukos' rights, because they were aimed at securing the debtor's assets for the enforcement of Yukos' tax debt and did not affect Yukos' production operations or prevent the company from receiving income from the subsidiaries whose shares had been seized. The courts also confirmed that the bailiffs were vested with ultimate discretion as to the determination of the assets to be seized. *See, generally:* (i) with respect to the July 1, 2004 seizures, Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521); (ii) with respect to the July 5 and 8, 2004 seizures, Decision of the Moscow Arbitrazh Court, Case No. A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522); (iii) with respect to the seizure of shares in YNG, Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144); (iv) with respect to the seizure of shares in Samaraneftegaz, Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527); and (v) with respect to the seizure of shares in Tomskneft, Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529).

585 *See* ¶ 1420 *infra*.

586 *See* Gregory L. White, Guy Chazan, *Yukos, Russian Officials Discuss Payment Terms for Back Taxes*, Wall St. J. (June 22, 2004) A3 (quoting Mr. Misamore as saying "*the company continues to reject the tax claims as politically motivated*") (Exhibit RME-586).

subsequent years had "*resulted in significant tax underpayments*."[587] But other Yukos managers immediately distanced themselves from that letter, claiming it did not reflect the company's official position.[588] As a result, not only were Yukos' payments of the 2000 tax assessment too little, too late,[589] but Yukos failed to make any provision for payment of taxes for later years.

412. Yet in the meantime, not surprisingly, the Tax Ministry had commenced the procedures to assess delinquent taxes for those later years. Specifically, the Tax Ministry: (i) on March 23, 2004, commenced the audit for the year 2001,[590] which resulted in the 2001 tax audit report (June 30, 2004)[591] and the

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587 *See* Letter from Y. Beilin to M.E. Fradkov, No. 401-658 (June 9, 2004) (excerpt published in the June 18, 2004 edition of Finansovye Izvestia) (Exhibit RME-587). Mr. Beilin also noted that Yukos was anticipating "*the necessity to make significant tax payments*" that would have the effect of putting the company "*on the edge of financial insolvency*." *Ibid. See also* Catherine Belton, *Yukos Refuses to Pay Full Bill*, Moscow Times (July 1, 2004) (Exhibit RME-530).

588 *See* Gregory L. White, *Putin Talks Reassuringly of Yukos,* Wall St. J. (June 18, 2004), A9 (Exhibit RME-531). *See also* Gregory L. White, Guy Chazan, *Yukos, Russian Officials Discuss Payment Terms for Back Taxes,* Wall St. J. (June 22, 2004), A3 (Exhibit RME-586).

589 *See, e.g.,* Statements on payments made by Yukos to discharge its tax debt (Annexes (Merits) C-212 *et seq*). Contrary to Claimants' allegation (Claimants' Memorial on the Merits, ¶ 358, Witness Statement of Frank Rieger (Sept. 9, 2010) ("Rieger Witness Statement"), ¶ 25, and Theede Witness Statement, ¶ 25), Yukos was constantly kept informed of the amounts collected and still outstanding. For example, Yukos' representatives regularly reviewed the file of the enforcement proceedings and made copies of documents, including periodic statements of amounts of taxes collected and still outstanding prepared by the bailiffs and the tax authorities. *See, e.g.,* confirmations (July 22 and July 29, 2004, Jan. 27, Feb. 24, Apr. 7 and May 23, 2005) that the representatives of Yukos was familiar with the file of the enforcement proceedings and received copies of the necessary documents (Exhibit RME-532). *See also, e.g.,* Letter of the Interregional Inspectorate of the Tax Ministry for Major Taxpayers No. 1, No. 52-10-10/14606 (Nov. 5, 2004) (Exhibit RME-533); Statement of enforcement measures taken as of Jan. 26, 2005 (Exhibit RME-534); Statement of enforcement measures taken as of May 20, 2005 (Exhibit RME-535); Statement of enforcement measures taken as of Aug. 11, 2005 (Exhibit RME-536); and Statement of enforcement measures taken as of Oct. 31, 2005 (Exhibit RME-537). From time to time, the tax authorities also sent to Yukos letters confirming the status of its payments. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 (June 21, 2006), 4 (Exhibit RME-538), referring to letters of the tax authorities to Yukos, No. 52-09-11/04705 (Apr.19, 2005), No. 52-11-11/00772 (Jan. 26, 2006), No. 52-11-11/00767 (Jan. 26, 2006), and No. 52-11-11/05567 (Apr. 6, 2006). The tax authorities repeatedly invited Yukos to jointly verify the status of its payments, but Yukos failed to attend the meetings. *See, e.g.,* Notices No. 52-06-11/07949 (July 2004), No. 52-06-11/12863 (Oct. 2004), No. 52-06-11/15505 (Nov. 2004), No. 52-06-11/16923 (Dec. 2004) (Exhibit RME-539). *See also* Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 (June 21, 2006), 3-4 (Exhibit RME-538).

590 The 2001 audit was a supervisory audit because the local tax inspectorate of Nefteyugansk had audited the 2001 tax year in the past (*see* ¶¶ 305-308 above).

591 *See* Field Tax Audit Report No. 30-3-14/1 (June 30, 2004), 3 (Exhibit RME-345).

final assessment of RUB 119.8 billion (US$ 4.1 billion) (September 2, 2004), which Yukos was required to pay by September 4, 2004;[592] (ii) on August 9, 2004, commenced the audit for the year 2002, which resulted in the 2002 tax audit report (October 29, 2004)[593] and the final assessment of RUB 193.8 billion (US$ 6.8 billion) (November 16, 2004),[594] which Yukos was required to pay by November 17, 2004; and (iii) on October 28, 2004, commenced the audit for the year 2003, which resulted in the 2003 tax audit report (November 19, 2004)[595] and the final assessment of RUB 170.4 billion (US$ 6.1 billion) (December 6, 2004),[596] which Yukos was required to pay by December 7, 2004.

413. For each of these tax years, Yukos failed to take timely advantage of the provisions of Russian law (discussed at ¶¶ 369-372 *supra*) that would have resulted in very significant reductions of the amounts due. As with the 2000 tax assessment, Yukos vigorously contested each of these assessments –- continuing to proclaim its innocence and the legality of its practices –- even though by then the courts had found substantially similar practices in tax year 2000 to be unlawful and Yukos' Deputy CEO had admitted as much.[597] In due course the courts rejected also Yukos' arguments as to the subsequent years, which were for

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592 *See* Decision No. 30-3-15/3 to Hold the Taxpayer Fiscally Liable for a Tax Offense (Sept. 2, 2004), 156-159 (Annex (Merits) C-155). The tax assessment for the year 2001 found that Yukos owed RUB 50.8 billion (approximately US$ 1.7 billion) in taxes, RUB 28.5 billion (approximately US$ 1 billion) of default interest, RUB 20.3 billion (approximately US$ 0.7 billion) in fines for deliberate violation and RUB 20.3 billion (approximately US$ 0.7 billion) in repeat offender fines.

593 *See* Field Tax Audit Report No. 52/852 (Oct. 29, 2004), 3 (Exhibit RME-346).

594 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 165-167 (Annex (Merits) C-175). The tax assessment for the year 2002 found that Yukos owed RUB 90.3 billion (approximately US$ 3.1 billion) in taxes, RUB 31.5 billion (approximately US$ 1.1 billion) in default interest, RUB 36 billion (approximately US$ 1.3 billion) in fines for deliberate violation, and RUB 36 billion (approximately US$ 1.3 billion) in repeat offender fines.

595 *See* Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 2 (Exhibit RME-260).

596 *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 143-146 (Annex (Merits) C-190). The tax assessment for the year 2003 found that Yukos owed RUB 86.2 billion (approximately US$ 3.1 billion) in taxes, RUB 15.3 billion (approximately US$ 0.5 billion) in default interest, RUB 34.5 billion (approximately US$ 1.2 billion) in fines for deliberate violation, and RUB 34.5 billion (approximately US$ 1.2 billion) in repeat offender fines.

597 *See* ¶ 411 *supra*.

the most part repetitions of its arguments with respect to tax year 2000, and upheld in all material respects the tax assessments for years 2001,[598] 2002,[599] and 2003[600] in well-reasoned decisions.

414. As summarized in Table 4 below, Yukos had a total of 66, 19, and 18 days, respectively, between the time when it was notified of the assessment due for each of the years 2001, 2002, and 2003, and the date on which payment became due. Considering the outcome of the litigation regarding tax year 2000, these notice periods were ample.[601] They were also not at odds with international practice.[602]

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598 Yukos appealed the tax assessment for the year 2001 on September 14, 2004 and on November 18, 2004 the Moscow Arbitrazh Court ultimately upheld the Tax Ministry's assessment on similar grounds as the Tax Assessment for Year 2000. *See* Decision of the Moscow Arbirtazh Court, Case No. A40-51085/04-143-92 and A40-54628/04-143-134 (Nov. 18, 2004) (Exhibit RME-252). All subsequent appeals with respect to the tax assessment for the year 2001 were also upheld in all material respects at the appellate, cassation and supervisory review levels. *See* note 2042 *infra*.

599 On December 23, 2004, the Moscow Arbitrazh Court rejected Yukos' appeal of the tax assessment for the year 2002, though it did adjust downward some of the Tax Ministry's initial figures, resulting in a savings of approximately RUB 1.3 billion (approximately US$ 46.7 million based on the RUB/US$ exchange rate on Dec. 23, 2004). *See* Decision of the Moscow Arbitrazh Court, Case No. A40-61058/04-141-151 and A40-63472/04-141-162 (Dec. 23, 2004) (Exhibit RME-1563). This ruling was later upheld at the appellate and cassation levels. *See* note 2043 *infra*.

600 On April 28, 2005, the Moscow Arbitrazh Court rejected Yukos' appeal of the tax assessment for the year 2003 and related tax payment demands, though it lowered the amount of Yukos' tax liability by approximately RUB 71 million (approximately US$ 2.6 million based on the RUB/US$ exchange rate on April 28, 2005), upholding the tax assessment for the year 2003 for an overall amount of approximately RUB 170.33 billion (approximately US$ 6.1 billion based on the RUB/US$ exchange rate on April 28, 2005). *See* Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9/A40-7780/05-98-90 (Apr. 28, 2005) (Annex (Merits) C-196). This ruling was subsequently upheld at the appellate and cassation levels. *See* note 2039 *infra*.

601 When Yukos challenged the legality of the 2001 tax assessment, the related tax payment demand and the collection orders of September 6, 2004, it complained before the Russian courts that the period for the voluntary payment granted to it in the payment demands was short. Russian courts confirmed the legality of the time limits set forth in the payment demands. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92 / A40-54628/04-143-134 (Nov. 18, 2004), 15 (Exhibit RME-252) holding: "[*i*]*n accordance with paragraph 4 Article 69 of the Tax Code of the Russian Federation, a demand to pay a tax shall contain information concerning the deadline for the fulfillment of the demand. The tax legislation does not stipulate any deadline for voluntary fulfillment by the taxpayer of the demand to pay taxes. Upon issue of the Claim, the Inspectorate is entitled to stipulate a time period for its voluntary execution*." This court decision was upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-40/05-AK (Feb. 16, 2005) (Annex (Merits) C-167), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588) and

TABLE 4 – TAX ASSESSMENTS

	Tax Years			
	2000	**2001**	**2002**	**2003**
Audit Report	Dec. 29, 2003[603]	June 30, 2004[604]	Oct. 29, 2004[605]	Nov. 19, 2004[606]
Tax Assessment/Tax Payment Demands	Apr. 14, 2004	Sept. 2, 2004	Nov. 16, 2004	Dec. 6, 2004
Payment Due by:	Apr. 16, 2004	Sept. 4, 2004	Nov. 17, 2004	Dec. 7, 2004
Days between Audit Report and Payment Due Date	109	66	19	18

415. Nonetheless, Yukos systematically failed to make any timely payment of the tax assessments for years 2001-2003, though it clearly could have done so. As a result, the tax authorities issued orders for the forced collection of the relevant tax arrears and interest from a number of Yukos' bank accounts[607]

Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb 20, 2006) (Exhibit RME-589). These decisions were in full compliance with Russian law and court practice. In many cases unrelated to Yukos, tax authorities have demanded payment within a one or two-day period, regardless of the amount of back taxes, and the legality of such periods has not been questioned by the Russian courts. *See, e.g.*, Resolution of Federal Arbitrazh Court of East-Siberian District, Case No. A33-16983/01-S3a-F02-1862/02-S1 (July 16, 2002) (Exhibit RME-1691); Resolution of Federal Arbitrazh Court of Volgo-Vyatsky District, Case No. A82-11/2003-A/6 (Jan. 19, 2004) (Exhibit RME-1692); Resolution of Federal Arbitrazh Court of West-Siberian District, Case No. F04-2648/2005(10969-A61-37) (May 4, 2005) (Exhibit RME-1693).

602 *See* ¶¶ 1414-1416 *infra*.

603 Audit started on December 8, 2003, *see* Field Tax Audit Report No. 08-1/1 of OAO Yukos Oil Company (Dec. 29, 2003), 2 (Annex (Merits) C-103).

604 Audit started on March 23, 2004, *see* Field Tax Audit Report No. 30-3-14/1 (June 30, 2004), 3 (Exhibit RME-345).

605 Audit started on August 9, 2004, *see* Field Tax Audit Report No. 52/852 (Oct. 29, 2004), 3 (Exhibit RME-346).

606 Audit started on October 28, 2004, *see* Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 2 (Exhibit RME-260).

607 *See, e.g.*, Decision No. 52/595 of the Tax Ministry's Interregional Inspectorate for Major Taxpayers No. 1 (Sept. 6, 2004) (Annex (Merits) C-159). The authorities' executive enforcement measures were in compliance with Russian law and practice. *See* Art. 46 and Art. 76 of the Russian Tax Code (Exhibit RME-541). Pursuant to Article 46 of the Tax Code, upon expiration of the time limits for voluntary payment of the amounts set out in the payment demands relating to each of the relevant tax years, the Russian tax authorities were entitled to collect the amounts due directly from Yukos' bank accounts. If there were no or insufficient funds in Yukos' Russian bank accounts, the tax authority had the right to collect taxes and

(while applying to the court to collect fines). Separately, the bailiffs commenced enforcement proceedings with respect to tax year 2001 on September 9, 2004,[608] with respect to tax year 2002 on November 18, 2004,[609] and with respect to tax year 2003 on December 9, 2004.[610] Yukos' legal challenges to halt these additional enforcement procedures were dismissed by the Russian courts after multiple levels of judicial review.[611]

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default interest by disposing of Yukos' other property, in which case the tax authorities were required to send an enforcement resolution to the bailiffs for them to initiate enforcement proceedings. Specifically, with reference to the enforcement procedure relating to tax year 2001, on September 2, 2004, the tax authorities issued tax payment demand No. 133, requesting the payment of taxes and default interest by September 4, 2004 (*see* Tax Payment Demand No. 133 (Sept. 2, 2004) (Annex (Merits) C-156). On September 6, 2004, following the expiration of the deadline for voluntary payment, the tax authorities ordered that cash on deposit in Yukos' bank accounts be applied to satisfy Yukos' overdue tax liabilities for tax year 2001 (*see* Decision No. 52/595 of the Interregional Tax Inspectorate for Major Taxpayers No. 1 (Sept. 6, 2004) (Annex (Merits) C-159)). Since Yukos did not have sufficient cash on its Russian bank accounts, the tax authorities issued resolution No. 52/648 to collect taxes and default interest by disposing of Yukos' other property and sent this resolution to the bailiffs for execution (*see* Resolution No. 52/648 of the Interregional tax Inspectorate for Major Taxpayers No. 1 (Sept. 8, 2004) (Exhibit RME-1559)). On the basis of this resolution the bailiffs then initiated enforcement proceedings (*see* Resolution of Bailiff D. A. Borisov to Initiate Enforcement Proceedings No. 13022/11/04 (Sept. 9, 2004) (Annex (Merits) C-161)).

608 *See* Resolution of Bailiff D.A. Borisov to initiate enforcement proceedings No. 13022/11/04 (Sept. 9, 2004) (Annex (Merits) C-161) and Resolution of Bailiff D.A. Borisov to join to enforcement proceedings No. 10249/21/04 (Sept. 9, 2004) (Annex (Merits) C-162). With respect to enforcement of the fines for tax year 2001, the Tax Ministry filed an application with the Moscow Arbitrazh Court to validate the fines included as part of the 2001 tax assessment. On October 15, 2004, the Moscow Arbitrazh Court issued its decision confirming the lawfulness of the Tax Ministry's assessment of fines. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-45410/04-141-34 (Oct. 15, 2004) (Exhibit RME-542). On November 18, 2004 after considering Yukos' appeal, the Ninth Arbitrazh Appellate Court upheld the decision of the lower court and enforced the fines associated with the tax assessment for the year 2001. *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-4414/04-AK (Nov. 18, 2004) (Exhibit RME-254).

609 Resolution of Bailiff I.V. Kochergin to initiate enforcement proceedings No. 15315/4/04 and to join to enforcement proceedings No. 10249/21/04 (Nov. 18, 2004) (Annex (Merits) C-179). Separately, the tax authorities enforced the fines assessed for tax year 2002 through court proceedings.

610 Resolution of Bailiff I.V. Kochergin to initiate enforcement proceedings No. 16305/4/04 and to join to enforcement proceedings No. 10249/21/04 (Dec. 9, 2004) (Annex (Merits) C-194). Separately, the tax authorities enforced the fines assessed for tax year 2003 through court proceedings.

611 With respect to the executive enforcement proceedings for taxes and default interest assessed for 2001, *see* Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92/A40-54628/04-143-134 (Nov. 18, 2004) (Exhibit RME-252), upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP -40/05-AK (Feb. 16, 2005) (Annex (Merits) C-167), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05

416. For each of these enforcement proceedings, which were subsequently consolidated, the bailiffs granted Yukos a further five-day grace period to discharge in full the relevant outstanding debt.[612] Yukos nonetheless again failed to pay the amounts due within these deadlines. As they had done with respect to tax year 2000, the bailiffs again assessed a 7% enforcement fee,[613] which was appropriate under applicable law.[614]

(Dec. 9, 2005) (Exhibit RME-588) and Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb. 20, 2006) (Exhibit RME-589). With respect to the executive enforcement proceedings for taxes and default interest assessed for 2002, *see* Decision of the Moscow Arbitrazh Court, Case No. A40-68502/04-127-742 (Feb. 7, 2005) (Exhibit RME-590), upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-2281/05-AK (Apr. 4, 2005) (Exhibit RME-591), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4941-05 (June 15, 2005) (Exhibit RME-592) and Ruling of the Supreme Arbitrazh Court, Case No. 11868/05 (Oct. 12, 2005) (Exhibit RME-593). Yukos does not appear to have taken issue with the executive enforcement proceedings with respect to taxes and default interest assessed for tax year 2003.

612 *See* Resolution of Bailiff D.A. Borisov to initiate enforcement proceedings No. 13022/11/04 (Sept. 9, 2004) (Annex (Merits) C-161); Resolution of Bailiff I.V. Kochergin to initiate enforcement proceedings No. 15315/4/04 and to join it to enforcement proceedings No. 10249/21/04 (Nov. 18, 2004) (Annex (Merits) C-179); Resolution of Bailiff I.V. Kochergin to initiate enforcement proceedings No. 16305/4/04 and to join it to enforcement proceedings No. 10249/21/04 (Dec. 9, 2004) (Annex (Merits) C-194). Yukos did not challenge these bailiffs' resolutions, but it complained about the five-day payment deadline in various other court proceedings. Russian courts consistently confirmed the legality of that deadline. *See* (i) Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004), 3 (Exhibit RME-543), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005) (Exhibit RME-544); (ii) Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005), 7 (Exhibit RME-496), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-4904-05 (June 16, 2005) (Exhibit RME-545); and (iii) Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-698 (Feb. 10, 2005), 4 (Exhibit RME-546), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4816-05 (June 14, 2005) (Exhibit RME-547).

613 S*ee*, *e.g.,* Resolution of Bailiff D.A. Borisov to collect an enforcement fee (Sept. 20, 2004) (Annex (Merits) C-164); Resolution of Bailiff I.V. Kochergin to collect an enforcement fee (Dec. 9, 2004) (Annex (Merits) C-182).

614 Russian courts confirmed that these fees were valid and appropriate under Russian law and practice, holding, in particular, that no *force majeure* exception applied to Yukos' failure to timely discharge its tax liabilities for years subsequent to 2000 in order to exempt Yukos from payment of the relevant enforcement fees. Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004) (Exhibit RME-543) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005) (Exhibit RME-544), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005) (Exhibit RME-496) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-4904-05 (June 16, 2005) (Exhibit RME-545), confirming the legality of the enforcement fee resulting from Yukos' failure to pay fines for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-

6. Yukos Misled The Russian Authorities By Offering Tainted Assets

417. Claimants concede that Yukos failed to pay its tax debts when they became due, and do not convincingly refute the fact that it could have done so. Instead, they describe various "*proposals to the bailiffs, the courts and other Russian authorities and officials*" that Yukos made "*in an attempt to discharge or settle its outstanding alleged tax liabilities*."[615] Claimants and their witnesses depict these proposals as good faith efforts on the part of Yukos "*to explore every single avenue that might appear acceptable to the Government and that would secure its future as a going concern*,"[616] and infer from the authorities' "*complete lack of responsiveness*"[617] that "*the Russian Federation's objective from the outset was to expropriate Yukos' assets*."[618] These claims are presposterous.

418. The authorities' responsiveness, of course, is not the touchstone for measuring the legality or propriety of Yukos' conduct. Russian law, in full accord with international practice,[619] reserved to the authorities exclusive discretion to accept or reject any of Yukos' "settlement" proposals, none of which suspended the company's obligation to pay the overdue amounts.[620] By then,

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698 (Feb. 10, 2005) (Exhibit RME-546) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4816-05 (June 14, 2005) (Exhibit RME-547), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2002.

Yukos had consistently asked the courts to cancel the enforcement fees rather than to reduce the relevant amounts. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005) (Exhibit RME-496) *and* Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-698 (Feb. 10, 2005), (Exhibit RME-546).

615 Claimants' Memorial on the Merits, ¶ 343.

616 Theede Witness Statement, ¶ 4. *See also* Rieger Witness Statement, ¶ 21.

617 Rieger Witness Statement, ¶¶ 23-24. *See also* Theede Witness Statement, ¶¶ 9, 14, and Misamore Witness Statement, ¶¶ 43-44.

618 Misamore Witness Statement, ¶ 51. *See also* Rieger Witness Statement, ¶ 24 and Theede Witness Statement, ¶¶ 24, 28.

619 *See* ¶¶ 1422-1424 *infra.*

620 Under Russian law, it is well-settled that while the debtor is entitled to propose to the bailiffs the assets upon which they could levy execution on first priority, the ultimate decision rests entirely within the full discretion of the bailiffs. Pursuant to Article 46(5) of the 1997 Enforcement Law (Exhibit RME-615/482), "[t]*he debtor may suggest property upon which execution may be levied first. The final order of priority in levying execution against the debtor's monetary funds and other property shall be determined by the court bailiff*" [emphasis added]. Court practice is in full accord. *See, e.g.,* Resolution of the Federal Arbitrazh Court of the Urals

Yukos' management faced a serious credibility problem, among other things because it had made manifestly false claims that it was unable to pay any of its tax bills. Those lies, together with the company's persistent obstructionism and history of asset dissipation, had taught the authorities to behave cautiously when exercising their discretion in considering the merits of those "settlement" offers.

419. In reality, Yukos never made a serious proposal, and the authorities' "*lack of responsiveness*" was fully justified by the fact that the proposals advanced by Yukos were invariably unacceptable, either because they were contrary to Russian law, or because they involved impaired assets, or because they were otherwise inadequate. The story of Yukos' dissembling proposals provides a further illustration of the self-destructive gamesmanship that characterized the conduct of Yukos' managers during this period. Indeed, the offer of tainted assets can be viewed as the fourth fateful misjudgment on the part of Yukos' management,[621] which eliminated any vestige of a basis for the authorities to trust anything Yukos did or said.

a) Yukos' Tainted Offers Of The Sibneft Shares Were Properly Rejected

420. On April 22, 2004, Yukos tried to convince the tax authorities (and the Moscow Arbitrazh Court) to accept as collateral, in lieu of the April Injunction, 2,724,362,618 shares (equivalent to a 57.5% stake) that Yukos claimed

District, Case No. F09-3056/03-GK (Oct. 28, 2003) (Exhibit RME-560) and Resolution of the Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-731/04 (Mar. 24, 2004) (Exhibit RME-561). *See also* Art. 324 of the Arbitrazh Procedure Code, discussed at note 647.

621 After, (i) the decision in the fall of 2003 to distribute the giga-dividend (¶¶ 349-352 *supra*), (ii) the decision in early 2004 not to take advantage of the opportunities to mitigate the company's exposure (¶¶ 369-371 *supra*), and (iii) the refusal throughout the spring of 2004 to pay the 2000 tax assessment (¶¶ 381-397 *supra*).

to own in Sibneft,[622] the oil company with which it had unsuccessfully sought to merge.[623]

421. Yukos, however, failed to disclose that it was enjoined from disposing of the proffered shares by an order issued by the Moscow Arbitrazh Court at the request of former Sibneft shareholders who vigorously contested Yukos' title to those shares.[624] Not surprisingly, the Moscow Arbitrazh Court rejected Yukos' proposal that the April Injunction be lifted in exchange for a pledge of shares whose ownership was in dispute.[625]

422. On July 2, 2004, Yukos requested the bailiffs to enforce against, or accept the transfer of, 1,637,633,048 Sibneft shares (equivalent to 34.5% of the share capital of that company),[626] finally conceding that it was not in a position to offer the 57.5% stake it had previously offered.[627] This reduced offer, however, had serious problems of its own.

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622 *See* Yukos' application on alteration of interim relief measures before the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 22, 2004) (Exhibit RME-476) and Yukos' addition to application on alteration of interim relief measures before the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (stamped received Apr. 23, 2004) (Exhibit RME-477).

623 It will be recalled (*see* ¶¶ 323-325 above) that Yukos had acquired its shareholdings in Sibneft, in part, pursuant to a share exchange agreement entered into with former shareholders of Sibneft in April 2003. Under this agreement, Yukos had exchanged 702,397,159 of its ordinary shares for 3,413,735,740 Sibneft ordinary shares, comprising 72% of the Sibneft share capital. The share swap had been implemented in two tranches: a first tranche of 238,879,333 Yukos shares was exchanged for 689,373,122 Sibneft shares, comprising 14.5% of the Sibneft share capital, and a second tranche of 463,517,826 newly-issued Yukos shares was exchanged for 2,724,362,618 Sibneft shares, comprising 57.5% of the Sibneft share capital. Separately, Yukos had purchased for cash from a Sibneft shareholder 948,259,926 Sibneft shares, comprising 20% of the Sibneft share capital. *See* Resolution of the Federal Arbitrazh Court for Far East District, Case No. F03-A80/06-1/3 (Apr. 25, 2006) (Annex (Merits) C-78).

624 *See* Order of the Moscow Arbitrazh Court, Case No. A40-2353/04-9235 (Feb. 16, 2004) (Exhibit RME-548). On March 1, 2004, the Moscow Arbitrazh Court declared invalid the issuance of the 2,724,362,618 Sibneft shares proffered by Yukos. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-2353/04-92-35 (Mar. 1, 2004) (Exhibit RME-549).

625 *See* Order of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 23, 2004), (Exhibit RME-452).

626 Yukos held 92% of the Sibneft share capital.

627 Petition for voluntary enforcement of the Resolution of June 30, 2004 to initiate enforcement proceedings and the Demand of June 30, 2004 (July 2, 2004) (stamped received on July 5, 2004) (Annex (Merits) C-126). *See also* Claimants' Memorial on the Merits, ¶ 344; Theede Witness Statement, ¶ 13; Misamore Witness Statement, ¶ 43.

423. First, the offer to "*transfer* [the Sibneft shares] *to the ownership of the Russian Federation*" was contrary to Russian law, which does not allow a taxpayer to satisfy tax liabilities in kind.[628] Second, the proffered shares had an uncertain value since they comprised a minority stake in a company where, as noted, the controlling 57.5% stake was the subject of an active dispute before the Russian courts. Third, the bailiffs had reasonable grounds to believe that Yukos' title to the proffered shares was also disputed since immediately after receiving Yukos' application, they were informed by former Sibneft shareholders that "*[r]ights to the shares of OAO Sibneft held by OAO NK YUKOS are the subject of the dispute and OAO NK YUKOS is unable to exercise ownership rights to such shares*."[629]

424. On July 6, 2004, the former Sibneft shareholders challenged Yukos' title to the Sibneft shares before the Chukotka court.[630] On July 9, 2004, that court enjoined Yukos from disposing of 72% of the Sibneft share capital (*i.e.*, the 57.5% stake previously encumbered by order of the Moscow Arbitrazh Court and an additional 14.5% stake, comprising 698,373,122 shares).[631] At this time, therefore, Yukos retained the ability to dispose of no more than 948,259,926 Sibneft shares (equivalent to a 20% stake), and its title even to these remaining shares was disputed.

425. On July 13, 2004, in clear violation of the Chukotka injunctions, Yukos once again requested the bailiffs to enforce on a priority basis against 1,637,633,048 Sibneft shares (equivalent to a 34.5% stake).[632] On the same day,

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628 *See* Art. 8 (Exhibit RME-551) and Art. 45 (Exhibit RME-550/270) of the Russian Tax Code.

629 *See* Application to the Chief Bailiff of the First Interdistrict Department of the Bailiff Service for the Central Administrative District of Moscow by White Pearl Investments Limited, Kindselia Holdings Limited, Heflinham Holdings Limited, Marthacello Co. Limited, and N.P. Gemini Holdings Limited (July 6, 2004), 1 (Exhibit RME-552). The former Sibneft shareholders also informed the bailiffs that a dispute involving Yukos' entire shareholding in Sibneft would be considered by the London Court of International Arbitration. *Ibid.*

630 Petition to Declare Invalid an Interested Party Transaction and to Apply the Consequences of the Invalidity of the Transaction (July 6, 2004) (Annex (Merits) C-76).

631 *See* Rulings of the Arbitrazh Court of the Chukotka Autonomous District, Case No. A80-141/2004 (July 9, 2004) (Exhibit RME-553).

632 *See* Application on the procedure of performance of the Resolution on commencement of enforcement proceedings of June 30, 2004 and the Demand of June 30, 2004 (July 13, 2004) (Exhibit RME-554).

the fomer Sibneft shareholders again warned the authorities that, due to the ongoing disputes, Yukos was "*not entitled to use the whole block of shares in OAO Sibneft held by it for settlements with its creditors, including with respect to tax liabilities.*"[633]

426. On July 14, Yukos amended its application, reducing its offer to a 20% stake.[634] This amended offer, however, also raised serious concerns since, in light of the warnings from the former Sibneft shareholders, the bailiffs had reason to believe that Yukos' title to even this block of proffered shares was in dispute. In any event, the asserted value of those shares, even accepting the generous valuation proposed by Yukos, was insufficient to satisfy Yukos' debt.[635]

427. On August 6, 2004, Yukos made still another offer. The new offer, received by the bailiffs on August 9, 2004, proposed that the bailiffs enforce on a priority basis against the 1,637,633,048 Sibneft shares (a 34.5% stake), as initially proposed on July 2, but –- in a now familiar pattern –- Yukos did not disclose the intervening issuance of the injunctions by the Chukotka court, covering 689,373,122 of those shares.[636] Yukos also offered a *potpourri* of other shares in unlisted companies, whose asserted –- but unascertainable -– value was claimed to be US$ 1 billion.[637] But Yukos virtually assured that its offer could not be accepted, even if its terms had been sound (which they were not). Bizarrely, Yukos demanded a response by August 10, the day following the bailiff's receipt

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633 Letter from White Pearl Investments Limited, Kindselia Holdings Limited, Heflinham Holdings Limited, Marthacello Co. Limited, and N.P. Gemini Holdings Limited to the Deputy Minister of Taxes and Levies of the Russian Federation (July 13, 2004), 1 (Exhibit RME-555).

634 *See* Addendum to Petition of July 13, 2004 regarding the process of enforcement of the Resolution of June 30, 2004 to initiate enforcement proceedings and the Demand of June 30, 2004 (July 14, 2004) (Annex (Merits) C-137).

635 Based on Yukos' US$ 2.84 per share valuation, the 20% stake was worth only US$ 2.7 billion, much less than the US$ 3.5 billion outstanding tax bill. *See* Application for voluntary performance of the Resolution on commencement of enforcement proceedings (June 30, 2004) and the Demand of June 30, 2004 (July 2, 2004) (stamped received on July 5, 2004), 3 (Annex (Merits) C-126).

636 In what was either purposeful dissembling or gross negligence, Yukos equated 1,637,633,048 Sibneft shares to 20% of the share capital less one share, rather than the 34.5% it was. *See* Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), chart at 10 (Annex (Merits) C-140).

637 *Ibid.*, 10-11.

of the offer, averring that thereafter "*the proposals herein will be considered rejected.*"[638]

428. By letter of August 16, 2004, the former Sibneft shareholders once again advised the tax authorities of the status of the disputes relating to Yukos' title to all of its Sibneft shares (equal to 92% of the Sibneft share capital), warning that:

> "all 92% of shares in OAO Sibneft that were transferred to OAO NK YUKOS under both agreements are in dispute. Until consideration of all the aforementioned cases is complete and all interim measures are lifted, OAO NK YUKOS is not entitled to transfer any portion of the aforementioned shares in OAO Sibneft in order to pay its tax arrears. If OAO NK YUKOS nevertheless continues to do it in violation of applicable legislation and court decisions, our companies as entities entitled to such shares in OAO Sibneft will have to recover such shares from any potential purchasers through a court."[639]

429. The following day, on August 17, 2004, the Moscow Arbitrazh Court dismissed Yukos' challenge to the bailiffs' refusal to enforce against any of the Sibneft shares.[640] Thereafter, Russian courts repeatedly –- and very

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638 *See* Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), 9 (Annex (Merits) C-140).

639 *See* Letter from N.P. Gemini Holdings Limited, Heflinham Holdings Limited, White Pearl Investments Limited, Kindselia Holdings Limited and Marthacello Co. Limited to the Deputy Minister of Taxes and Levies of the Russian Federation (Aug. 16, 2004), 2 (Exhibit RME-559). With particular reference to Yukos' title to the 20% Sibneft stake resulting from a share purchase agreement (Apr. 30, 2003) the former Sibneft shareholders stated that: "*allegations by OAO NK YUKOS that the shares in OAO Sibneft received by it under the share purchase agreement* [equivalent to a 20% stake] *are free from any third parties' rights are not true. These shares are the subject of the dispute and may be claimed from OAO NK YUKOS. In addition, pursuant to the Rules of the London Court of International Arbitration and arbitration clauses of the aforementioned share exchange and share purchase agreements dated April 30, 2003, the official procedure for the consideration of the dispute between OAO NK YUKOS and our companies in connection with performance of these agreements has commenced now.*" [emphasis added].

640 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-34962/04-94-425 (Aug. 17, 2004). (Annex (Merits) C-143). In particular, the court held that: "*the Bailiff was not obliged to uphold the petition of* [...] *Yukos* [...] *to enforce against the* [...] *Sibneft shares, obtained by* [...] *Yukos* [...] *in violation of current legislation, the acquisition of which is disputed by the shareholders of* [...] *Yukos* [...] *itself and by the entities from which the shares have been received and upon which a seizure has been imposed by the Arbitrazh Court of the Chukotka Autonomous District and the Moscow Arbitrazh Court.*" The court also confirmed that, under Russian law, the bailiffs have full discretion to determine which assets of a debtor should be used for execution. Of course, under Russian law, execution may only be levied against what the debtor actually owns, not against the property of third parties that the debtor merely claims to own.

reasonably -- confirmed that the bailiffs' treatment of Yukos' offers of the Sibneft shares was legal and appropriate.[641]

430. On September 9, 2004, the bailiffs responded to Yukos' self-terminating offer of August 6 -- giving the lie to Claimants' assertion that the Russian authorities "*were unresponsive*"[642] -- and drew the company's attention to the August 17, 2004 ruling.[643] But Yukos stubbornly chose to ignore the bailiffs' clear statement and the obvious impairment of the assets at issue and, on September 16, November 24, and December 16, 2004, responded to the bailiffs' requests that it discharge in full the assessments for tax years 2001-2003 by simply reiterating its August 6, 2004 offer of 1,637,633,048 Sibneft shares, which

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641 *See, e.g.,* (i) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525), all regarding Yukos' challenge of the seizure of the YNG shares; (ii) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479), regarding Yukos' challenge of the 7% enforcement fee for non-payment of the tax assessment for year 2000; (iii) Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529), both regarding Yukos' challenge of the seizure of shares in Tomskneft; (iv) Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527), both regarding Yukos' challenge of the seizure of shares in Samaraneftegaz; (v) Decision of the Moscow Arbitrazh Court, Case No. A40-37946/04-12-398 (Sept. 20, 2004) (Exhibit RME-520) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521), both regarding Yukos' challenge of the seizure of shares in 24 other subsidiaries; (vi) Decision of the Moscow Arbitrazh Court, Case No.A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12602-04 (Jan. 20, 2005) (Exhibit RME-523), both regarding Yukos' challenge of the seizures of shares in four other Yukos subsidiaries; and (vii) Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004), 6 (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) (Annex (Merits) C-292), all regarding Yukos' challenge of the bailiff's decision to sell the YNG common shares and dismissing, *inter alia*, Yukos' argument that the bailiff should have accepted its offer of Aug. 6, 2004.

642 *See* Theede Witness Statement, ¶ 9. *See also* Rieger Witness Statement, ¶¶ 23, 24.

643 *See* Letter from Deputy Head of the Bailiffs Department of the Russian Ministry of Justice S.V. Sazanov to Yukos' counsel D.V. Gololobov (Sept. 9, 2004) (Annex (Merits) C-146).

the bailiffs had previosuly rejected. Those rejections were upheld by the Russian courts.[644]

b) Yukos' Requests For Deferred Payments Were Properly Rejected

431. In parallel, Yukos submitted equally self-defeating applications to the Moscow Arbitrazh Court and the Ministry of Finance,[645] respectively, requesting authorization to defer its obligations to pay its 2000 tax debts (equal to US$ 3.5 billion), or the ability to pay in installments. Neither application was accepted, because they were not valid as a matter of law.[646] The application to the Moscow Arbitrazh Court was dismissed because Yukos failed to prove any "extraordinary" circumstances that would justify payment of its tax liabilities in installments.[647] The application to the Ministry of Finance was declined because the tax authorities simply did not have the authority to grant such a request. As the Ministry of Finance explained in a letter to Yukos dated August 30, 2004, "[*i*]*n accordance with Article 62(1)(2) of the Russian Federation Tax Code, the term for*

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644 *See* Petition for voluntary enforcement of Resolution of September 9, 2004 to initiate enforcement proceedings and Demand (Sept. 16, 2004) (Annex (Merits) C-163); Application for voluntary enforcement of Resolution of November 19, 2004 to initiate enforcement proceedings (Nov. 24, 2004) (Annex (Merits) C-180); and Application for voluntary enforcement of Resolution of December 9, 2004 to initiate enforcement proceedings (Dec. 16, 2004) (Annex (Merits) C-195).

645 *See* Application to the Ministry of Finance for Granting Respite, Payment Spread (July 16, 2004) (Annex (Merits) C-138) and Decision of the Moscow Arbitrazh Court, Case No. A40-1397/04ip-109 (Aug. 12, 2004) (Annex (Merits) C-142). Claimants' comparison of Yukos' application to the Ministry of Finance with the restructuring plan provided for repayment of YNG's tax liabilities is completely misplaced, because that restructuring was obtained by Rosneft pursuant to a special procedure, for which Yukos did not apply and, in any case, was not eligible. *See* Konnov Report ¶ 91.

646 This outcome was consistent with international practice. *See* ¶ 1423 *infra*.

647 Pursuant to Article 324 of the Russian Arbitrazh Procedure Code (Exhibit RME-556), "[i]*f there exist circumstances that make it difficult to perform a judicial act, the arbitrazh court that issued the writ of execution may, upon application from the creditor, from the debtor or from the bailiff, permit payment deferral or payment by installments of the judicial decision, or to alter the method and the procedure for its execution.*" On August 12, 2004, the Moscow Arbitrazh Court dismissed Yukos' application to pay its outstanding liabilities in installments, finding that: "*According to the spirit of the provision of Article 324(1) of the Arbitrazh Procedure Code of the Russian Federation, circumstances that hamper enforcement of a judicial act are, for example, the physical absence of the adjudicated assets, extraordinary circumstances and other similar circumstances. According to the court, there are no such circumstances in this case. The circumstances, to which the petitioner points, are not of this kind.*" [emphasis added]. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-1397/04ip-109 (Aug. 12, 2004) (Annex (Merits) C-142).

payment of tax cannot be changed if the entity applying for such a change is the subject of proceedings for tax offence."[648]

432. Subsequent events revealed that Yukos' applications were also insincere as a matter of fact. As noted at paragraph 394 above, Yukos, albeit belatedly, discharged its debt for tax year 2000 in a relatively limited amount of time, when it finally elected to do so.

c) The "Settlement" Offers Submitted By Mr. Chrétien Were Properly Rejected

433. Claimants also note a "settlement" proposal Mr. Jean Chrétien submitted to the then Russian Prime Minister and President on behalf of Yukos and the Oligarchs' Group Menatep.[649] The proposal -- which was first submitted on July 6, 2004, and floated occasionally thereafter through November 17, 2004 -- consistently contemplated a final settlement of all of Yukos' liabilities for tax years 2000 to 2003, in exchange for the payment of US$ 8 billion within 24 months.[650] This proposal was initially premised on Yukos' offering "*as collateral the approximately 35% of the shares of OAO Sibneft, which Yukos owns*

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[648] *See* Letter from the Russian Tax Ministry to Yukos (Aug. 30, 2004) (Annex (Merits) C-145). Under Russian law, a request to delay payment or to pay in installments may be granted only: (i) on limited statutory grounds; (ii) if the tax debt is paid in full within a period ranging from one to six months from the original due date; and (iii) if there are no pending tax proceedings with respect to the applicant. *See* Art. 62(1) (Exhibit RME-557) and Art. 64 (Exhibit RME-558) of the Russian Tax Code. Yukos' application failed on all three grounds because: (i) in its application, Yukos failed to specify any valid statutory ground; (ii) the original due date had expired in 2001; and (iii) there were at that time pending tax proceedings and assessments with respect to Yukos.

[649] The firm of Mr. Chrétien, Heenan Blaikie, was retained by Yukos and Group Menatep Limited to "*engage in discussions* […] *with official and administrative representatives of the government of the Russian Federation and its constituent bodies* […] *regarding the resolution of certain disputes of a fiscal nature and related matters*." Letter from Heenan Blaikie to Yukos (July 6, 2004) countersigned by Mr. Misamore on behalf of Yukos (Annex (Merits) C-128). Yukos expressly consented to the retainer of Heenan Blaikie and Mr. Chrétien by Group Menatep Limited "*notwithstanding any possible conflict of interest arising from the mandates,*" and authorized the consultants "*to reveal*" to Group Menatep Limited any information they received from Yukos in connection with the provision of their services. *Ibid. See also* Letter from Jean Chrétien to President Vladimir Putin (Nov. 17, 2004) (Annex (Merits) C-129).

[650] *See, generally,* letters from Mr. Chrétien to the Russian Prime Minister and President (July 6, July 15, July 30, Sept. 10 and Nov. 17, 2004) (Annex (Merits) C-129).

outright and are uncontested"[651] -- a statement that, as explained above, was simply not true -- and subsequently on Yukos' offering to transfer (or sell) "*all of*" its Sibneft shares "*in partial payment of the global tax settlement.*"[652]

434. Mr. Chrétien's proposal was not only inadequate in overall amount and payment terms, but was subject to the same deficiencies that vitiated Yukos' other offers of its purported stake in Sibneft, as discussed above.

d) Yukos' Other "Settlement" Offers

435. Claimants refer to a "two-page" proposal (not in the record) that was allegedly submitted by Dmitry Gololobov and Frank Rieger to bailiff Andrey Belyakov in the summer of 2004[653] and to an equally unidentified "*full settlement proposal* […] *in the range of US$ 21 billion*," including, *inter alia*, "*non-core assets and Sibneft shares*," allegedly submitted by Yukos to the Russian authorities in October 2004.[654] In addition, in his witness statement, Mr. Steven Theede

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651 *See* Letter from Jean Chrétien to Prime Minister Fradkov (July 6, 2004) (Annex (Merits) C-129), and Letter from Jean Chrétien to President Vladimir Putin (July 30, 2004) (Annex (Merits) C-129). On July 30, 2004, while reiterating Yukos' offer of 35% of the Sibneft stake, Mr. Chrétien ambiguously noted that "[t]*his would not include the additional 20% of Sibneft shares owned by Yukos, the ownership of which had been contested*." *Ibid.*

652 Specifically, in the letter of September 10, 2004 Mr. Chrétien informed President Putin that "*Yukos will take steps to dispose of its interest in Sibneft, if you are not prepared to take the Sibneft shares in partial payment of the global tax settlement*." According to the proposal, the expected proceeds from the sale of Yukos' Sibneft shares (between US$ 3 and US$ 4 billion) would cover the bulk of the amounts still due under the US$ 8 billion global settlement. *See* Letter from Jean Chrétien to President Vladimir Putin (Sept. 10, 2004) (Annex (Merits) C-129). In the letter of November 16, 2004, Mr. Chrétien conveyed to President Putin an undertaking by his clients Yukos and Group Menatep that "*as soon as we agree* [on] *a settlement amount, it will be paid almost immediately. As part of this undertaking, I would again confirm to you that Yukos would be prepared to immediately transfer all of its shares in Sibneft as partial payment of any settlement that we would reach*." *See* Letter from Jean Chrétien to President Vladimir Putin (Nov. 17, 2004) (Annex (Merits) C-129).

653 *See* Claimants' Memorial on the Merits, ¶ 348. *See also* Rieger Witness Statement, ¶ 22.

654 *See* Claimants' Memorial on the Merits, ¶ 355. *See also* Misamore Witness Statement, ¶ 47 *and* Theede Witness Statement, ¶¶ 21-24. Claimants' charge that Alexander Temerko, Yukos' chief negotiator, was threatened with arrest and fled Russia as a direct consequence of his negotiating role in October 2004 (Claimants' Memorial on the Merits, ¶ 355) is contradicted by the facts. Already in August 2004, Yukos' board of directors had acknowledged the risk that criminal and civil charges might be brought against Alexander Temerko (Minutes No. 120-18 of Meeting of Yukos' Board of Directors (Aug. 19, 2004), 2 (Annex (Merits) C-210)) as he was involved in a criminal investigation since March 2004, well before he allegedly assumed the role of Yukos' negotiator (*see* Irina Reznik, Yulia Bushuyeva, *Prosecutors Found US$ 5 Bln*, Vedomosti (Mar. 12, 2004) (Exhibit RME-565)).

mentions "*approximately 80 proposals and attempts to open communications with the various authorities*."[655] Respondent cannot comment on these alleged proposals at this time because Claimants have failed to submit copies of them.

436. In the meantime, however, it is clear that, in light of the serious cloud on Yukos' title to the offered Sibneft shares, and Yukos' repeated failure to disclose to the bailiffs (as well as to the Russian Government) the existence of injunctions and rulings that rendered illusory the proffered alternative security, it would have been irresponsible for the bailiffs or the Russian Government to accept any of Yukos' offers.

437. It is equally clear that Yukos' requests to delay payment of its tax debt were spurious if only because of Yukos' vast offshore assets.

438. Significantly, while Yukos was offering tainted or otherwise inadequate assets to discharge its tax debt, it refused to sell any of its unencumbered foreign assets, even though it had at one point claimed that it was prepared to do so,[656] nor did it or Claimants cause the foreign subsidiaries to distribute cash dividends to Yukos, or even provide significant loans to enable it to pay its taxes. Instead, those assets were applied to the preferential benefit of Claimants and the Oligarchs and to mire Yukos further in debt.[657]

439. These facts confirm that Yukos' proposals constituted mere pretexts, and were simply intended to gain time and provide a basis -- however false -- for blaming the company's failure to pay its taxes on the Russian authorities. Given the evident insufficiency and bad faith of Yukos' proposals, the Russian authorities' rejection of them was fully justified and indeed, the only prudent response to Yukos' continued refusal to pay.

7. Yukos' Management Falsely Blamed Yukos' Self-Inflicted Insolvency On The Russian Authorities And Resisted Filing For

655 Theede Witness Statement, ¶ 9.

656 Rieger Witness Statement, ¶ 21.

657 *See infra* ¶ 592 .

Bankruptcy In Russia, Which Would Have Suspended The Tax Enforcement Measures

440. Faced with mounting tax liabilities and growing balance sheet deficit,[658] Yukos' management began openly talking of bankruptcy and the financial ruin of the company, continuing to blame the Russian tax authorities for the company's self-inflicted predicament.

441. On May 27, 2004, in the immediate aftermath of the May 26, 2004 ruling which upheld all relevant aspects of the 2000 tax assessment, Yukos' management issued a public statement that read, in part, "*if the Tax Ministry's efforts continue, we are very likely to enter the state of bankruptcy before the end of 2004*."[659]

442. Despite Russian authorities' expressions of hope that Yukos' bankruptcy could be avoided,[660] Yukos' management persisted in warning that bankruptcy might be imminent. On June 29, 2004, upon confirmation of the 2000 tax assessment on appeal, Yukos' management declared: "[t]*he threat depends on the final settlement and payment terms of the tax liability* [...]. *If we have to pay immediately or if we can't find a solution, then we face bankruptcy*."[661]

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658 RAS Balance Sheets of Yukos (June 30, 2004) showed total liabilities at RUB 637 billion (approximately US$ 21.9 billion) and total assets at RUB 575 billion (approximately US$ 19.8 billion), a deficit of RUB 62 billion (approximately US$ 2.1 billion). Based on the RUB/US$ exchange rate on June 30, 2004. *See* Yukos RAS Balance Sheets for 2Q 2004 as of June 30, 2004 (Exhibit RME-566) and Denis Skorobogatko, *Extraction Income and Losses*, Kommersant (Aug. 17, 2004) (Exhibit RME-567). Yukos' balance sheet deficit increased in the following quarters of 2004. *See* ¶¶ 546, 549 *infra*.

659 *See* Yukos Oil Company, Statement in connection with the court decision on collection of additional profit tax for the year 2000 (May 27, 2004) (Exhibit RME-568). *See also* Greg Walters, *Yukos Warns It May Go Bankrupt*, Moscow Times (May 28, 2004) (Exhibit RME-475).

660 President Vladimir Putin told reporters during an official visit to Tashkent, Uzbekistan on June 17, 2004, that "[t]*he official authorities of the Russian Federation, the government and the country's economic authorities are not interested in the bankruptcy of a company like Yukos*." President Putin also observed that Yukos' ultimate fate would be decided by the independent judiciary and not by his political or economic advisors–"*what happens in the courts is a separate matter. The courts should speak of this themselves*." *See* Catherine Belton, *Putin Tip Powers Yukos Recovery*, Moscow Times (June 18, 2004) (Exhibit RME-569).

661 *See* Erin E. Arvedlund, *Russian Court Upholds Tax Claim Against Yukos*, N.Y. Times (June 29, 2004), quoting Mr. Theede, Yukos' CEO (Exhibit RME-508).

443. On July 22, 2004, after the seizure of YNG shares by the bailiffs on July 14, 2004, Yukos' management announced as follows:

> "The Company management is currently making every effort to raise additional funds in order to repay, as soon as possible, the tax liability and to finance current operations. However, should those efforts prove unsuccessful and [YNG] is sold, in the present circumstances, the management of the Company would be compelled to announce the bankruptcy of Russia's largest oil company."[662]

444. In August 2004, Yukos' management continued to warn of impending insolvency. Mr. Theede noted, "[u]*nless the company works out a settlement with the Tax Ministry, [...] the company will soon be unable to pay its bills and may have to declare bankruptcy*,"[663] which he added was "very likely."[664]

445. In reality, the insolvency of the Yukos holding company was the consequence of the Oligarchs' and Yukos' management's disastrous strategy of tax evasion, resistance to and obstruction of the collection of overdue taxes, self-imposition of massive non-tax and intercompany liabilities on the company, and failure to draw on Yukos' ample offshore assets.

446. If Yukos had been insolvent, this would have triggered management's duty to take remedial measures, including by filing for voluntary bankruptcy in Russia, without the need for shareholder approval.[665] Such a duty exists in many other jurisdictions.[666]

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662 *See* Yukos Oil Company, Statement regarding the current financial situation (July 22, 2004) (Exhibit RME-464).

663 *See* Erin E. Arvedlund, *Despite Its Troubles, Yukos Keeps Pumping*, International Herald Tribune (Aug. 2, 2004) (Exhibit RME-493).

664 *See* Guy Faulconbridge, *Yukos Sends Mixed Signals Over Bankruptcy*, Moscow Times (Aug. 17, 2004) (Exhibit RME-570). As Mr. Misamore further explained: "*If we are insolvent because we do not have the cash to pay our bills, we have to declare bankruptcy... All the cash is being swept up. We can't survive.*" *Id.*

665 Pursuant to Article 9(1) of the Russian bankruptcy law applicable at the time, Russian Federal law No. 127-FZ (Oct. 26, 2002) on Insolvency (Bankruptcy) ("2002 Russian Bankruptcy Law"), the debtor's Chief Executive Officer was required to file for voluntary bankruptcy if the satisfaction of claims of one or several creditors leads to the debtor's inability to perform in full its monetary obligations due to other creditors. *See* Art. 9 of the 2002 Russian Bankruptcy Law (Exhibit RME-571). According to Russian courts, such a duty is triggered either when a

447. Under Russian law, upon the filing of a voluntary bankruptcy petition by a debtor, existing encumbrances on the debtor's assets are lifted, enforcement proceedings are suspended, and no further enforcement actions can be taken.[667] Accordingly, upon any such filing by Yukos' management, the encumbrances then existing on the company's assets and cash would have been lifted, consolidated enforcement proceedings for the collection of the tax assessments would have been suspended, no further enforcement fees would have been levied, and no enforcement auction of the YNG shares would have taken place.

448. Never missing the opportunity to miss an opportunity, however, Yukos' management decided not to avail themselves of the reprieve that filing for bankruptcy in Russia would have afforded, though they were well aware both that if the company was insolvent, they would have a statutory duty to follow that route[668] and that doing so would provide a respite from enforcement measures.[669]

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debtor is unable to pay a debt of at least RUB 100,000 (approximately US$ 3,500) that is overdue for three months (*see, e.g.*, Resolution of the Federal Arbitrazh Court of the West-Siberian District, Case No. F04/367-2333/A45-2003 (Jan. 26, 2004) (Exhibit RME-595)) or when the value of liabilities on the debtor's balance sheet exceeds the value of the assets (*see, e.g.*, Resolution of the Federal Arbitrazh Court of the Povolzhskiy District, Case No. A65-17015/05-SG4-27 (Dec. 6, 2005) (Exhibit RME-596)). *See also* Art. 8 of the 2002 Russian Bankruptcy Law (providing that a debtor had the right to file a bankruptcy petition in anticipation of bankruptcy if circumstances are present that clearly demonstrate that the debtor will not be able to satisfy the monetary or mandatory payment obligations on time) (Exhibit RME-571).

666 *See* ¶¶ 1495-1496 *infra*.

667 *See* Art. 63(1) of the 2002 Russian Bankruptcy Law (Annex (Merits) C-406); Art. 60(4) (Exhibit RME-575) and Art. 24(2) of the 1997 Enforcement Law (Exhibit RME-576).

668 Messrs. Theede and Misamore confirmed as much. *See* Erin E. Arvedlund, *Yukos Shareholders Will Vote on Filing for Bankruptcy*, N.Y. Times (Nov. 4, 2004), W-1 (Exhibit RME-572) and Misamore Testimony, *In re Yukos Oil Co.*, No. 04-47742-H3-11, Hr'g Tr. 32:20-22 (Feb. 16, 2005) ("*Q: Isn't it true that Yukos management could have filed bankruptcy in Russia without having to get shareholder approval? A: That's correct legally.*") (Exhibit RME-661). Likewise, in the bankruptcy proceedings initiated by Yukos before the Houston Bankruptcy Court, Yukos' expert, Professor Maggs, testified that "*under Article 9 the head of organization is obligated to act, regardless of whether the other bodies in the company, such as the general meeting of shareholders, tell it to act or tell it not to act.*" *In re Yukos Oil Co.*, United States Bankruptcy for the Southern District of Texas, Houston Division, Case No.04-47742-H3-11, Deposition of Professor Peter Maggs (Feb. 11, 2005), 67: 4-19 (Exhibit RME-578) *See also* Resolution of the Plenum of the

449. Instead, Yukos' management continued its strategy of evading rather than paying its serious outstanding tax obligations[670] and then resolved to file a spurious bankruptcy petition in Texas, based upon a jurisdictional sham whose immediate purpose was to sabotage the auction of YNG and whose ultimate purpose was to obstruct tax enforcement in Russia. The U.S. filing afforded none of the benefits of a Russian filing and resulted only in eliminating competitive bidding at the YNG auction, a further self-inflicted wound in the downward spiral that Yukos' management pursued, as discussed below.[671]

J. The YNG Auction, Which Was Conducted In Accordance With Russian Law To Help Satisfy Yukos' Tax Liabilities, But Which The Oligarchs Sabotaged, Causing Yukos To Suffer Yet Another Self-Inflicted Wound

450. As shown below, the Russian tax authorities pursued the auction of YNG to help satisfy Yukos' tax liabilities, in the face of Yukos' refusal to pay its bill. In yet another example of Claimants' penchant for blaming the Russian Government for the consequences of Yukos' own self-inflicted wounds, they have the temerity to challenge how the auction was conducted, when indisputably Yukos sabotaged that auction, thereby preventing it from realizing as much money as possible to help satisfy Yukos' tax debt, and despite the fact that the auction was conducted fully in accordance with Russian law.

Supreme Arbitrazh Court "On Certain Issues of Practice of Application of the Federal Law "On Insolvency (Bankruptcy)" No. 29 (Dec. 15, 2004), ¶ 5 (Exhibit RME-574).

669 In the Houston bankruptcy proceedings, Mr. Theede testified as follows: "*Q. Do you know whether there is a provision under Russian bankruptcy law that would have prevented the Government from seizing the YNG* […] *shares and selling those shares if Yukos had filed bankruptcy? A. My understanding is that under Russian bankruptcy and under liquidation accounts are unfrozen, assets are unfrozen, and all of the restrictions that have been placed on Yukos would have been freed up*." *In re Yukos Oil Co.*, United States Bankruptcy for the Southern District of Texas, Houston Division, Case No.04-47742-H3-11, Deposition of Steven Theede (Feb. 4, 2005), 48:7-15 (Exhibit RME-577).

670 During the meeting of August 19, 2004, Yukos' board of directors admitted that "*the Company intends to avoid declaring bankruptcy. B. Misamore stated that in order to avoid bankruptcy, the Company would need, in the nearest time, to stop paying VAT and the mineral extraction tax.*" Minutes of Yukos' Board of Directors (Aug. 19, 2004) (Annex (Merits) C-210).

671 *See* ¶¶ 497-506 *infra*.

1. The YNG Auction Was Prompted By Yukos' Failure To Discharge Its Tax Liabilities And Was Organized So As To Maximize Participation And Proceeds

451. Faced with Yukos' persistent failure to pay its overdue taxes, the Russian authorities began preparations for the sale of the YNG shares, which had been seized on July 14, 2004,[672] in order to satisfy Yukos' growing tax bill. On July 20, 2004, the Ministry of Justice announced plans to assess the value of the YNG shares with a view toward sale.[673] This was fully compliant with Russian law, which mandates execution on a debtor's property when monetary funds are insufficient, as they were in the case of Yukos, given the company's failure to tender assets held by its affiliates in Russia and overseas.[674] The authorities' selection of YNG as an appropriate subject for execution in view of Yukos' mounting tax liabilities was reasonable and, as confirmed by Russian courts, did not offend any rule of Russian law.[675]

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672 *See* Warrant of the Court Bailiff Service for the Central Administrative District of Moscow for Inventory and Seizure of Securities (July14, 2004) (Exhibit RME-611). Yukos brought a legal challenge to the bailiffs' decision to seize the YNG shares. The challenge was ultimately dismissed by the Russian courts after multiple levels of appellate review. *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612). Yukos appealed the Federal Arbitrazh Court decision before the Supreme Arbitrazh Court, which declined to exercise its supervisory review. *See* Ruling of the Supreme Arbitrazh Court, Case No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525).

673 *See* Gregory L. White, *Yukos Arm May Be Sold by Russian to Help Satisfy Tax Obligations*, Wall St. J. (July 21, 2004), 3 (Exhibit RME-613). *See also Yuganskneftegaz's Stock Will Be Appraised by Independent Appraisers and Put Up For Sale*, AK&M News Release (July 20, 2004) (Exhibit RME-614).

674 *See* Art. 46 and Art. 59 of the 1997 Enforcement Law (Exhibit RME-482 and RME-495).

675 In his witness statement, Mr. Misamore refers to Yukos' claim that "*the company's core production assets* [such as, allegedly, the YNG shares] *should not be sold in advance of non-core assets and other liquid investments*." Misamore Witness Statement, ¶ 55. *See also Ibid,* ¶ 52 and Illarionov Witness Statement, ¶ 42. Russian courts rejected as groundless this claim when it was made by Yukos, and there is no reason to believe that these decisions were unsound. Pursuant to Article 59 of the 1997 Enforcement Law, a debtor's assets that are not directly involved in production activities (*i.e.*, "non-core" assets), such as securities (*e.g.*, shares) should be seized and sold on a priority basis. Pursuant to Article 46(5) of the 1997 Enforcement Law, a debtor may suggest property upon which execution may be levied first, but the final order of execution is determined by the bailiff. *See* Art. 46 and Art. 59 of the 1997 Enforcement Law (Exhibit RME-482 and RME-495). Russian courts found that the YNG shares were not core assets and could therefore be seized and sold as a matter of first priority. *See* (i) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK, (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow

452. Under Russian law in effect at the time, the YNG shares could have been sold either at public auction or through a privately-negotiated transaction to any willing purchaser, including State-owned companies.[676] Accordingly, the Russian authorities could have sold the YNG shares directly to a recipient of their choice. Specifically, if, as alleged by Claimants, the Russian authorities' master plan had always been to renationalize Yukos by selling YNG at a cheap price to Rosneft, nothing would have prevented the Russian Government from doing just that, instead of running the risk, through the auction process, that a foreign company or a Russian private sector bidder would win (or that, at a minimum, they would drive up the price for YNG). As discussed below,[677] the fact that they did not do so further demonstrates that Claimants' "conspiracy" theory is fanciful.

453. On August 6, 2004, Yukos asked the bailiffs "that, with regard to the sale of the stock and shares owned by OAO Yukos Oil Company, an open auction should be organized […], subject to preliminary public notice in federal media […], so that the largest possible amount of money can be obtained by selling each asset against which enforcement is levied."[678]

454. Although not legally required to do so, the Russian authorities granted Yukos' request, opting to sell the YNG shares at public auction so as to ensure a competitive process potentially leading to higher proceeds.

District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court, Case No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525), all regarding Yukos' challenge of the seizure of the YNG shares; and (ii) Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004) (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) (Annex (Merits) C-292), all regarding Yukos' challenge of the bailiff's decision to sell the YNG common shares (Nov. 18, 2004).

676 Under Article 54(2) of the 1997 Enforcement Law, a debtor's property is sold on commission or contractual basis. Article 54(3) of the same law requires that only a debtor's real estate be sold at the auction. *See* Art. 54 of the 1997 Enforcement Law (Exhibit RME-615). This is consistent with international practice. *See* ¶ 1360 *infra*.

677 *See* discussion at ¶ 771, *infra*.

678 Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004, stamped received on Aug. 9, 2004), 9 (Annex (Merits) C-140).

455. Long before it was actually held, however, the YNG auction became the target of an intense public relations campaign on the part of Yukos' management and its controlling shareholders, who falsely depicted the auction process as being somehow unfair to Yukos. As shown below, the reality is that the auction process followed procedures that respected Yukos' interests and complied with Russian law -- which was, in turn, significantly more debtor-protective than the law of many other countries[679] -- and, to the extent within the control of the Russian authorities, was intended to maximize the auction proceeds. While the Yukos publicity campaign drew attention to the auction, its purpose was not to grow the field of bidders, but precisely the opposite, to chill competition, to the detriment of maximizing the auction price.

a) The Auction Procedures Were Fair And Were Aimed At Maximizing Participation And Proceeds

456. The Russian authorities organized the auction in accordance with the stringent procedures mandated by Russian law for auction sales (which would not have applied if the authorities had decided instead to sell the YNG shares in a privately-negotiated sale).[680] These procedures were aimed at maximizing auction participation -- and therefore proceeds.

457. On August 12, 2004, the bailiffs hired as independent appraiser the local affiliate of a world-class financial institution, Dresdner Kleinwort Wasserstein ("DKW"), from the Dresdner Bank Group, to perform a professional market-value valuation of the YNG shares "*in accordance with internationally accepted valuation standards*."[681] Yukos was notified of DKW's appointment,

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679 *See* discussion at ¶¶ 1359-1367, *infra*.

680 Articles 447-449 of the Russian Civil Code, which set forth the primary rules governing auctions, do not apply to privately-negotiated sales. *See* Art. 447-449 of the Russian Civil Code (Annex (Merits) C-400).

681 Article 2.1.1 of the Valuation Contract No. 3-UYu, (Aug. 12, 2004) (Annex (Merits) C-271). Article 1 of the Valuation Contract provides as follows: "*The Customer* [the Ministry of Justice] *engages DrKW and the latter undertakes to perform work to evaluate 100 percent of the market enterprise value* […] *(pursuant to the meaning of the term as used internationally in financial markets, and net of any debts and other liabilities, and equity) of the open joint-stock company Yuganskneftegaz* […] *by using various methods of valuation, including discounted cash flow analysis, comparable businesses and comparable transactions*." Claimants claim to find it "*interesting*" that "*the bailiffs planned to pay for the appraisal services out of the sale proceeds*." Claimants' Memorial on the

which was widely publicized in the Russian and foreign press.[682] Yukos never challenged this appointment.[683]

458. On October 6, 2004, DKW delivered to the Ministry of Justice a summary valuation opinion of YNG's share capital and the full text of its related valuation report (the "DKW Report").[684] On the same day, the Ministry of Justice sent a copy of the DKW Report to Yukos.[685] On October 14, 2004, pursuant to authorization by the Ministry of Justice, DKW published on its website the summary valuation opinion, which was in English and therefore accessible to a broader public of potential investors.[686]

Merits, ¶ 363. This is, however, a rule contemplated by Russian law, which provides that appraiser's fees qualify as expenses of the procedure and, as such, are reimbursable by the debtor. *See* Art. 82 and Art. 84 of the 1997 Enforcement Law (Exhibit RME-615). DKW's € 1 million fee was consistent with customary charges by investment banks such as DKW for valuation services.

682 Resolution of Bailiff D.A. Borisov, Clause 7 (Aug. 12, 2004) (Annex (Merits) C-270). *See, e.g.,* Guy Chazan, *Russia Seeks Banker's Valuation on Sale of Yukos Production Unit*, Wall St. J. (Aug. 13, 2004), A2 (Exhibit RME-616); Peter Klinger, *DKW to Set Sale Value on Yukos Subsidiary*, Times Online (Aug. 13, 2004) (Exhibit RME-617); Erin E. Arvedlund, Jad Mouawad, *Yukos Crisis Eases, but Oil Prices Keep Climbing*, N.Y. Times (Aug. 12, 2004) (Exhibit RME-618); Jill Treanor, *Dresdner Called in Over Yukos Crisis*, Guardian (Aug. 13, 2004) (Exhibit RME-619); and Christopher Hope, *Russia Runs Role Over Yukos Arm*, Daily Telegraph (Aug. 13, 2004) (Exhibit RME-620).

683 When notifying Yukos of the appointment of DKW, the bailiffs also informed the company that it could challenge the relevant resolution in court within 10 days. *See* Resolution of Bailiff D.A. Borisov, Clause 8 (Aug. 12, 2004) (Annex (Merits) C-270).

684 *See* ZAO Dresdner Bank Summary Valuation Opinion Letter (Oct. 6, 2004) (the "DKW Summary Opinion"), 2 (Annex (Merits) C-273) and DKW Report (Annex (Merits) C-274).

685 Yukos received a copy of the DKW Report on October 13, 2004. *See* DKW Report, Cover Letter (Annex (Merits) C-274).

686 *See* DKW Press Release regarding the DKW Summary Opinion (Oct. 14, 2004) (Exhibit RME 621). Mr. Illarionov alleges that "*ZAO Dresdner considered it necessary to release the results of the valuation report on its website in order to set the record straight*" in an attempt "*to distance itself from the self-serving and unconventional interpretation of its report by the Russian authorities.*" Illarionov Witness Statement, ¶ 45. *See also* Claimants' Memorial on the Merits, ¶¶ 369-371. This contention is unsupported. First, the results of DKW's valuation (including, the US$ 15-17 billion valuation range) were in the public domain well before DKW released its summary valuation on October 14, 2004. *See Official Yugansk Asset Price Hasn't Reached Russia's Justice Ministry*, RIA Novosti (Oct. 5, 2004) (Exhibit RME-622) and *Yukos Licenses Hang in the Balance*, Moscow Times (Sept. 28, 2004) (Annex (Merits) C-705). Second, as noted, the Ministry of Justice agreed to the publication of the Summary Valuation by DKW, thereby allowing access to the valuation (which, unlike the DKW Report, was in English) to the broadest possible number of foreign potential investors. Third, according to Mr. Illarionov and Claimants, DKW reacted to a press statement by an official of the Ministry of Justice disclosing DKW's most conservative valuation at US$ 10.4 billion (Claimants' Memorial on the Merits, ¶ 369

459. The DKW Report valued YNG on a going-concern basis, *i.e.*, on the assumption that the entirety of YNG would be sold on an arm's length basis by a willing seller to a willing buyer. Thus, it did not discount YNG's value to take into account the compulsory nature of the sale (a debtor-unfavorable practice allowed in many other countries).[687] The DKW Report also noted that the valuation did not take into account several other factors that would justify a lower price, notably (i) YNG's tax liabilities, (ii) the fact that some of DKW's assumptions about YNG's future were optimistic, and (iii) various other risks involved in purchasing the YNG shares.[688]

460. Subject to these important qualifications, suggesting that DKW had in all likelihood erred on the high side, DKW valued 100% of YNG's shares in the range of RUB 459–534 billion (US$ 15.7–18.3 billion).[689] In addition to this value range, which was primarily based on a discounted cash flow analysis,[690] DKW mentioned a variety of other possible valuations using different methodologies, including a valuation at US$ 14.3 billion based on a "proved" as opposed to "proved and probable" reserves model[691] and a valuation at US$ 15.27 billion based on a Lukoil-ConocoPhillips comparable transaction analysis.[692] DKW's

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and footnote 551; (Annex (Merits) C-710)). At that time, however, the press also reported statements by officials of the Ministry of Justice referring to DKW's highest valuation range: "*a source in the Ministry of Justice as saying that Yuganskneftegaz would be valued at between $ 15 billion and $ 17 billion*." *See Yukos Licenses Hang in the Balance*, Moscow Times (Sept. 28, 2004) (Annex (Merits) C-705).

687 *See* discussion at ¶¶ 1362-1364, *infra*.

688 DKW Report, ¶¶ 1.10, 10.2 and 12 (Annex (Merits) C-274).

689 At the CBR exchange rate of RUB 29.2187/US$ 1 as of September 17, 2004, as stated in the DKW Report, ¶ 1.5 (Annex (Merits) C-274). This range is before adjustment to reflect the sale of only a 76.79% stake and the tax claims discussed below.

690 The DKW value range, which was primarily based on a "50-year discounted cash flow" analysis, employed a discount rate equal to YNG's actual weighted average cost of capital (or "WACC"), which DKW estimated at 12.7% per annum.

691 *See* DKW Report, ¶¶ 1.5 and 6.1 (Annex (Merits) C-274). The DKW Report gives a figure of US$ 14.3 billion, before adjustment to reflect the sale of only a 76.79% stake and the tax claims discussed below.

692 DKW Report, ¶ 6.3.6 (Annex (Merits) C-274). DKW referred to a then-recent auction to sell a 7.6% equity interest in Lukoil, which ConocoPhillips bought for US$ 1.988 billion. That purchase price implied a valuation coefficient of US$ 1.31 per proven barrel of oil equivalent. Noting that this was the "*freshest benchmark*" to assess YNG, DKW valued YNG at US$ 15.27

most conservative estimate, based on "*adjusted independent assessors 2003 case DCF valuation*," was US$ 10.4 billion.[693] Even though Yukos challenged the YNG auction on numerous grounds before the Russian courts, it never criticized DKW's valuation.[694]

461. On October 11, 2004, after receiving the DKW Report and noting Yukos' persistent delinquency in paying of its tax bills, the bailiffs issued an order to proceed with the sale of 76.79% of the YNG shares.[695] The following day, on October 12, 2004, the Ministry of Justice publicly confirmed that it had given its "*green light*" for such a sale because of Yukos' failure to pay its large tax liability.[696]

462. In response to the Ministry of Justice's announcement that those YNG shares would be sold to cover Yukos' still unpaid tax bill, Tim Osborne, a director of Group Menatep, threatened sustained and aggressive legal action, stating "*Whoever buys* [YNG] *is going to be buying themselves a lifetime of litigation*."[697] This was part of an intense campaign of intimidation against

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billion, before adjustment to reflect the sale of only a 76.79% stake and the tax claims discussed below.

693 *See* DKW Summary Opinion, 6 (Annex (Merits) C-273).

694 Yukos' failure to challenge the DKW Report was noted in several Russian court decisions. *See*, in particular, the Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004) ("[*t*]*he applicant failed to challenge information contained in the report in accordance with article 13 of the Federal Law No. 135-FZ dated July 29, 1998 'On appraisal Activities'*") (Exhibit RME-562); the Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK, (Jan. 27, 2005) ("*OAO NK YUKOS, as a party to the enforcement proceedings, was provided with the appraisal of the seized property on October 13, 2004 and the First Interdistrict Department of the Court Bailiff Service for the Central Administrative District of Moscow received no comment in respect of the expert appraisal. OAO YUKOS does not dispute this fact.*") (Exhibit RME-563); and the Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) ("[o]*n October 13, 2004, the parties to the enforcement proceedings examined the valuation of the seized assets of OAO Yukos Oil Company, produced by the expert. No comments were received by the First Inter-District Department of the Bailiffs Service for the Central Administrative District of Moscow as regards the valuation produced by the expert.*") (Annex (Merits) C-292).

695 The Bailiff's order of October 11, 2004 is cited in Article 1.3 of the Agreement No. 4-UYu/2-1/1772-1 between the Main Department of the Ministry of Justice of the Russian Federation for Moscow and the Russian Federal Property Fund (Nov. 18, 2004), 2 (Exhibit RME-623).

696 *See* Stephen Hall, Nadia Rodova, *Russia to Sell Yukos' Main Production Unit; Says Company Has Lagged in Paying Massive Tax Debt*, Platts Oilgram News (Oct. 13, 2004), 1 (Exhibit RME-624).

697 *See* Guy Faulconbridge, *Yukos Unit Up for Sale at Discount Price*, Moscow Times (Oct. 13, 2004) (Exhibit RME-625).

potential bidders that was orchestrated by Yukos' managers and controlling shareholders (*see* ¶¶ 492-496).

463. On November 18, 2004, the bailiffs appointed the Specialized State Institution of the Government of the Russian Federation "Russian Federal Property Fund" to sell the YNG shares at auction.[698] Concurrently, the Ministry of Justice provided the Federal Property Fund with the parameters for the YNG auction.[699] These parameters included the number of shares to be sold, a minimum starting price -- which had been "*determined taking into account the recommendations of ZAO DRESDNER BANK*" -- and a requirement that "[t]*he Fund shall organize the tendering for the sale of the Shares by holding a public auction by way of open competitive bidding*."[700]

464. The following day, on November 19, 2004, the Federal Property Fund issued a notice, published both on the website of the official government publication *Rossiskaya Gazeta* and in hard copy form,[701] conveying to the public the parameters for the YNG auction and related information. This notice set forth: (i) the number of shares to be sold (43 ordinary shares representing 76.79% of YNG's share capital); (ii) the starting price for the same (RUB 246.8 billion or

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698 *See* Resolution of Bailiff I.V. Kochergin to appoint a seller (Nov. 18, 2004) (Annex (Merits) C-279). Yukos' challenge of this resolution was definitively dismissed by Russian courts. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004) (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) (Annex (Merits) C-292).

699 *See* Agreement No. 4-UYu/2-1/1772-1 between the Main Department of the Ministry of Justice of the Russian Federation for Moscow and the Russian Federal Property Fund (Nov. 18, 2004) (Exhibit RME-623). Also on November 18, 2004, the Federal Property Fund issued a regulation reflecting the auction parameters provided by the Ministry of Justice. *See* Regulation approved by the Federal Property Fund's Order No. 183 on November 18, 2004, published in Reforma No. 158 on November 22, 2004 (Exhibit RME-626).

700 Agreement No. 4-UYu/2-1/1772-1 between the Main Department of the Ministry of Justice of the Russian Federation for Moscow and the Russian Federal Property Fund (Nov. 18, 2004), clauses 1.1 and 2.1 (Exhibit RME-623). Under this agreement, the Federal Property Fund undertook to sell 43 ordinary shares of YNG (representing 76.79% of the company's share capital) (clause 1.1) for a price that "*shall not be lower than two hundred forty six billion seven hundred fifty three million four hundred forty seven thousand rubles 18 kopecks (RUR 246,735,447,000.18* [sic]*) determined taking into account the recommendations of ZAO DRESDNER BANK*" (clause 2.1).

701 *See Notice of the Auction of Yuganskneftegaz*, Rossiskaya Gazeta (Nov. 19, 2004) (Annex (Merits) C-280) and (Exhibit RME-694).

approximately US$ 8.85 billion);[702] (iii) the date and place of the auction (Sunday,[703] December 19, 2004, in the Rosstandart building in central Moscow); (iv) the eligibility requirements for bidders, including a pre-auction cash deposit of 20% of the starting price (RUB 49.4 billion or US$ 1.77 billion[704]), to be paid no later than the day before the auction;[705] and (v) a statement that "[n]*o restrictions to participation* [will be] *imposed on any particular categories of private individuals or legal entities, including foreign individuals and legal entities*."[706]

465. The foregoing parameters, including the starting price, were fully consistent with Russian law.[707]

b) The Auction Starting Price Was Fair

466. The starting price for the auctioned shares was consistent with the DKW Report and was fair to Yukos.

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702 Based on the RUB/US$ exchange rate on Dec. 18, 2004, the day before the YNG auction. Due to a 2.8% appreciation of the Russian ruble against the US dollar between November 18, 2004 and December 19, 2004 the YNG auction starting price as expressed in US dollars also increased by 2.8%, although the actual YNG auction starting price as expressed in Russian rubles did not change after November 18, 2004.

703 In Russia, holding auctions on Sundays is permitted.

704 Based on the RUB/US$ exchange rate on Dec. 18, 2004, the day before the YNG auction.

705 According to the "general provisions" set forth in the auction notice, the deadline for submission of applications and payment of the cash deposit was December 18, 2004. *See Notice of the Auction of Yuganskneftegaz*, Rossiskaya Gazeta (Nov. 19, 2004), 1 and Section III (Exhibit RME-694). *See also Notice of Auction,* published by the Russian Federal Property Fund in Rossiyskaya Gazeta (Nov. 19, 2004), 1 and Section III (Annex (Merits) C-280).

706 *Notice of the Auction of Yuganskneftegaz*, Rossiskaya Gazeta (Nov. 19, 2004), Section III.1 [emphasis added] (Annex (Merits) C-280) and (Exhibit RME-694).

707 As confirmed by the Russian courts: (i) Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004) (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) (Annex (Merits) C-292), all regarding Yukos' challenge of the bailiff's decision to sell the YNG common shares (Nov. 18, 2004); and (ii) Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007) (Exhibit RME-680); Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007-GK (May 30, 2007) (Exhibit RME-681); and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007), (Annex (Merits) C-294), all regarding Yukos' challenge of the results of the YNG auction. *See also* Art. 447-449 of the Russian Civil Code (Annex (Merits) C 400) and Regulation approved by the Federal Property Fund's Order No. 183 on November 18, 2004, published in Reforma No. 158 on November 22, 2004 (Exhibit RME-626)

467. The Russian authorities determined the starting price for the 43 YNG common shares after "*taking into account*" the DKW Report.[708] But DKW was not asked to establish the starting price for an auction of the shares, and the authorities were not bound by its report.[709] DKW cautioned that "*this valuation is not an opinion of the price that could be achieved through the sale of YNG; or a recommendation for the starting price of an auction if YNG should be sold by the MINISTRY or any other government agency.*"[710] DWK also noted that:

> "[t]he decision about a starting auction price is a tactical one and must secure a balance between the desire to achieve a maximum price, on the one hand, and the need to attract a maximum number of potential purchasers, on the other. Therefore, the starting auction price is most likely to be different form [sic] the valuation."[711]

468. In other words, DKW was cautioning the authorities not to try to derive a starting price mechanically from their report.

469. It is a truism that prices achieved at auctions under compulsory or distressed circumstances may not match those achieved in leisurely negotiations, as Yukos itself has previously conceded.[712] Among the reasons why forcible auctions may depress prices are the relatively high levels of uncertainty

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708 As required by the Agreement No. 4-UYu/2-1/1772-1 between the Main Department of the Ministry of Justice of the Russian Federation for Moscow and the Russian Federal Property Fund (Nov. 18, 2004), clause 2.1 (Exhibit RME-623).

709 While the authorities were required to "*take into account the recommendations*" made by DKW, they were not bound by those recommendations, and were free to reach their own conclusion regarding the most appropriate starting price. This conclusion follows from Art. 52 and Art. 54 of the 1997 Enforcement Law (Exhibit RME-513 and RME-615).

710 DKW Report, ¶ 1.2 (Annex (Merits) C-274). As DKW further cautioned, the "*assessment of the value of a standalone enterprise may differ from the price that could be practically realized if selling the assets or the company at some particular moment in time. To evaluate what YNG might fetch at auction would entail answering a whole range of important questions. A detailed consideration of these questions lies outside the scope of DKW's work on this issue.*" DKW Report, ¶ 2.2 (Annex (Merits) C-274).

711 DKW Report, ¶ 11.9 (Annex (Merits) C-274).

712 This point was conceded by Yukos in the U.S. bankruptcy proceedings subsequently initiated by it in Texas. In its petition to the U.S. court to enjoin the auction of YNG from going forward, Yukos noted that "*the value one would expect to derive from* [. . .] *a forced tax sale is much less than the going concern value of YNG, or from an arms-length sale of YNG or its assets through the bankruptcy process.*" *See* Plaintiff's Verified Emergency Motion for Temporary Restraining Order & Preliminary Injunction. *In re Yukos Oil Co.*, Case No. 04-47742-H3-11 (Dec. 14. 2004) (Bankr. S.D. Tex.), ¶ 45 (Exhibit RME-629).

surrounding the auctioned company's value, given the lack of cooperation with the auction process by the company's managers, and the high costs of attempting to evaluate the company relative to the risk that those costs will be wasted if the bid is not the winning one.

470. The foregoing is particularly true when, as here, the assets to be auctioned are shares in an unlisted company.[713] Unlisted shares are typically sold via negotiated sales, after the buyer and its advisors (financial, legal, tax, accounting and oil reserves) have had an opportunity to conduct a "due diligence" examination of the underlying company, and on the basis of a share purchase agreement in which the seller undertakes to indemnify the buyer against all undisclosed liabilities, and sometimes against specified disclosed risks as well. In an auction setting, neither "due diligence" nor indemnity protection is available to the buyer, and buyers are therefore compelled to buy on an "as is" basis, bearing the full *caveat emptor* risk.[714] As a result, bidders at auctions set their bids on the assumption that previously unknown facts will be discovered after the purchase has been completed. In the case of YNG, these risks were particularly acute, because Yukos' management and controlling shareholders, instead of cooperating with the auction, were attempting to sabotage it with threats of a "*lifetime of litigation*." Given the intensity of the opposition of Yukos' managers, and their principals' long track record of improper business practices, there existed a real risk that Yukos' managers and controlling shareholders had been stripping assets out of YNG or burdening it with additional liabilities, as in fact they did.[715] There also was a risk –- which materialized -– that Yukos would

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713 At the time of the auction, Yukos was a listed company, but YNG was not.

714 The auctioned shares were, in fact, sold without any indemnity. *See* Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 5-7 (Annex (Merits) C-290). The protocol of the auction constitute the contract of sale. *See* Art. 448 (5) of the Russian Civil Code (Annex (Merits) C-400), and Art. 2.3 of the Regulation approved by the Federal Property Fund's Order No. 183 on November 18, 2004, published in Reforma No. 158 on November 22, 2004 (Exhibit RME-626).

715 As discussed, ¶ 487 *infra*, the management of Yukos ceased to pay YNG for purchases of crude oil so that, by the time of the auction, Yukos and its trading shells owed very large sums to YNG for oil delivered before the auction.

challenge the results of the auction before the courts, attempting to annul them.[716] In formulating their bids, potential bidders would need to take all of these risks into account.

471. Contrary to Claimants' contention that the Russian authorities fixed the auction starting price "at the lowest possible level,"[717] the price of US$ 8.85 billion for a 76.79% stake was, in reality, not only compatible with DKW's value range based on a discounted cash flow analysis (US$ 15.7-18.3 billion), but higher than DKW's other valuations based on proven reserves (US$ 14.3 billion) and on the Lukoil-ConocoPhillips benchmark (US$ 15.27 billion), once those are properly adjusted, as explained below.

472. First, DKW's value range and other valuations referred to 100% of the capital of YNG, whereas the auctioned shares represented only 76.79% of the shareholder equity. For only 76.79% of YNG's equity, the DKW value range would not have exceeded US$ 12–14 billion.[718]

473. Second, as expressly underscored by DKW, the DKW Report did not take into account "*any assessments of tax liabilities that have or may be presented to YNG.*"[719] When DKW issued a letter to the Ministry of Justice summarizing its advice on October 6, 2004, after it was learned that a US$ 951 million tax claim in respect of 2002 tax claims had been assessed against YNG, DKW concluded that,

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716 Indeed, just after the YNG auction, Yukos challenged the results before U.S. courts for an alleged breach of the automatic stay and before Russian courts under Russian law. Ultimately, both claims were dismissed. *See* discussion *infra*.

717 Claimants' Memorial on the Merits, ¶ 376. *See also* Misamore Witness Statement, ¶ 54.

718 The DKW Report suggests that simply multiplying its estimates by 76.79% -- as we have done --- probably overstates the value of the shares sold, all of which were common shares. This is because, contrary to the recommendation of DKW, prior to the auction, the YNG preferred shares were not converted into common shares (at a 1:1 ratio), nor were the preferred shares sold together with the common shares (*i.e.*, "united," in DKW's terminology). As DKW explained, however, "*the continuing uncertainty over the payment of dividends on preferred shares and therefore over the potential possibility that the holders of preferred shares might use their right of vote* [would tend to] *lower the value of ordinary shares*." DKW Report, ¶ 7.1.2 (Annex (Merits) C-274).

719 *See* DKW Report, ¶ 1.5 (Annex (Merits) C-274).

if that claim were judicially upheld, "*YNG's equity value range would decrease.*"[720] That is, according to DKW, it would need to reduce its range of valuations dollar-for-dollar by the amount of the tax liabilities. By November 18, 2004, however, when the starting price was actually set, the publicly announced tax claims against YNG had grown much larger, to US$ 3.4 billion for the 2001 and 2002 tax years.[721] Following the logic of DKW's analysis, this would have meant (on a 76.79% proportionate basis) a further reduction of DKW's range from US$ 12.1–14.1 billion to no more than US$ 9.5–11.5 billion.[722] Moreover, it was obvious, when the starting price was set that YNG would soon receive an assessment for tax year 2003 as well. Had it been assumed -- as turned out to be the case[723] -- that this further tax assessment would be on the order of US$ 1.2 billion (increasing YNG's total tax liability from US$ 3.4 billion to US$ 4.6 billion), DKW's adjusted range (again taking into account the sale of a 76.79% stake) would have fallen to US$ 8.6-10.6 billion. The starting price of US$ 8.85 billion was commensurate with this range.

474. Adjusted for the sale of a 76.79% stake and the tax liabilities discussed above, DKW's other valuations, based on proven reserves and the Lukoil-ConocoPhillips benchmark, suggested a price no higher than US$ 7.45 billion and US$ 8.2 billion, respectively. The actual starting price exceeded these figures by 19% and 8%, respectively.

475. Table 5 below summarizes the foregoing analysis:

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720 "*If YNG's alleged tax liabilities with respect to 2002 were to be judicially upheld, YNG's equity value range would decrease to between US$ 14.7 billion and US$ 17.3 billion.*" DKW Summary Opinion, 6 (Annex (Merits) C-273).

721 *See Yukos Plummets on Shock Tax Bill*, Moscow Times (Nov. 3, 2004) (Exhibit RME-630), reporting revised claim for 2002 tax year of US$ 1 billion and claim for 2001 tax year of US$ 2.4 billion.

722 The likelihood that YNG would be called upon to pay higher taxes in all future years suggests that, instead of deducting the tax assessments on a dollar-for-dollar basis, as though they were a one-time charge, the adjustment should have been a multiple of the assessment, reflecting the continuing burden of higher taxation. If this factor had been taken into account, it would have depressed the valuation even further.

723 It became known publicly no later than December 8, 2004 that YNG's assessment for 2003 was US$ 1.2 billion. *See* Catherine Belton, *Foreign Banks to Lend Gazprom US$ 13.4 Bln*, Moscow Times (Dec. 8, 2004) (Exhibit RME-631).

TABLE 5 – DKW AND ADJUSTED VALUATION

	DKW Valuation		
	DKW's valuation based on proven reserves: US$ 14.3bn	DKW's valuation based on LUKOIL-Conoco Phillips benchmark: US$ 15.27bn	DKW's valuation based on discounted cash flow @ 12.7% WACC: US$ 15.7bn-18.3bn
	Adjusted Valuation		
Adjusted for sale of 76.79% stake actually sold	US$ 10.98bn	US$ 11.73bn	US$ 12.1-14.1bn
	Adjusted Valuation		
Adjusted for tax claims of US$ 4.6bn at 76.79% = US$3.53bn	US$ 7.45bn	US$ 8.2bn	US$ 8.57-10.57bn
Starting Price of US$8.85bn as a percentage of Adjusted Valuation	119%	108%	103% (using low end of the range)

476. Third, as noted, DKW's valuation tended toward a high valuation. This is confirmed by the fact that the low end of DKW's value range for 100% of YNG (US$ 15.7 billion) was considerably higher than contemporaneous published estimates of other analysts,[724] and within 2% of the average (as

[724] *See, e.g.,* Morgan Stanley's equity research report "*YNG Sale: A Shock and Awe Negotiating Tactic?*" (July 22, 2004) (Exhibit RME-632), valuing 100% of YNG at US$ 8.9 billion; and UBS Brunswick's analyst report cited in the DKW Report, valuing 100% of YNG at US$ 7.8 billion. The foregoing estimates are before any adjustments for the sale of 76.79% and YNG's taxes. *See also* Merrill Lynch's Comment (Nov. 23, 2004) (Exhibit RME-851), valuing 76.79% of YNG at US$ 8.7 billion". Claimants refer to an October 27, 2004 "valuation report" prepared by JP Morgan, commissioned by Yukos (Claimants' Memorial on the Merits, ¶¶ 373-374 and (Annex (Merits) C-277)). Not surprisingly, Yukos' own bankers, after reviewing the DKW Report, arrived at a higher valuation than DKW, albeit only marginally so. There is no reason to believe that the JP Morgan valuation was more accurate than the DKW valuation, and some reason to believe that it was less accurate, since it was not based on as thorough an analysis as the DKW Report. In any event, it would have been improper for the Russian authorities to give any weight to the JP Morgan report (even assuming they were aware of it, which does not appear to have been the case), insofar as they were required to take into account only the DKW Report that had been commissioned for this purpose.

opposed to low-end) valuation of YNG reported in a survey of 11 leading Russian and international analysts, conducted by Reuters in August 2004.[725]

477. Fourth, all of DKW's estimates were based on a series of optimistic assumptions regarding Yukos' future, which, if not shared by the authorities setting the starting price (or by prospective bidders), would have mandated lower amounts. These included the assumptions that:

(i) Yukos would continue to cooperate with YNG after the auction, notwithstanding the intense opposition to the auction that had been voiced by Yukos' management and controlling shareholders. This cooperation would be critically important to a purchaser of YNG, because it would be dependent on Yukos' continuing willingness (directly or through affiliates) (i) to refine crude oil produced by YNG,[726] (ii) to lend rail cars to YNG to enable it to transport its crude oil to refineries,[727] and (iii) to lease certain wells and related equipment. [728]

(ii) The unaudited YNG financial data upon which the DKW valuation was based would prove reliable, notwithstanding DKW's disclosure that it had been denied significant information that it had requested from Yukos and that there were other reasons to doubt the data's accuracy.[729]

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725 DKW Report, ¶ 8.3.

726 DKW Report, ¶ 1.10 (Annex (Merits) C-274).

727 DKW Report, ¶ 2.2 (Annex (Merits) C-274).

728 *See* Rosneft IPO Prospectus, 37 (Annex (Merits) C-380). Those leases were short-term and there was no assurance that they would be renewed.

729 As noted by DKW: "[s]*ince YUKOS had never previously disclosed detailed financial and technical information on YNG, DrKW had to rely on a series of key assumptions and use confidential internal information concerning YNG that was provided by YUKOS. When using the data provided to DrKW and the MINISTRY by YUKOS management, DrKW was obliged to trust in the reliability and accuracy of this information and did not have the opportunity to audit or verify it*." DKW Report, ¶ 1.4, *see also* ¶ 10.2.4 (Annex (Merits) C-274). In Appendix 1 to the DKW Report, DKW lists some of the significant information that it requested but did not receive.

(iii) Russian inflation would fall to 2.5% per annum by 2014 and that new export pipelines with a throughput capacity of 100 million tons/year would be commissioned by 2010.[730]

478. If one takes into account the foregoing and the other risk factors outlined above, it is clear that the starting price of US$ 8.85 billion for the 76.79% of YNG's share capital that was offered for sale was fully consistent with the DKW Report.

479. Claimants contend, erroneously, that Respondent "*sought to diminish the value*" of YNG by (i) assessing sizeable taxes against the company, contending "*the vast majority of which miraculously vanished after Rosneft acquired*" it, (ii) allegedly causing YNG to default on payments to oil service providers as a result of an August 31, 2004 seizure of YNG's "*various bank accounts as collateral in a criminal case against Yukos' chief accountant, Ms. Irina Golub,*" and (iii) notifying YNG, on October 8, 2004, of the possible withdrawal of a number of its oil licenses.[731] These contentions are demonstrably false.

480. At the outset, it should be noted that Claimants' charges that, in the weeks and months preceding the YNG auction, the Russian authorities took steps to artificially depress that company's value (and hence the auction price) so as to make it cheaper for Rosneft to buy it, is fundamentally illogical, because it assumes that the authorities knew in advance that Rosneft would be the acquiror, whereas the open auction format that the authorities had chosen (instead of the direct sale mechanism that was permissible under Russian law) made it impossible for anyone to rule out the possibility that the acquiror would be a private sector company, or even a foreign one. Claimants have failed to explain why it would have been in the Russian Federation's interest to give a windfall to such a buyer, by artificially cheapening the value of YNG. Nor, in fact, have they explained why the authorities would have had an interest in allowing Rosneft (or another State-owned company) to buy YNG for less than full value, even if they

730 *See* DKW Report, ¶¶ 6.2(4) and 10.2.9 (Annex (Merits) C-274).

731 Claimants' Memorial on the Merits, ¶¶ 365-367.

had assumed that Rosneft would bid and win. At best, such an artifice would have been revenue neutral, because the winning State-owned company's gain (from the bargain purchase) would have been offset ruble-by-ruble by the Russian Treasury's loss of revenues (as a result of depreciation of the value of the asset sold).

481. We nevertheless examine each of the techniques that Claimants contend the authorities used to artificially depress the value of YNG, starting with the allegedly *mala fide* tax assessments.

482. By way of background, in the unconsolidated Russian tax system, YNG was a distinct taxpayer from Yukos. As will be recalled, Yukos' "tax optimization" scheme was fueled by below-market sales to the trading shells of oil and products by YNG and Yukos' other production affiliates. All of those production companies were indisputably *bona fide* businesses, with very large staffs and ample assets, and none of them was organized in a low-tax jurisdiction. Their vulnerability to tax assessments, therefore, did not arise under the anti-abuse doctrines applied by the authorities to Yukos, but rather, under Article 40 of the Russian Tax Code, which allows the authorities to reassess companies found to have made sales to other parties at prices substantially below market. As explained by Mr. Oleg Konnov, however, Article 40 is a very technical provision, and taxpayers are often successful in challenging assessments made under this provision.[732] It was thus not surprising that YNG -- by then under the control of Rosneft -- was to a large extent successful in overturning the assessments for tax years 2001, 2002, and 2003.[733] This circumstance does not, however, provide support for Claimants' contention that the assessments were *mala fide*. For one, the success of YNG/Rosneft, though substantial, was not complete; part of the assessments was upheld despite the strenuous objections of YNG/Rosneft. The charge of favored treatment of Rosneft is further undermined –- fatally -- by the fact that YNG, at the time when it was still owned by Yukos, had actually been even more successful in contesting analogous assessments for

732 *See* Konnov Report, ¶¶ 41, 87.

733 *See* Rosneft 2005 U.S. GAAP Consolidated Financial Statements, 59 (Annex (Merits) C 374).

the two immediately preceding tax years -- 1999 and 2000. In decisions handed down on September 15, 2003, the courts -- at the urging of Yukos-controlled YNG -- had overturned the authorities' Article 40 assessments for tax years 1999 and 2000 in their totality, a result more favorable than the one achieved by YNG under Rosneft's ownership in the following year.[734]

483. As for the second allegation, the seizure of bank accounts in an unrelated criminal case to which Claimants refer was in reality limited to only five[735] of YNG's 30 bank accounts,[736] and covered relatively insignificant amounts (approximately US$ 1.34 million).[737] Therefore, if YNG defaulted on payments to commercial creditors, that would hardly have been attributable to those seizures or be evidence of an intent to "*diminish the market value*" of YNG. Tellingly, and contrary to Claimants' allegations,[738] DKW did not consider the freezes of YNG's assets to be a material risk for YNG's operations.[739]

484. As for the final allegation, Claimants concede that the October 8, 2004 notice of potential withdrawal of certain of YNG's oil licenses was "*due to Yuganskneftegaz's arrears in payment of the mineral extraction tax,*"[740] which Yukos' board and management had allowed to accrue. On August 19, 2004, Yukos' management had chosen to "*stop paying* […] *the mineral extraction tax*," on the

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734 *See* Resolution of the Federal Arbitrazh Court of the West-Siberian District, Case No. F04/4647-765/A75-2003 (Sept. 15, 2003) (Exhibit RME-695) *and* Resolution of the Federal Arbitrazh Court of West-Siberian District, Case No. F04/4678-780/A75-2003 (Sept. 15, 2003) (Exhibit RME-696).

735 *See* YNG Quarterly Report for the Third Quarter 2004 (excerpts), 6-8, 31 (Exhibit RME-633); and Resolution of Judge V.M. Pilganova of the Basmanny Court of Moscow (Aug. 31, 2004), 4 (Annex (Merits) C-272).

736 YNG's Quarterly Report shows that YNG had 30 bank accounts with six banks as of October 1, 2004. *See* YNG Quarterly Report for the Third Quarter 2004 (excerpts), 6-8, 31 (Exhibit RME 633).

737 As of October 1, 2004, the money frozen in YNG's bank accounts was approximately RUB 39 million (or US$ 1.3 million, based on the RUB/US$ exchange rate on Dec. 18, 2004). *See* YNG Quarterly Report for the Third Quarter 2004 (excerpts), 31 (Exhibit RME-633).

738 Claimants incorrectly allege that "*Dresdner accounted for the hostile efforts of the Russian Federation to diminish the market value*" of YNG. Claimants' Memorial on the Merits, ¶ 369.

739 *See* DKW Report, ¶¶ 1.10 and 10.2 (Annex (Merits) C-274).

740 Claimants' Memorial on the Merits, ¶¶ 365-367.

false pretext that this was necessary to "*avoid declaring bankruptcy*."[741] In October 2004, Yukos spokesperson Alexander Shadrin confirmed that "'[they] *have not been paying* [mineral extraction] *tax since August, which no doubt is a breach of the license agreements*'."[742] Yukos invoked insolvency when that served its purposes -- to avoid payment of taxes -- while maintaining large balances abroad in offshore Cypriot and BVI companies and trusts. The authorities' threat to withdraw YNG's oil licenses was therefore a predictable and entirely legitimate reaction to Yukos' deliberate and unlawful conduct, not a measure that had been contrived by the Russian authorities.[743] In any event, contrary to Claimants' allegations,[744] DKW did not "price in" the risk of revocation in its evaluation of

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741 During the meeting of Yukos' board of directors, "*B. Misamore stated that in order to avoid bankruptcy, the Company would need, in the nearest time, to stop paying VAT and the mineral extraction tax*." *See* Minutes of Yukos' Board of Directors (Aug. 19, 2004) (Annex (Merits) C-210).

742 *Yuganskneftegaz May Lose Licenses in Three Months*, RIA Novosti (Oct. 11, 2004) (Annex (Merits) C-709). Under standard practice, payment terms for subsoil use (including the mineral extraction tax) are set forth in the relevant oil production license and are considered material terms of the license. Failure to discharge these payments constitutes a breach of the license terms and a violation of Russian law, which may result in the revocation of the license. *See* Art. 12 and Art. 20 of Russian Federal Law No. 2395-1, "On Subsoil" (Feb. 21, 1992) (Exhibit RME-634); and Rosneft IPO Prospectus (July 14, 2006), 207 (Annex (Merits) C-380).

743 Claimants allege that after YNG was acquired by Rosneft, the Ministry of Natural Resources waived any claims for breach of oil production licenses against YNG. *See* Claimants' Memorial on the Merits, ¶ 179. In reality, YNG was threatened with withdrawal of its oil licenses both before and after it was acquired by Rosneft. *See Russian Regulator To Seek Rosneft Subsidiary License Withdrawal*, RIA Novosti (Jan. 18, 2007) (Exhibit RME-704).

Claimants further allege that in November 2003, "[t]*he Russian Federation threatened to revoke Yukos' oil licenses*" to undermine Yukos' operations. *See* Claimants' Memorial on the Merits, § II.C.4. In fact, oil companies are routinely monitored for compliance with license terms and conditions, violations of which may result in possible revocation. There are many reports of violations and potential revocations concerning Yukos from well before the supposed "threat" in November 2003, and the same is true of other oil and gas majors, such as Lukoil, Sibneft, and Gazprom, during the same time period, some of whom actually suffered losses of licenses. *See, e.g., Natural Resources Ministry Conducts Natural Resources Production Licenses Inventory*, WPS - CIS Oil & Gas Report (Dec. 10, 2001) (Exhibit RME-699); *Russian Nature Ministry To Withdraw Licenses, Joint Ventures Included*, Novecon Press Digest (Jan. 10, 2002) (Exhibit RME-700); *Yukos May Lose Licenses For Some Fields*, WPS - CIS Oil & Gas Report (Mar. 7, 2003) (Exhibit RME-701); *Ministry Of Natural Resources RF Declared JSC "Sibneft," JSC "Lukoil" And JSC "YUKOS" In Licenses Violations*, SKRIN – News (Apr. 3, 2003) (Exhibit RME-702); *Working Group Of Natural Resources Ministry Recommends Revoking Of Licenses From Yukos*, WPS - CIS Oil & Gas Report (Apr. 14, 2003) (Exhibit RME-703). Yukos management did not express concern, bluntly stating that it did "*not take the claims of the Natural Resources Ministry seriously*." *Working Group Of Natural Resources Ministry Recommends Revoking Of Licenses From Yukos*, WPS - CIS Oil & Gas Report (Apr. 14, 2003) (Exhibit RME-703).

744 Claimants' Memorial on the Merits, ¶ 369.

YNG,[745] likely because that revocation could be remedied by any purchaser, as allowed under Russian law.[746]

485. The decision to stop paying YNG's mineral extraction tax is only one of several instances in which Yukos' management and controlling shareholders unlawfully sacrificed the interests of YNG to further their own interests –- in this instance, their interest in maintaining intact and subject to the Oligarchs' control the totality of Yukos' offshore assets.

486. Another glaring example involved the "upstream guarantees" that Yukos foisted upon YNG in May 2004 for up to US$ 5 billion.[747] "Upstream guarantees" are guarantees that a company gives for the indebtedness of one or more of its shareholders. YNG's May 2004 "upstream guarantee" of up to US$ 3 billion was in favor of GML's subsidiary Moravel -- an entity owned by the Oligarchs -- securing Yukos' alleged debt to Moravel under the US$ 1.6 billion loan discussed at paragraphs 390 ad 391 above. (The remaining guarantee of up to US$ 2 billion secured Yukos' debt to a syndicate of Western banks under a parallel US$ 1 billion loan.)[748] DKW rightly took into account the liabilities arising from these guarantees (in the aggregate amount of US$ 2.037 billion[749]) since at that time, no acquirer of YNG could have predicted with any

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745 Although "*aware that the Ministry of Natural Resources is carrying out a review of the terms of YNG's licenses and the company's compliance with those terms*" and that the review might result in the revocation of the licenses, DKW assumed "*that the existing licenses will be retained*" by YNG. DKW Report, ¶ 1.10 (Annex (Merits) C-274). *See also* DKW Summary Opinion, 2 (Annex (Merits) C-273). Nor did DKW account for YNG's liabilities for the mineral extraction tax. The "*alleged tax liabilities with respect to 2002*" considered by DKW did not include undisputed current payments, such as the mineral extraction tax for 2004. *See Ibid.,* 50-51.

746 Under Russian law, YNG had a three month remedial period to pay undisputed taxes and to cure the breach of the license terms. *See* Art. 21(4) of the Russian Federal Law No. 2395-1, "On Subsoil" (Feb. 21, 1992) (Exhibit RME-634). Accordingly, any buyer of the YNG shares could have availed itself of the possibility to remedy the license breach, thereby eliminating the risk of license revocation. Indeed, in its presentation to Gazprom regarding YNG, Deutsche Bank did not even mention the risk of license revocation. *See* Deutsche Bank, Project Chekov (Dec. 2004) Slides 6 and 9 (Annex (Merits) C-284).

747 *See* Art. 2.2 of the Financial and Performance Guarantee between YNG and Société Générale (May 24, 2004) (Exhibit RME-581) and Art. 2.2 of the Financial and Performance Guarantee between YNG and Société Générale (May 25, 2004) (Exhibit RME-582).

748 *See* ¶ 578 *infra.*

749 *See* DKW Report, 50 (Annex (Merits) C-274). Deutsche Bank warned Gazprom that "[w]*hen taking a resolution to purchase Yuganskneftegaz, one should take into account* […] *potential further*

degree of certainty that the guarantees would not be called upon, as indeed Moravel later attempted.[750]

487. Following the same predatory logic, immediately after the seizure of the YNG shares in July 2004, Yukos began "bleeding" YNG by stopping payments for the oil YNG delivered to Yukos and Yukos-controlled companies. YNG's RAS balance sheet as at October 1, 2004[751] revealed a huge and sudden increase in the company's accounts receivable, from RUB 9.1 billion (approximately US$ 314.5 million) as of July 1, 2004,[752] the date of the last accounts reviewed by DKW, to RUB 61.8 billion (approximately US$ 2.1 billion).[753] In the last quarter of 2004, YNG's accounts receivable reached RUB 114.2 billion (approximately US$ 4.1 billion).[754] DKW did not consider these accounts receivables because YNG RAS balance sheet as at October 1, 2004 became public only in mid-November 2004, *i.e.*, after issuance of the DKW Report. Unlike DKW, however, any bidder for the YNG shares would have

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liabilities of Yuganskneftegaz with respect to taxes and Yukos's obligations under debt to Western banks." Deutsche Bank, Draft Memorandum on the Strategic Possibilities for Gazpromneft Development (Nov. 26, 2004) DBX 001067 (Annex (Merits) C-281). In its presentation to Gazprom regarding YNG, Deutsche Bank assumed that "*c. US$ 1.3 bn of guarantees issued by Chekhov* [YNG] *will be called upon during 2005*." Deutsche Bank, Project Chekov (Dec. 2004), Slide 6 (Annex (Merits) C-284).

750 The guarantee securing US$ 1.6 billion loan was invalidated by the judgment of the Moscow Arbitrazh Court (Mar. 22, 2006) which was later upheld by the Resolution of the Federal Arbitrazh Court of the Moscow District, (Sept. 7, 2006) in Case No. KG-A40/7419-06 and finally the Order No. 15710/06 of the Supreme Arbitrazh Court (Jan. 18, 2007). The decision of the Russian courts was consistent with Russian corporate laws and similar laws of other countries that view "upstream guarantees" as wrongful misuses of corporate assets, insofar as they benefit one or more shareholders rather than the company itself. Thereafter, it was reported that an LCIA arbitration panel dismissed a claim brought in arbitration by Moravel to enforce a guarantee. *See* "Moravel Investments vs. OAO Yuganskneftegaz" *Law.com - Arbitration Scorecard 2007: Top 50 Contract Disputes* (June 13, 2007), 12 (Exhibit RME-584).

751 *See The Net Profit of Yuganskneftegaz for the Nine Months Increased by 25.4 Times to RUB 29.4 Billion,* Ria Novosti (Nov. 15, 2004) (Exhibit RME-637).

752 Based on the RUB/US$ exchange rate on July 1, 2004. *See* YNG's RAS Balance Sheets as at July 1, 2004 (Exhibit RME-639). This information became public on or around August 17, 2004. *See Yukos' Subsidiaries Do Not Have Enough Funds*, Kommersant (Aug. 18, 2004) (Exhibit RME-640).

753 Based on the RUB/US$ exchange rate on Oct. 1, 2004. *See* YNG's RAS Balance Sheets as at October 1, 2004 (Exhibit RME-638).

754 Based on the RUB/US$ exchange rate on Dec. 31, 2004. *See* YNG's RAS Balance Sheets as at December 31, 2004 (Exhibit RME-628).

known of this development[755] and taken it into account when calibrating its bid.[756]

488. Each of the foregoing examples shows that it was the management of Yukos -- and not the Russian authorities[757] -- that effectively "*depressed the value*" of YNG in anticipation of the auction.

489. As discussed in greater detail below,[758] the starting price was, if anything, more than what was required to conform to international practice. Many countries do not require an appraisal of the market value of auctioned assets or a minimum starting price, while other countries, even if they do require a minimum starting price, provide that it can be set substantially below the low end of the appraised value.

2. Claimants Themselves, Through The Yukos Managers They Installed, Sabotaged The YNG Auction

490. The world press gave extensive coverage to the announcement of the YNG auction.[759] As a result, in the ensuing weeks, a number of Russian and non-Russian companies expressed interest in participating in the auction. Russian companies initially indicating interest included OAO Gazprom ("Gazprom")[760] and OAO Surgutneftegaz ("Surgutneftegaz");[761] non-Russian

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755 The information concerning YNG RAS Balance Sheets as at October 1, 2004 became public on or around November 16, 2004 (*see* Company Profile. OAO Yuganskneftegaz, SKRIN (Nov. 18, 2004) (Exhibit RME-706)), and would thus have been available to bidders before the auction date, even though they were published after DKW finalized its report.

756 In its presentation to Gazprom regarding YNG, Deutsche Bank "*assumed that 30% of accounts receivables from Anton* [Yukos] *will be written off which is based on a preliminary analysis of Anton's* [Yukos'] *liquidation value. The recovery of receivables from Anton* [Yukos] *is one of the key value drivers for Chekhov* [YNG]." Deutsche Bank, Project Chekov (Dec. 2004), Slide 6 (Annex (Merits) C-284).

757 Claimants' Memorial on the Merits, § II.F.2.

758 *See* ¶¶ 1361-1365 *infra.*

759 *See*, *e.g.*, Gregory L. White, *Russia Puts Yukos's Core Asset on Auction Block*, Wall St. J. (Nov. 22, 2004) (Annex (Merits) C-724); Stephen Hall, Nadia Rodova, *Moscow Sets Auction Date for Key Yukos Unit*, Platts Oilgram News (Nov. 22, 2004) (Exhibit RME-641). Erin E. Arvedlund, *Russia Moves to Auction Crucial Unit of Yukos*, N.Y. Times (Nov. 20, 2004) (Exhibit RME-685); Sarah Rainsford, *Yukos Auction Date Announced*, BBC (Nov. 19, 2004) (Exhibit RME-686).

760 Claimants' Memorial on the Merits, ¶ 379. *See* Management Committee addresses Gazpromneft's involvement in Yuganskneftegaz's 76.79% stake sale tender, Gazprom Press

companies included ENI, Chevron Texaco, China National Petroleum Corporation, ONGC, and E.ON.[762]

491. Yukos' management and controlling shareholders conspired to do all they could to undermine the effectiveness of the auction they previously insisted upon. They resorted to both litigation threats and actual legal action to intimidate and eventually enjoin likely participants and their financing institutions. As shown below, they succeeded in preventing all but one bidder from placing a bid, with predictable effects on the competitiveness of the auction.

a) Yukos' Campaign Of Intimidation Deterred Potential Bidders

492. Yukos' management and its controlling shareholders mounted an aggressive media campaign, threatening potential auction participants with endless litigation. The opening salvo was a warning by Group Menatep's spokesman Tim Osborne on July 23, 2004, immediately after the authorities' announcement of their intention to sell YNG, that any purchaser of YNG would "*be buying a whole heap of trouble*."[763] He reiterated the threat on October 13, 2004 when he declared: "[w]*hoever buys* [YNG] *is going to be buying themselves a lifetime of litigation.*"[764]

Release (Nov. 30, 2004) Gazprom Website (Annex (Merits) C-729). *See also Russia's Gazprom Plans to Bid For the Primary Yukos Oil Asset*, Wall St. J. (Dec. 1, 2004) (Exhibit RME-688).

761 "*On Tuesday, Surgut Deputy Director Sergei Fyodorov hinted that the oil company was interested in bidding on Yugansk. 'When they announce (the sale), then we will start looking into the price and the conditions,' the Interfax news agency quoted him as saying.*" *Surgut Drops First Hint of Interest in Yukos Assets*, Agence France Presse (Sept. 28, 2004) (Annex (Merits) C-704).

762 *See* Guy Faulconbridge, *Fitch Tips E.ON as Possible Bidder for Yugansk*, Moscow Times (Oct. 27, 2004) (Exhibit RM-642); *Foreigners Are Interested Not Only in Yuganskneftegaz*, Vedomosti (Nov. 26, 2004) (Exhibit RM-643). *See also Russia*, Platts Oilgram News (Nov. 24, 2004) (Exhibit RME-644); Gregory L. White, *Russia Puts Yukos's Core Asset on Auction Block*, Wall St. J.(Nov. 22, 2004) (Annex (Merits) C-724); and *Gazprom Might Team Up to Bid*, Financial Times (Nov. 26, 2004) (Annex (Merits) C-726).

763 *See* Erin E. Arvedlund, *Yukos Says Asset Sale Could Prove Fatal Blow*, N.Y. Times (July 23, 2004) (Exhibit RME-648).

764 *See* Guy Faulconbridge, *Yukos Unit Up for Sale at Discount Price*, Moscow Times (Oct. 13, 2004) (Exhibit RME-625). "*Group Menatep director Tim Osborne said the company had retained lawyers and that legal action could start soon after the auction of Yugansk on Dec. 19. 'We are well advanced in knowing exactly what we are going to do in the various jurisdictions,' Osborne told Reuters.*" Tom Bergin, *Investor Ready to Sue Yugansk Buyer, Advisers*, Reuters News (Dec. 13, 2004) (Exhibit

493. Yukos' media campaign intensified in the run-up to the auction. On December 13, 2004, six days before the auction, the Oligarchs' Group Menatep placed a full-page advertisement in the *Financial Times*, ominously entitled "Buyer Beware" and promising that "*full legal redress*" would be sought against any successful purchaser of the YNG shares, any banks that provided financing to the purchaser, and, for good measure, anyone doing business with YNG after the sale.[765] In Mr. Osborne's words:

> "Anybody who assists in the acquisition -- the expropriation -- of Yuganskneftegas is as much a party as the purchaser itself. I find it very difficult to envisage a situation where we will not sue. We can't just sit and watch the core asset of Yukos expropriated and take no action."[766]

494. As explained by another Yukos executive, "[t]hose who take Yukos assets without [Yukos'] permission may have to worry, because those assets could be contested in the US."[767] A lawyer for Mr. Khodorkovsky also warned: "[w]e're going to put everyone on notice that these [YNG assets] are stolen goods. These banks are facilitating an illegal expropriation and whoever they loan to will never have legal title to the asset."[768] All of these threats were made without regard to how much any bidder might pay or how much the sale might benefit Yukos.

RME-654). "*Yukos and its main shareholder say that the sale of Yugansk is expropriation and that they likely will sue both the Russian government and any potential buyers of the assets in foreign courts.*" *Russia's Gazprom Plans to Bid For the Primary Yukos Oil Asset*, Wall St. J. (Dec. 1, 2004) (Exhibit RME-688).

765 *See "Buyer Beware,"* Advertisement, Financial Times (Dec. 13, 2004) (Exhibit RME-649).

766 Pälvi Munter, *Yukos Shareholder Threatens Legal Move*, Financial Times (Dec. 13, 2004) (Exhibit RME-650).

767 The executive went on to say that, as a result of the Texas litigation, Yukos would be able "*to go after bank accounts or physical assets of Gazprom*." Erin E. Arvedlund, *To Try to Stop Sale, Yukos Files Chapter 11 in US*, N.Y. Times (Dec. 16, 2004) (Exhibit RME-651).

768 Guy Chazan, *Yukos Ads Target Banks Backing Gazprom's Bid*, Wall St. J. (Dec. 13, 2004) (Exhibit RME-652). Several hours before the auction, Group Menatep's American lawyers assembled journalists to announce that "'*Menatep intends to take every action available in order to protect its interest in Yukos,' Sanford Saunders, a lawyer for Menatep, said at a Moscow news conference. In the U.S., Yukos lawyers say they will press for a permanent injunction to block Gazprom, should it reemerge, or others from taking the assets.*" *Ibid.* Yukos management reiterated their threats immediately after the YNG auction: "'*We will contest this here and overseas,' said Yukos spokesman Alexander Shadrin*." *Ibid.*

495. Multinational oil companies -- all vulnerable to suit outside of Russia, in particular in the United States[769] -- perceived the risk "*of lengthy court battles*"[770] as having become "*too high.*"[771] As a result, none of the several foreign companies that had expressed an interest in taking part in the YNG auction actually participated, "*despite their eagerness to buy Russian oil assets.*"[772]

496. On December 10, 2004, with only nine days left, the Federal Antimonopoly Service reported that three entities -- Gazpromneft, ZAO Intercom and OOO First Venture Company -- had filed for antitrust clearance to participate in the YNG auction.[773]

b) Yukos' Spurious Bankruptcy Filing In The United States Prevented All But One Party From Bidding

497. Compounding the self-destructiveness of their threats, Yukos' management and controlling shareholders caused the company to file a spurious bankruptcy petition in the United States, with the avowed purpose and effect of enjoining the three applicant bidders and any other prospective bidder,[774] as well as their financiers, from purchasing any YNG shares. This move was one more

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769 Any potential Russian bidder with assets in Western jurisdictions faced similar risks. Even if a potential bidder were itself prepared to go forward, its Western bankers and the banks' credit committees -- which would be expected to provide at least US$ 8.85 billion in acquisition financing -- would no doubt have been deterred.

770 "*The possibility of lengthy court battles is one reason why Western oil companies are unlikely to take part in the Yugansk auction, despite their eagerness to buy Russian oil assets.*" Tom Bergin, *Investor Ready to Sue Yugansk Buyer, Advisers*, Reuters News (Dec. 13, 2004) (Exhibit RME-654).

771 "*Most international oil majors have downplayed market rumours they are looking to buy Yugansk in tandem with Gazprom, saying the risks are too high that YUKOS or its minority shareholders, who control 25 percent of the company, will sue the winner.*" [emphasis added]. *Gazprom to Study Deutsche Advice to Buy Yugansk*, Reuters News (Nov. 29, 2004) (Exhibit RME-645).

772 *See* Tom Bergin, *Investor Ready to Sue Yugansk Buyer, Advisers*, Reuters News (Dec. 13, 2004) (Exhibit RME-654). *See also Gazprom to Study Deutsche Advice to Buy Yugansk*, Reuters News (Nov. 29, 2004) (Exhibit RME-645), and Catherine Belton, *Yukos Under the Hammer at $8.6 Bln*, Guardian (Nov. 20, 2004) (Exhibit RME-655) ("*Analysts said they doubted any foreign oil company would bid for the unit because of the potential legal risks involved. Yukos' core shareholder Group Menatep has threatened any potential buyer with 'a lifetime of litigation'. Last night a BP spokesman ruled out bidding, while Royal Dutch Shell refused to comment.*").

773 *See FAS of Russia Received Three Applications to Participate in the Auction for the Sale of Yuganskneftegaz*, FAS Press Release (Dec. 10, 2004) (Exhibit RME-684).

774 In many auctions, it is standard for some potential bidders, for technical reasons, to enter into the auction process only at the latest possible moment, which in this case was December 18, 2004, the eve of the auction.

example of Yukos' addiction to *abus de droit* and at least the fifth misstep in Yukos' self-destructive strategy.

498. On December 14, 2004, Yukos, with the support of Group Menatep, filed a bankruptcy petition under Chapter 11 of the U.S. Bankruptcy Code before the U.S. District Court in Houston, Texas.[775] In support of the petition, Yukos' Chief Financial Officer, Bruce K. Misamore, certified under penalty of perjury that, as of October 31, 2004, Yukos' total debts of US$ 30.79 billion were substantially in excess of its total assets of US$ 12.28 billion.[776] When that claim no longer suited them -- that is, once the U.S. bankruptcy court dismissed Yukos' petition -- Yukos' management never again claimed publicly that the company was insolvent.

499. Yukos' bankruptcy filing triggered the automatic stay provision under U.S. bankruptcy law, which upon filing of the petition automatically suspends all proceedings by or against the debtor and prohibits transactions

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775 *See* Yukos-Moscow Limited, Resolution No. 1 of the Management Board (Dec. 10, 2004) (Exhibit RME-657). In the relevant minutes, it was noted that "*Group Menatep Limited support*[ed] *this resolution*." Later, in February 2005, Yukos Universal entered an appearance in the Southern District of Texas bankruptcy proceedings as an interested party (along with Hulley and Moravel -- same counsel for all three). It also participated in the proceedings after that point, usually joining in Yukos' pleadings and generally trying to convince the judge to keep the bankruptcy case. *See* Hearing Transcript, United States Bankruptcy Court for the Southern District of Texas, Houston Division (Feb. 16, 2005), Vol. 1, 5:24-25, 6:1-4 (Exhibit RME-705). The eleventh-hour timing of this decision suggests that the intent of Yukos' management was to preclude due consideration of the matter by the U.S. court. "*And if you had to cut to the notice issues, I think you would miss the overly broad pell-mell rush to justice that they have created under the guise of an emergency. This sale for Sunday has been noticed for a month over there, and this gentleman shows up on December 4th with his laptop -- basis for jurisdiction -- and he deposits $5 million as a retainer of an indirect subsidiary's fund in Fulbright & Jaworski. He puts $2 million of an indirect subsidiary's money in Southwest Bank of Texas.*" United States Bankruptcy Court for the Southern District of Texas, Houston Division, Transcript of Hearing on Motion for Expedited Appeal (Dec. 18, 2004), 44-47 (46:12-22) (Annex (Merits) C-289).

776 *See* Official Form–Voluntary Petition signed by Bruce K. Misamore, Yukos' Chief Financial Officer (Dec. 14, 2004) *In re Yukos Oil Co.*, Case No. 04-47742 (Bankr. S.D. Tex. Dec. 14, 2004) (Exhibit RME-658). Mr. Misamore subsequently filed, also under oath, additional Yukos financials in which he estimated approximately the same shortfall. Those financials (containing data as of September 30, 2004, except insofar as data as at December 31, 2004 were already available at the time) show Yukos' tax liabilities of US$ 23.02 billion as at December 31, 2004. *See* Documents No. 143 and 143-1, *In re Yukos Oil Company*, Case No. 04-47742 (Feb. 9, 2005) (Bankr. S.D. Tex.) (Exhibit RM-659).

outside the ordinary course of business without court approval.[777] As a result, any successful bidder was exposed to the risk of either being forced to return the YNG shares (or their equivalent value) to Yukos' U.S. bankruptcy estate[778] -- but not getting back the money paid for the shares in Russia -- or being sued for damages, including punitive damages.[779]

500. Yukos' management made no attempt to conceal that the immediate goal of the U.S. bankruptcy filing "*was to stop the sale of Yuganskneftegaz.*"[780] The ultimate goal was to shield Yukos' assets from the tax claims of the Russian Government,[781] while allowing Yukos' management and

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777 As its name suggests, an "automatic stay" took effect with respect to Yukos' assets (including the YNG shares) from the moment Yukos filed its bankruptcy petition with the U.S. court on December 14, 2004, without any action on the part of the court. Under U.S. bankruptcy law, the filing of a bankruptcy petition operates as an "automatic stay" of any and all proceedings that could affect the estate of the debtor. *See* 11 U.S.C. § 362 (Exhibit RME-660). In particular, the automatic stay bars the continuation or enforcement of any claim or proceeding that was commenced against the debtor (or could have been commenced against the debtor) before the bankruptcy petition was filed. *See*, *Ibid.* In any case in which the bankruptcy court has jurisdiction, the bankruptcy court also has jurisdiction over all of the debtor's property, "wherever located," including outside the U.S. *See* 28 U.S.C. § 1334(e) (Exhibit RME-660).

778 The U.S. Bankruptcy Code provides that any property of the debtor transferred to a third party may be "clawed back" into the debtor's estate, *i.e.,* forcibly recovered from the purchaser. *See* 11 U.S.C. § 549 (Exhibit REM-660).

779 Section 362 of the U.S. Bankruptcy Code contemplates that any person injured by a "willful violation" of an "automatic stay" may seek damages, including punitive damages, from the party alleged to have violated it. *See* 11 U.S.C. § 362 (k) (1) (Exhibit RME-660).

780 Deposition of Steven Theede, *In re Yukos Oil Co.*, No. 04-47742-H3-11, 22:20-22; 23:8-11 (Feb. 4, 2005) (Exhibit RME-577). Similarly, Mr. Misamore testified in the U.S. bankruptcy proceedings that through the U.S. bankruptcy filing and the resulting temporary restraining order, "*we sought to stop the sale of 60 percent of the production of the company*" or, at least, to defer it. *See* Deposition of Bruce Misamore, *In re Yukos Oil Co.*, No. 04-47742-H3-11, 29, 96, 124-125 (Feb. 16, 2005) (Exhibit RME-661).

781 The attraction for Yukos was that U.S. bankruptcy courts claim jurisdiction over the bankrupt's assets throughout the world and can prohibit creditors and others from interfering with those assets. Yukos' management filed for Chapter 11 protection, believing that it would be deemed the debtor in possession and thus be able to curtail rights of its creditors on a global basis. To this purpose, Yukos submitted to the U.S. bankruptcy court a "reorganization plan," proposing that: (i) all disputes concerning "Russian Government Tax Claims" against Yukos would be referred to international arbitration, where Yukos intended to "*prove that the conduct of the Russian Government in connection with Yukos is not in keeping with Russian law or international norms*" (Yukos Oil Company's Response to Deutsche Bank's Motion to Dismiss, *In re Yukos Oil Co.*, No. 04-47742-H3-11, 8-9, filed January 31, 2005 (Exhibit RME-662); and (ii) if confirmed in the arbitration proceedings, the "Russian Government Tax Claims" would be admitted to the plan as subordinated claims and would be paid *pari passu* only after all other claims had been repaid in full. *See* Art. XIII of the Yukos' Plan of

principal shareholders to remain in control of the company[782] so as "*to have the freedom to run the company in the way* [they] *knew it could be run*"[783] -- in other words, to continue their self-destructive and self-dealing behavior for as long as possible and eliminate any possibility that the tax claims could be satisfied, let alone adjudicated in Russia.

501. To pursue their goals, Yukos' management and controlling shareholders characteristically manufactured a sham jurisdictional nexus, by setting up a company in Texas two days before the filing of the petition and claiming to have deposited approximately US$ 480,000 in a Texas bank account and paid US$ 6 million in advance fees to its Texas lawyers just before filing the petition.[784] Yukos' Chief Financial Officer, Bruce Misamore, subsequently admitted to back-dating the relevant documents, which were drawn up weeks after the bankruptcy filing.[785]

Reorganization Under Chapter 11 of the U.S. Bankruptcy Code (Feb. 11, 2005) (Exhibit RME-663).

782 U.S. bankruptcy laws are well-known to be among the most favorable in the world to debtors by allowing, *inter alia,* the debtor's management to remain in control of the company after filing.

783 Deposition of Steven Theede, *In re Yukos Oil Co.*, No. 04-47742-H3-11, 22:20-22; 23:8-11 (Feb. 4, 2005) (Exhibit RME-577).

784 Mr. Misamore testified as much in the Texas bankruptcy proceedings (*e.g.*, "*[w]e determined that we needed some company in the US to conduct the bankruptcy activities, and so this was a part of the creation of that general capability to pursue the bankruptcy filing*"; "*Q: Yukos USA doesn't have any operations, other than to support the bankruptcy? A: No* […]"). Misamore Deposition, *In re Yukos Oil Co.*, No. 04-47742-H3-11, 37:8-10, 47:24-48:4, 98:10-13, 103:13-17 and 104:10-20 (Feb. 10, 2005) (Exhibit RME-687). *See also* Memorandum Opinion dismissing Yukos' Chapter 11 petition *In re Yukos Oil Co.*, Case No. 04-47742 (Bankr. S.D. Tex. (Feb. 24, 2005), 31 (Exhibit RME-664) ("*The funds which created jurisdiction in this court were transferred to banks in the United States less than one week prior to the filing of the petition, and were transferred for the primary purpose of attempting to create jurisdiction in the United States Bankruptcy Court.*").

785 *See* Memorandum Opinion dismissing Yukos' Chapter 11 petition *In re Yukos Oil Co.*, Case No. 04-47742 (Bankr. S.D. Tex. (Feb. 24, 2005), 10 (Exhibit RME-664) ("*Misamore testified that, after the petition was filed in the instant case, Misamore caused Brittany Assets, Ltd. to transfer an additional $1.5 million to Yukos USA, for the benefit of Yukos. Subsequently, Misamore caused a loan document to be prepared, reflecting a transfer of funds from Brittany Assets, Ltd. to Yukos USA, "as of" December 14, 2004.*"). The fictitious nature of the jurisdictional nexus is further confirmed by the fact that, only shortly before the bankruptcy filing, "*Yukos* [had] *convinced a Houston Federal court to dismiss a 2002 lawsuit against the company concerning $17 million in contested payments for oilfield services, by arguing its ties to Texas were 'virtually non-existent.' Yukos* [had] *said then that a Texas court had no jurisdiction 'under any conceivable legal theory.'" Mystery*

502. Simultaneously with the filing of the bankruptcy petition, Yukos requested a temporary restraining order ("TRO"), seeking to prevent the Russian Federation, prospective bidders, and any banks financing bids from proceeding with the auction. In particular, in its complaint, Yukos asked the U.S. Bankruptcy Court to:

> "enjoin the Russian Government from completing the sale of the YNG Stock that is currently proposed at the Auction on 19 December 2004, […] Gazprom and any other persons that either have bid, or might bid, from participating in that Auction [… and] various international financial institutions, that have operations in the United States, from financing the bid of Gazprom, or any other person to purchase the assets of Yukos."[786]

503. On December 16, 2004, the U.S. Bankruptcy Court improvidently granted Yukos' TRO request, and enjoined:

(i) all three applicant bidders -- Gazpromneft, ZAO Intercom and OOO First Venture Company;[787]

(ii) the multinational banks that were reported to be preparing to fund bids -- ABN Amro, BNP Paribas, Calyon, Deutsche Bank AG, JP Morgan, DKW;

(iii) and any "persons in active concert or participation with them";

from taking any actions with respect to the sale of YNG shares.[788]

Russian Company Wins Bid on Yukos Unit, Wall St. J. (Europe) (Dec. 20, 2004) (Annex (Merits) C-738).

786 *See* Yukos' Original Complaint for Injunctive Relief, *In re Yukos Oil Company,* Case No. 04-47742-H3-11 (Dec. 14, 2004) (Bankr. S.D. Tex.), ¶¶ 45-46 (Exhibit RME-656).

787 In the TRO, OOO First Venture Capital is incorrectly referred to as an "OAO."

788 Temporary Restraining Order, *In re Yukos Oil Company*, No. 04-47742-H3-11 (Dec. 16, 2004) (Bankr. S.D. Tex.) (Annex (Merit) C-288); and Memorandum Opinion, *In re Yukos Oil Company*, No. 04-47742-H3-11 (Dec. 16, 2004) (Bankr. S.D. Tex.) (Annex (Merit) C-288). The U.S. bankruptcy court did not, however, enjoin the Russian Federation from conducting the auction, citing jurisdictional concerns ("*With respect to Russia, the court finds that Plaintiff has presented insufficient evidence to support a finding that Russia has waived its sovereign immunity with respect to the instant adversary proceeding*"). *Ibid.*

504. Although TROs are ephemeral (not surprisingly, because they are granted with no or little notice or opportunity to be heard),[789] and the factual findings on which they rest do not bind the courts in the cases in which they are granted, much less any other court or tribunal,[790] they are nonetheless injunctions and carry with them the power to punish violations as contempts of court.[791] The effect of the TRO therefore was not only to prohibit the proscribed conduct, but to expose all of the named defendants and all persons working with them to "contempt of court" charges in the United States in the event of any violation.

505. The combination of the automatic stay and the TRO thus gave Yukos' management and controlling shareholders a predicate to sue any entity that succeeded in acquiring the auctioned shares, or that participated in the financing, including potentially for punitive damages, and, from the winning bidder, at a minimum for the return of YNG (or its equivalent value), without any offset for or recovery of the price paid in Russia for the shares.[792] As for the nine parties named in the TRO (and anyone else in "*active concert or participation*"

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789 Under U.S. Federal Rule of Civil Procedure 65(b), a TRO can last no longer than a total of 28 days.

790 Even in the case of a preliminary injunction, which may follow from a TRO, "*the findings of fact and conclusions of law made by a court granting a preliminary injunction are not binding at a trial on the merits*." *University of Texas v. Camenisch*, 451 U.S. 390, 392 (1981) (Exhibit RME-689). Claimants' attempt to attribute significance to the bankruptcy judge's findings (Claimants' Memorial on the Merits, ¶ 384; Misamore Witness Statement, ¶ 56) is thus without foundation. Also, the sole support for those erroneous findings was testimony about Russian law by two biased and incompetent witnesses, Mr. Bruce Misamore and Mr. Pierce Gardner, an English-qualified attorney for Yukos, neither of whom was trained in Russian law. *See* Memorandum Opinion, *In re Yukos Oil Company*, No. 04-47742-H3-11 (Bankr. S.D. Tex.) (Dec. 16, 2004), 47-48 (Annex (Merit) C-288).

791 In the U.S. legal system, an injunction is an extraordinarily powerful remedy because it is backed by the court's "contempt" power, which authorizes courts to enforce their orders in summary proceedings through fines and, in exceptional cases constituting criminal contempt, through imprisonment. *See* Joseph T. McLaughlin, Moore's Federal Practice -- Civil, Vol. 13 (2009), § 65.80 (Exhibit RME-665) (explaining that violation of an injunction may be punished as either civil or criminal contempt); *Armstrong v. Guccione*, 470 F.3d 89, 104-08 (2d. Cir.2006) (recounting history and scope of courts' contempt power) (Exhibit RME-666).

792 In fact, both Yukos and the judge in the Texas bankruptcy proceeding took the position that the "automatic stay" prevented any entity from bidding for or purchasing YNG at auction. *See* Debtors' Report Concerning Violations of the Automatic Stay and Non-Compliance with Court Orders ¶¶ 7, 14, *In re Yukos Co.*, Case No. 04-47742, Adv. No. 04-3952 (S.D. Tex. Dec. 22, 2004) (Exhibit RME-667); Tr. of Appeal of TRO 29:9-15, 37:15-38:19, 51:5-7, 53:4-8, 56:12-57:9, 60:3-17, 120:18-22, 123:7-124:6, *Yukos Oil Co. v. OOO Gazpromneft*, Case No. 04-04756 (S.D. Tex. Dec. 18, 2004) (Exhibit RME-668).

with them), they faced the additional risk of "contempt of court" proceedings. Yukos' own attorneys warned that a violation of the automatic stay would "*leave Gazprom and the Russian government and the banks, if they participate, open to damages of an excess of $20 billion …. Gazprom operates all over the face of the earth. It is not that hard to enforce this judgment against Gazprom*."[793] Yukos was as good as its threats, as shown below.

506. On December 18, 2004, both Gazpromneft and Deutsche Bank, the bank prepared to finance Gazpromneft's bid, appealed the TRO. Arguments on this appeal were heard on the same day, on an emergency basis. The appeal was denied at the end of the hearing, approximately 10 hours before the auction was scheduled to start,[794] leaving all the parties named in the TRO, anyone else in "*active concert or participation*" with them and any other potential purchaser of the auctioned shares exposed to the aforementioned risks. As Yukos and the controlling shareholders intended, the effect of Yukos' U.S. bankruptcy filing thus was to enjoin the named bidders and to make it impossible for those or any other bidders to obtain financing from the international credit markets.[795]

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793 United States Bankruptcy Court for the Southern District of Texas, Houston Division, Transcript of Hearing on Motion for Expedited Appeal (Dec. 18, 2004), 52 (53:4-11) (Annex (Merits) C-289).

794 The hearing on Gazpromneft's appeal ended at 8:30 p.m. (Dec. 18, 2004) Houston time, which, considering the nine hour time difference, corresponded to 5:30 a.m. (Dec. 19, 2004) Moscow time. The auction was scheduled to begin at 4 p.m. (Dec. 19, 2004) Moscow time, and it proceeded as scheduled. *See* Hearing Minutes and Order (Dec. 18, 2004) (Exhibit RME-697); and Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 2 (Annex (Merits) C-290).

795 *See* Erin E. Arvedlund, *Banks Drop Support of Bid For Russian Oil Giant's Unit*, N.Y. Times (Dec. 18, 2004) (Exhibit RME-707) ("*'We remain realistic about the ruling's immediate effect,' Yukos said in a statement published on its Web site. 'While Russian authorities have stated their intention to proceed with the auction, we hope the ruling will lead international banks and other parties to reconsider their participation.'*"). *See also Little-Known Russian Company Buys Yukos' Core Unit At Auction*, Associated Press (Dec. 19, 2004) (Annex (Merits) C 736) ("*Following* [TRO], *the banks – including Deutsche Bank, ABN Amro, BNP Paribas, and Dresdner Kleinwort Wasserstein – froze between $10 billion and $13 billion they had pledged to loan Gazprom for its bid*"); and *Mystery Russian Company Wins Bid on Yukos Unit*, Wall St. J. (Europe) (Dec. 20, 2004) (Annex (Merits) C-738) ("*the banks, led by Deutsche Bank AG, said they wouldn't violate the order.*"). Several banks that "*had been in discussions with Gazprom concerning the advance of funds to Gazprom in connection with its proposed bid at the Auction,*" subsequently acknowledged that they had "*recognized and honored the automatic stay and the temporary restraining order*" and, as a result, had not extended financing to any auction participant. Certain Bank Defendants' Motion to Dismiss Adversary Proceeding (Jan. 12, 2005), ¶¶ 3-4 (Exhibit RME-669).

3. The Outcome Of The YNG Auction Reflected Yukos' Sabotage, Even Though The Russian Authorities Conducted The Auction In Accordance With Russian Law And International Practice

a) The Auction

507. On December 19, 2004, the YNG auction proceeded in Moscow as scheduled.[796] The Federal Property Fund ensured that the proceedings would be public by permitting full media access.[797]

508. The TRO and automatic stay had their intended chilling effect on potential bidders at the auction. Of the three potential bidders that were named parties in the TRO, two -- ZAO Intercom and OOO First Venture Company -- never showed up, and the third one, Gazpromneft, attended but did not place a bid. None of the foreign companies that had previously expressed an interest in purchasing YNG attended.

509. In the meantime, a fourth bidder, OOO Baikalfinancegroup ("Baikal Finance"), had qualified to bid, but was not subject to the TRO. At the auction, Baikal Finance was represented by Mr. Igor Minibayev, "*who was at that time an employee of another Russian oil and gas company, Surgutneftegaz*."[798]

510. Mr. Minibayev opened the bidding by making a preemptive bid of RUB 260.7 billion (approximately US$ 9.4 billion[799]), exceeding the starting price by five increments in a single opening move (for an amount of RUB 14 billion, approximately US$ 502 million, 5.6% higher than the starting bid price).[800]

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796 The TRO did not apply to the Russian Federation, and the Russian Government was dismissive of Yukos' U.S. maneuver. *See* Alan Cullison and Russell Gold, *Putin Slams US Court's Yukos Stance,* Wall St. J. (Dec. 24, 2004) (Exhibit RME-670).

797 *See* Guy Faulconbridge and Catherine Belton, *Mystery Bidder Wins Yugansk for $9.4 Bln*, Moscow Times (Dec. 20, 2004) (Annex (Merits) C-737) (noting that the Federal Property Fund made arrangements for over 100 reporters to cover the YNG auction).

798 Claimants' Memorial on the Merits, ¶ 387. Mr. Minibayev also signed the protocol on the results of the auction on behalf of Baikal Finance. *See* Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 5, 7 (Annex (Merits) C-290).

799 Based on the RUB/US$ exchange rate on Dec. 18, 2004.

800 *See* Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 3 (Annex (Merits) C-290).

Mr. Nikolai Borisenko,[801] representing Gazpromneft, then requested a brief pause in the proceedings, which was granted.[802] When Mr. Borisenko returned, he stated that Gazpromneft, which was a participant in the Houston bankruptcy proceedings and was subject to both the automatic stay and the TRO, and whose appeal Gazpromneft by then knew had been denied, would not submit a bid. There being no other bidder, Baikal Finance was thereupon declared the winner of the auction.

511. On December 23, 2004, Rosneft announced that it had acquired Baikal Finance on December 22.[803] As verified by contemporaneous corporate records of Baikal Finance (which are publicly available),[804] Rosneft had no

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801 Claimants allege that the presidential award for "*services 'in the development of the oil and gas industry'*" granted to Mr. Nikolai Borisenko would confirm "*the undisputed role of the Russian State in coordinating the 'acquisition' of Yuganskneftegaz*" (Claimants' Memorial on the Merits, ¶ 405). The allegation is based on press speculations. The reality is that Mr. Borisenko had been working in Russia's oil industry for over 20 years, and was awarded for his work among the dozens of his fellow workers. *See* Rosneft IPO Prospectus, 196 (Annex (Merits) C-380); and Decree of the President of the Russian Federation No. 1097 of September 20, 2005, On Granting State Awards of the Russian Federation to Employees of Open Joint-Stock Company Rosneft Oil Company (Annex (Merits) C 764).

802 *See* Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 4 (Annex (Merits) C-290). The protocol reported that "[t]*he participant holding ticket number 2 asked the Commission for a recess"* and that further to this request "[*a*]*t 5:15 PM* [...] *the holding Commission declared a recess*" and that "[*a*]*t 5:17 PM* [...] *the Auction resumed.*"

803 *See* Rosneft Press Release, Rosneft Website (Dec. 23, 2004) (Annex (Merits) C-741) and Rosneft IPO Prospectus (July 14, 2006), 75 (Annex (Merits) C-380). Claimants cite a statement made on an English-language page of Rosneft's website that allegedly describes Rosneft's purchase of YNG as "*the most monumental bargain in Russia's modern history.*" *See* Claimants' Memorial on the Merits, ¶ 409 and Rosneft, *Place in economy of Russia*, 2003, Archived Rosneft Corporate Website (Annex (Merits) C-381). A cursory glance to the page in question ("[a]*t the end of 2004 Rosneft made the decision to quit its participation in the project to release assets, necessary for completing the most monumental bargain in Russia's modern history, OJSC Yuganskneftegas control stock purchase. Rosneft took this uneasy decision on selling its Arctic offshore assets for buying Yuganskneftegas*") shows that it was manifestly not written by a native speaker of English and that its Russian author was simply making the point that Rosneft's purchase of YNG was a large transaction. This explanation is consistent with the fact that, in the same paragraph, the author indicates that Rosneft's "decision" was an "uneasy" one -– a statement that contradicts any suggestion that the author viewed the acquisition of the YNG shares as the best deal in Russian history. In English as well, "bargain" does not necessarily imply an advantageous deal (as, for example, in the phrase "the court held the parties to their bargain").

804 At the time of the YNG auction, ownership of equity interests in a Russian limited liability company (referred to as "participation interests" in the relevant Russian statutory scheme) was recorded (i) in the company's corporate charter filed with the Unified State Register of Legal Entities ("Unified Register"), and (ii) in the Unified Register itself, maintained by the federal tax authorities of the Russian Federation. The charter and information in the Unified Register is public. *See* Art. 2(1) and Art. 12 of the Federal Law No.14-FZ "On Limited

ownership interest in Baikal Finance prior to the YNG auction. Baikal Finance was incorporated on December 6, 2004, by its sole founder, Ms. Valentina Davletgareeva.[805] Effective December 9, 2004, Ms. Davletgareeva sold her 100% stake in Baikal Finance to Makoil, a limited liability company ("Makoil").[806] At the time it purchased Baikal Finance, Makoil was owned by two individuals, Mr. Alexander Zhernovkov and Mr. Viktor Panichev.[807] Thus, on the date of the YNG auction, Baikal Finance was a wholly-owned subsidiary of Makoil, which, in turn, was 100% owned by Messrs. Zhernovkov and Panichev. No new participants in either Baikal Finance or Makoil were registered until after the YNG auction, when, on December 23, 2004, OOO RN-Trade was registered as the sole participant in Makoil,[808] and Rosneft and OOO RN-Trade were registered as participants in Baikal Finance.[809]

512. On December 31, 2004, Baikal Finance paid the remaining portion due on its winning bid[810] through funds received from Rosneft after the auction. In particular, the record is clear that: (i) Rosneft refinanced the "*debt incurred* [by

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Liability Companies" (Feb. 8, 1998) (Exhibit RME-671); and Art. 5(1) and Art. 6 of the Federal Law No.129-FZ "On State Registration of Legal Entities and Individual Entrepreneurs" (Aug. 8, 2001) (Exhibit RME-690).

805 *See* Charter of Baikal Finance, registered with the Unified Register (Dec. 6, 2004) (Exhibit RME-672). *See also* Certificate of registration of OOO Baikalfinancegroup as a legal entity (Dec. 6, 2004) (Annex (Merits) C-286).

806 *See* Minutes No. 2 of the extraordinary meeting of participants in Makoil (Dec. 8, 2004) filed with the Unified Register (Dec. 9, 2004) (RM-673); Charter of Baikal Finance (amended version), registered with the Unified Register (Dec. 9, 2004) (Exhibit RME-674).

807 *See* Amendments to the Charter of Makoil, filed with the Tver branch of the Ministry of Taxes (Dec. 6, 2004) (Exhibit RME-675); and Extract from the Unified Register for Makoil (Nov. 8, 2010) (Exhibit RME-676).

808 *See* Extract from the Unified Register for Makoil (Nov. 8, 2010) (Exhibit RME-676). No amendments to the corporate documents of Makoil were registered with the Unified Register (between December 8, 2004 and December 23, 2004) as evidenced by the extract.

809 *See* Extract from the Unified Register for Baikal Finance (Mar. 19, 2011) (Exhibit RME-677). No amendments to the corporate documents of Baikal Finance were registered with the Unified Register (between December 9, 2004 and December 23, 2004) as evidenced by the extract.

810 *See* Resolution of Bailiff D.A. Borisov (Dec. 31, 2004) (Annex (Merits) C-291); and Rosneft IPO Prospectus (July 14, 2006), 76 (Annex (Merits) C-380). After payment of the auction price, YNG complied with its duty to make the required amendments to its shareholder register. *See* Extract from the Shareholders' Register of YNG, No. 001 (Dec. 31, 2004) (Exhibit RM-678) (showing that the account of Baikal Finance was credited with 43 ordinary registered shares of YNG).

Baikal Finance] *to finance its deposit for the auction*"[811] and financed payment of the outstanding purchase price by Baikal Finance by means of a one-year interest-free loan granted to the latter after the auction, on December 30, 2004;[812] subsequently, Rosneft set-off this loan by purchasing the YNG shares owned by Baikal Finance in two tranches;[813] (ii) Rosneft, in turn, funded the loan to Baikal Finance through direct and indirect borrowings from Russian State-controlled banks Vnesheconombank and Sberbank, also after the YNG auction;[814] (iii) as a result of Rosneft's new indebtedness to fund its loan to Baikal Finance, Rosneft incurred breaches of a number of covenants on its own prior borrowings, thereby triggering cross-defaults and threatened acceleration of payments;[815] and (iv) the borrowings by Rosneft to fund payment of the purchase price were repaid and refinanced in 2005 with funds ultimately originating from foreign banks.[816]

b) Yukos Made Good On Its Threat Of Litigation

513. Yukos' management and its controlling shareholders then went forward with the litigation they threatened on the path to sabotaging the auction. For example, soon after the auction, staying true to its promise of a *"lifetime of litigation,"* Yukos filed the announced US$ 20 billion damages claim for alleged violations of the automatic stay against the auction participants, Rosneft (which by then had acquired control of Baikal Finance) and Deutsche Bank in the United States.[817]

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811 "*Following Rosneft's acquisition of Baikalfinancegroup, Rosneft made loans to Baikalfinancegroup to enable it to repay the principal of and interest on the debt it had incurred to finance its deposit for the auction, and to purchase and pay for the shares of Yuganskneftegaz it had won in the auction. Baikalfinancegroup purchased and paid for these shares on 31 December 2004*." Rosneft IPO Prospectus (July 14, 2006), 75-76 (Annex (Merits) C-380).

812 *See* Rosneft Quarterly Report for The First Quarter 2006, 351 (Annex (Merits) C-375) and Rosneft IPO Prospectus (July 14, 2006), 75-76 (Annex (Merits) C-380).

813 *See* Rosneft Quarterly Report for The First Quarter 2006, 353, 355 (Annex (Merits) C-375).

814 *See* Rosneft Quarterly Report for The First Quarter 2006, 349-351 (Annex (Merits) C-375).

815 *See* ¶¶ 579-580 *infra*. *See also* OJSC Rosneft, Interim Consolidated Financial Statements as of the Nine Months Ended September 30, 2005 and 2004 (Jan. 30, 2006), 21 (Exhibit RME-698).

816 *See* Rosneft IPO Prospectus (July 14, 2006), 76 (Annex (Merits) C-380) and Rosneft Quarterly Report The First Quarter 2006, 352-354 (Annex (Merits) C-375).

817 *See* Yukos Notice of Filing Complaint under Seal Pursuant to Protective Order (Jan. 27, 2005), *In re Yukos Oil Company*, Case No. 04-47742-H3-11 (Feb. 11, 2005) (Bankr. S.D. Tex.) (Exhibit

514. It was only on February 24, 2005, that the U.S. Bankruptcy Court finally dismissed the entire proceeding on jurisdictional grounds.[818] Of importance here, the court found that dismissal was "*in the best interest of the creditors and the estate*" because of, *inter alia*, the manufactured nature of Yukos' puported jurisdictional link to Texas and the fact that "*the debtor is not a United States company, but a Russian company, and its assets are massive relative to the Russian economy, and since they are primarily oil and gas in the ground, are literally a part of the Russian land.*"[819] By then, however, potential bidders had been deterred from bidding at the YNG auction. As Yukos' counsel in the bankruptcy case admitted, it had never expected to prevail anyway, but only to use its specious suit to influence public perception.[820]

515. When its U.S. maneuver failed, Yukos moved to challenge the results of the auction in Russia. Russian courts, after multiple appellate reviews, dismissed all of Yukos' challenges to the YNG auction.[821] As discussed below,

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RME-679) (noting that "[Yukos] *has filed its First Amended Complaint* […] *seeking (1) damages for violations of Sections 362 and 549 of the Bankruptcy Code against some defendants, and (2) an injunction to prohibit further violations of the automatic stay against all defendants*.").

818 *See* Memorandum Opinion, *In re Yukos Oil Company*, Case No. 04-47742-H3-11 (Feb. 24, 2005) (Bankr. S.D. Tex.) (Exhibit RME-664).

819 Memorandum Opinion (dismissing Yukos Chapter 11 Petition) of the United States Bankruptcy Court for the Southern District of Texas, *In re Yukos Oil Company*, Case No. 04-47742-H3-H11 (Feb. 24, 2005) (Exhibit RME-682). The U.S. bankruptcy court also noted: "[t]*he vast majority of the business and financial activities of Yukos continue to occur in Russia. Such activities require the continued participation of the Russian government, in its role as the regulator of production of petroleum products from Russian lands, as well as its role as the central taxing authority of the Russian Federation*." *Ibid.*, 1. The court considered it necessary to "*allow resolution in a forum in which participation of the Russian government is assured*." *Ibid.*, 33.

820 Mark Baker, Yukos's counsel in the U.S. bankruptcy proceedings, admitted publicly that Yukos had never realistically expected to win those proceedings, but brought them for publicity purposes. *See* Michael D. Goldhaber, "*Strategic Arbitration*," Global Lawyer (June 2005), 78 (Exhibit RME-683).

821 On May 25, 2005, Yukos filed a claim before the Moscow Arbitrazh Court against the Federal Property Fund, Baikal Finance, Rosneft, OOO Gazpromneft, Gazprom and the Ministry of Finance of the Russian Federation for the invalidation of the YNG auction and Baikal Finance's purchase agreement, as well as compensation for losses and damages. Yukos' claims were rejected by the following Russian court decisions: (1) Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007) (Exhibit RME-680); (2) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007-GK (May 30, 2007) (Exhibit RM-681); and (3) Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007), (Annex (Merits) C-294) (declining Yukos' cassation appeal of the above-mentioned lower court decisions recognizing the validity of the auction).

the auction had also been conducted in accordance with procedures that were consistent with international practice.[822]

516. Even though it was fair and resulted from a fair auction process, the price paid by Baikal Finance was not sufficient to satisfy Yukos' tax bills, by then amounting to approximately RUB 344.2 billion (or US$ 12.4 billion).[823] This lone fact confirms that the seizure and the sale of the YNG shares were fully "proportional" and justified.[824]

c) The Auction Purchase Price Was Fair

517. The purchase price for the auctioned shares exceeded the DKW adjusted valuations discussed above by substantial percentages, ranging from 10% to 26% as shown in the table below, and was not "*absurdly low,*" as Claimants allege.[825]

822 *See* ¶¶ 1359-1367 *infra*.

823 Auction proceeds were subject to a 24% tax. *See* Konnov Report, ¶¶ 29-30.

824 *See* Notification from the Bailiffs to the Federal Tax Service (Dec. 17, 2004) (Annex (Merits) C-211).

825 *See e.g.,* Claimants' Memorial on the Merits, ¶ 813.

TABLE 6 – DKW VALUATION

	DKW's valuation based on proven reserves:	DKW's valuation based on LUKOIL-Conoco Phillips benchmark:	DKW's valuation based on discounted cash flow @ 12.7% WACC:
Adjusted Valuations as per Table 5	US$ 7.45bn	US$ 8.20bn	US$ 8.57-10.57bn
Purchase Price of US$ 9.4bn as a percentage of the Adjusted Valuation	126%	115%	110% (using low end of the range)

518. The price of US$ 9.4 billion also exceeded contemporaneous fair market value estimates. For instance, in a report issued by the investment bank Morgan Stanley in July 2004, many months prior to the bidder-inhibiting U.S. bankruptcy proceedings,[826] Morgan Stanley had estimated that the sale of 100% of YNG's shares would fetch only US$ 8.9 billion. Adjusted for the 76.79% stake actually sold, and for the intervening tax assessments of US$ 4.6 billion,[827] that projection implied pricing of barely US$ 3.3 billion for the auctioned shares. According to a July 22, 2004 UBS Brunswick analyst report cited in Appendix X to the DKW Report, "*the sales price of Yuganskneftegaz would be US$ 7.8 billion*"[828] (before adjustment for the 76.79% stake and taxes), *i.e.*, the equivalent of US$ 6.0 billion after the adjustment. A few months later, Merrill Lynch was predicting proceeds of US$ 8.7 billion.[829]

519. In the face of such contemporaneous valuations indicating that the price paid for YNG was well within market expectations, all the more so in light of Yukos' and its controlling shareholders' efforts to depress the price paid, Claimants have put forward a new valuation prepared by its expert

826 *See* Report of Morgan Stanley relating to Yukos (July 22, 2004) (Exhibit RME-632).

827 *See* ¶¶ 472-473, *supra*.

828 DKW Report, 128 (Annex (Merits) C-274).

829 *See* Merrill Lynch Comment (Nov. 23, 2004), 3 (Exhibit RME-851).

Brent Kaczmarek six years later, which they claim shows that US$ 28 billion should have been obtained for YNG.[830] Although Mr. Kaczmarek claims to have developed that figure from the perspective of a purchaser in December 2004, he failed to carry through on that promise, resulting in a very substantial overvaluation.

520. In particular, contrary to what he states in his report, Mr. Kaczmarek used a U.S. rather than Russian inflation rate to project the growth of transportation costs for YNG, and he failed to account properly for increases in customs duties and mineral extraction taxes that he acknowledges had been announced well before December 2004 and that would apply thereafter. As shown in the expert report of Professor James Dow submitted with this Counter-Memorial, if only these three fundamental flaws are accounted for, Mr. Kaczmarek's own model would lead to a value of US$ 12.5 billion for YNG as of December 2004, before taking account of the fact that only 76.79% of the share capital was being sold, or the other value impairments a purchaser would face and at least some of which Mr. Kaczmarek acknowledged.[831] Taking account of the 76.79% would reduce the figure further by about US$ 3 billion, and YNG's outstanding tax liabilities US$ 4.6 billion further still. In context, the

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830 Claimants' Memorial on the Merits, ¶¶ 406, 990; Expert Report of Brent C. Kaczmarek, C.F.A., Septemebr 15, 2010 ("Kaczmarek Report"), ¶¶ 485.

831 *See* Expert Report of James Dow, 2011 ("Dow Report), ¶¶ 461 *et seq.* Mr. Kaczmarek acknowledges, for example, that further discounts would be made by a purchaser due to YNG's own outstanding tax liabilities. Kaczmarek Report, ¶ [497]. In addition, in the last quarter of 2004, YNG's accounts receivable -- which were largely the result of Yukos' further "bleeding" of YNG in anticipation of the auction, after the seizure of the setting of the price -- had ballooned to RUB 114.2 billion (approximately US$ 4.1 billion based on the RUB/US$ exchange rate on Dec. 31, 2004). *See* YNG's RAS Balance Sheets as at December 31, 2004, (Exhibit RME-628). Also, a further tax claim of US$ 1.2 billion against YNG in respect of the 2003 tax year had become public on December 8, 2004 -- again, after the setting of the starting price -- bringing the announced total tax liabilities of YNG to US$ 4.6 billion. *See* Catherine Belton, *Foreign Banks to Lend Gazprom US$ 13.4 Bln*, Moscow Times (Dec. 08, 2004) (Exhibit RME-631). Table 4 takes this additional tax assessment into account. In a memorandum dated November 26, 2004, Deutsche Bank had warned Gazprom that "[*w*]*hen taking a resolution to purchase Yuganskneftegaz, one should take into account* […] *potential further liabilities of Yuganskneftegaz with respect to taxes*." [emphasis added]. Deutsche Bank, Draft Memorandum on the Strategic Possibilities for Gazpromneft Development (Nov. 26, 2004) DBX 001067 (Annex (Merits) C-281). As noted, in its subsequent assessment of the value of YNG, Deutsche Bank had taken into account this additional tax assessment. *See* Deutsche Bank, Project Chekov (Dec. 2004) Slide 6 (Annex (Merits) C-284).

US$ 9.4 billion achieved was certainly reasonable and not a "knock-down" price.[832]

d) The Conduct Of The Auction Does Not Demonstrate Conspiratorial Conduct

521. The foregoing account of the factual circumstances surrounding the YNG auction is based on official records or first-hand information released by direct participants. Claimants self-servingly alter these facts by interjecting opinions of witnesses who lack first-hand knowledge[833] or speculation taken selectively from the press, in an attempt to create a semblance of evidence supporting their theory that Respondent "*organized,*" "*conducted,*" "*coordinated*" and *"financed" "the sham auction of Yuganskneftegaz*," "*while masking the State's involvement*,"[834] in furtherance of a "'*secret' plan to appraise and sell*" YNG to Rosneft.[835] According to Claimants, this "*secret plan*" was allegedly "*corroborated*"[836] by the fact that, after the auction, State-owned Rosneft purchased the winner,[837] in consideration for post-auction financing of the "*knock-down*"[838] purchase price. This is manifestly a *non sequitur*, for a number of reasons.

522. First, as just shown, the price achieved was fair and reasonable, not a "knock down"; the payment was actually made in cash by the bidder to the bailiffs,[839] and Yukos received full credit for the amount paid against its

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832 Documents prepared long after the auction in December 2004, upon which Claimants rely (*see* Claimants' Memorial on the Merits, ¶¶ 407-408) are wholly irrelevant to what might reasonably have been achieved at the auction. Those later analyses necessarily were based on later events and data and had entirely different purposes.

833 None of Claimants' witnesses, Andrei Illarionov, Bruce Misamore or Steven Theede, claim to have first-hand knowledge of the facts relating to the YNG auction.

834 Claimants' Memorial on the Merits, §§ II.F.3 and II.F.4.

835 *Ibid.*, ¶¶ 350, 395.

836 *Ibid.*, ¶ 392.

837 *Ibid.*, ¶¶ 386, 389, 391, 394, 596, 813. *See also* Illarionov Witness Statement, ¶¶ 46, 50 and Misamore Witness Statement, ¶ 7.

838 Claimants' Memorial on the Merits, § II.F.2.

839 *See* Resolution of Bailiff D.A. Borisov (Dec. 31, 2004) (Annex (Merits) C-291); and Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 5 (Annex (Merits) C-290). *See also* Claimants' Memorial on the Merits, ¶ 388.

outstanding liabilities.[840] Baikal Finance's offer of a pre-emptive bid of US$ 500 million over the starting price is not at all consistent with the auction being "rigged" or a "sham." Gazpromneft's decision not to submit a bid of its own is entirely consistent with its failure, only a few hours beforehand, to have the Texas TRO vacated in Houston. That TRO prevented Gazpromneft and its lenders from "*taking any actions with respect to the stock or shares*" of YNG, under penalty of "contempt of court."[841] The confirmation of the TRO left Gazpromneft with no choice but to abstain.

523. Second, as shown above, the Russian authorities were not required by law to conduct an auction for sale of the shares at all. Had their purpose been to convey the shares to a preferred party, they could have negotiated a direct sale.

524. Third, it is apparent from the record that Rosneft never displayed any intent or plan to acquire YNG. Rosneft made no preparations and did not receive corporate authorization to bid at the auction, did not submit a bid package to the Property Fund or the Federal Antimonopoly Service for authorization to bid, did not arrange or pay a deposit to participate in the auction, and did not in fact participate in the auction. As even the facts Claimants discuss show, Rosneft had made no preparations to finance its acquisition of Baikal Finance (or, for that matter, YNG). Rather, the finance package was put together after the auction. This is far more suggestive of Rosneft having seized an unexpected opportunity than its having fulfilled a long-planned and carefully orchestrated acquisition strategy. That Baikal Finance was

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840 This included Yukos' liability for the tax on the gain realized from the sale equal to 24%. Although Claimants mock the collection of the 24% tax (Claimants' Memorial on the Merits, ¶¶ 376), there is no question that Yukos made a sizeable profit on the sale of YNG against its carrying cost, and the Kaczmarek Report has no criticism of the collection of the tax. This is not surprising, as it is customary to assess and collect tax on profits realized from the sale of assets at auction. *See* ¶ 665 *infra*. *See also See* Konnov Report, ¶¶ 29-30.

841 Claimants' reference to a television interview of then-President Putin in February 2006 (Claimants' Memorial on the Merits, ¶ 396) reads far too much into it. Baikal Finance was structured as a special purpose vehicle, which was reasonable considering that Yukos' management and GML had promised to any bidder a "*lifetime of litigation*." President Putin's statement says no more than that. *See* Interview to the Spanish Media, February 7, 2006, President of Russia Official Website, 7 (Exhibit RME-859).

previously unknown hardly proves that it "*was a front company for Rosneft*."[842] Baikal Finance's origins and ownership were matters of public record,[843] and while Claimants cite speculation in various conflicting press reports regarding the identity of the ultimate beneficial owner of Baikal Finance at the time of the auction, none refers to Rosneft.[844] The only fact, as opposed to speculation, that Claimants recite is that Baikal Finance's representative at the auction was Mr. Igor Minibayev, but as they admit, he "*was at that time an employee of another Russian oil and gas company, Surgutneftegaz*"[845] -- not Rosneft.

525. Fourth, Gazprom, whose subsidiary Gazpromneft had qualified to participate in the auction (by obtaining the requisite antitrust clearance and paying the US$ 1.77 billion cash deposit), determined in a transparent, commercial process whether and on what terms to bid. As Claimants have acknowledged, Gazprom hired Deutsche Bank to evaluate whether to make a bid, the amount and terms of financing that might be available, and how large a

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842 Claimants' Memorial on the Merits, ¶¶ 600, 813.

843 *See* ¶ 511 *supra.*

844 All sorts of speculation appeared in press at the time, some referring to Gazprom or Surgutneftegaz, as to the owner of Baikal Finance ("[s]*ome analysts believe Baikal may have undisclosed ties to Gazprom or to OAO Surgutneftegaz, another energy giant*"; *Mystery Russian Company Wins Bid on Yukos Unit*, Wall St. J. (Europe) (Dec. 20, 2004) (Annex (Merits) C-738); *see also* Gregory L. White, *Russia Puts Yukos's Core Asset on Auction Block*, Wall St. J. (Nov. 22, 2004) (Annex (Merits) C-724)), others even pointing to Roman Abramovich or Shell ("*Alfa Bank chief strategist Chris Weafer* […] *speculated that billionaire Roman Abramovich could be behind Baikal as part of a complicated strategy to sell his oil company Sibneft and exit Russia without incurring the Kremlin's wrath.* […] *attempts to access the Internet site www.baikalfinance.com ended up on Anglo-Dutch oil giant Shell's home page. An amused Shell spokesman in Moscow said he wasn't aware of any connections between his company and the mysterious buyer of Yugansk*." *Mystery Bidder Wins Yugansk for $ 9.4 Bln*, Moscow Times (Dec. 20, 2004) (Annex (Merits) C-737)).

845 Claimants' Memorial on the Merits, ¶ 387. Mr. Minibayev also signed the minutes on the results of the auction on behalf of Baikal Finance. *See* Protocol of the results of the auction to sell shares in OAO Yuganskneftegaz (Dec. 19, 2004), 5, 7 (Annex (Merits) C-290). Prior to the auction, Surgutneftegaz had reportedly expressed an interest "*in bidding on Yugansk.*" *Surgut Drops First Hint of Interest in Yukos Assets*, Agence France Presse (Sept. 28, 2004) (Annex (Merits) C-704). At the time, it was noted that "[t]*he acquisition of Yugansk – which produces roughly 60 percent of Yukos's oil and is the Western Siberian field which gave Russia's largest oil producer its name – would catapult Surgut into a global energy major*." *Ibid.* According to public disclosure by Surgutneftegaz, Mr. Zhernovkov, one of the two indirect shareholders of Baikal Finance at the time of the YNG auction, was the secretary to the board of directors of Surgutneftegaz in 2003. *See* Surgutneftegaz Quarterly Report for the Third Quarter 2003 (excerpt) (Oct. 10, 2003) (Exhibit RME-691). Surgutneftegaz's oilfields and infrastructure are near Yuganskneftegaz' assets in West Siberia.

bid might be supported.[846] Following that work, Gazprom publicly announced on November 30, 2004 that its Management Committee had reviewed a presentation from Gazpromneft and Deutsche Bank concerning a potential bid and had agreed to recommend that Gazprom's Board of Directors authorize Gazpromneft to proceed with a bid on the terms proposed "*based on the potential purchase economic efficiency*," to be financed by funds Gazprom would borrow from Deutsche Bank and then lend to Gazpromneft.[847] On December 8, Gazprom announced that its Board of Directors approved these recommendations.[848] On December 17, Gazprom announced that its Board of Directors had reviewed an updated finance and budget plan for 2005, but that the plan would need to be amended and updated if Gazpromneft's bid at the forthcoming auction for YNG shares succeeded.[849] The Deutsche Bank advisory presentation -- disclosed to Yukos and its controlling shareholders in confidence in connection with the Houston bankruptcy litigation on an "attorneys-eyes only" basis, but produced by them as an exhibit in these proceedings[850] -- demonstrates the professionalism

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846 Gazprom hired Deutsche Bank, a leading western bank, "*as advisor on Gazprom's oil business strategic development.*" Management Committee addresses Gazpromneft's involvement in Yuganskneftegaz's 76.79% stake sale tender, Gazprom Press Release (Nov. 30, 2004) (Annex (Merits) C-729). *See also* Engagement Letter between OAO Gazprom and Deutsche Bank AG London (Nov. 7, 2004), 1 (Annex (Merits) C-282). Deutsche Bank recommended the acquisition of YNG, along with other "strategic possibilities" in the oil industry. Deutsche Bank worked on its strategic advice to Gazprom from October 22, 2004 to November 26, 2004. Deutsche Bank advised Gazprom to consider buying Sibneft, Surgutneftegaz or YNG. *See* Deutsche Bank, Draft Memorandum on the Strategic Possibilities for Gazpromneft Development (Nov. 26, 2004) (Annex (Merits) C-281); and Engagement Letter between OAO Gazprom and Deutsche Bank AG London (Nov. 27, 2004), 1 (Annex (Merits) C-282).

847 *See Management Committee Addresses Gazpromneft's Involvement in Yuganskneftegaz's 76.79% Stake Sale Tender*, Gazprom Press Release (Nov. 30, 2004) (Annex (Merits) C-729). *See also Gazprom to Study Deutsche Advice to Buy Yugansk*, Reuters News (Nov. 29, 2004) (Exhibit RME-645); Julia Bushuyeva, Irina Reznik, *Buy All and Everything*, Vedomosti No. 219 (1259) (Nov. 29, 2004) (Exhibit RME-646), reporting that, "[*a*]*n official close to the President's Administration said that it was "quite logical,"* referring to Deutsche Bank's advice to Gazprom to buy YNG. "*Gazprom can now take advantage of it to convince the government in the necessity of its participation in the auction for Yuganskneftegaz*," he says confidently." *Ibid.*

848 *See Board of Directors Approves Gazpromneft's Involvement in Yuganskneftegaz's 76.79% Stake Sale Tender*, Gazprom Press Release (Dec. 8, 2004) (Exhibit RME-647). Under its engagement, Deutsche Bank provided a broad range of services to Gazprom, "*including syndicated loan finance*." *See* Engagement Letter between OAO Gazprom and Deutsche Bank AG London (Nov. 27, 2004), 1 (Annex (Merits) C-282).

849 Board of Directors Reviews Gazprom's 2004 Preliminary Operating Results and Approves 2004 Financial Highlights, Gazprom Press Release (Dec. 17, 2004) (Exhibit RME-860).

850 *See* Deutsche Bank, Project Chekov (Dec. 2004) (Annex (Merits) C-284).

with which both Gazprom and Deutsche Bank approached the prospect of a Gazpromneft bid and Deustche Bank financing, had Yukos and its controlling shareholders not enjoined them from doing so.[851] Baikal Finance's preemptive bid undermines any allegation that Baikal Finance and Gazpromneft were acting in concert.

526. Fifth, Rosneft's acquisition of Baikal Finance after the auction derailed the announced governmental plan for Rosneft to be merged into Gazprom. As is well known, the Russian Federation was interested in bringing its ownership of Gazprom, which then stood below 40%, to just over 50% so as to obtain a controlling interest,[852] and to liberalize the market for Gazprom shares.[853] The plan was to exchange the Government's 100% ownership of Rosneft shares for Gazprom treasury shares so as to give the government majority ownership of Gazprom.[854] Following this exchange, Rosneft's "*oil assets* [would] *be handed over to Gazpromneft*," a newly-created subsidiary of Gazprom.[855] To this end, the President and the Government of the Russian Federation ordered that Rosneft shares should be contributed to the share capital of OAO Rosneftegaz,[856] a holding company "*created by the Government in order to facilitate*

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851 *Ibid.*

852 *See* Management Committee addresses Gazpromneft's involvement in Yuganskneftegaz's 76.79% stake sale tender, Gazprom Press Release (Nov. 30, 2004) (Annex (Merits) C 729).

853 Beginning in May 1997, foreign ownership of Gazprom shares was restricted to a certain percent. *See* Decree of the President of the Russian Federation No. 529 of May 28, 1997 on the Procedure of Circulation of the Shares of the Russian Joint-Stock Company "Gazprom" During the Period of their Securing in the Federal Property (Exhibit RME-852). This restriction was abolished in December 2005. *See* Decree of the President of the Russian Federation No. 1519 of December 23, 2005 on the Invalidation of Certain Decrees of the President of the Russian Federation (Exhibit RME-853).

854 *See* Summary of the Working Group Meeting on Consolidation of the Assets of OJSC Gazprom and OJSC Rosneft, Gazprom Press Release (Sept. 14, 2004) (Exhibit RME-854); and Management Committee addresses Gazpromneft's involvement in Yuganskneftegaz's 76.79% stake sale tender, Gazprom Press Release (Nov. 30, 2004) (Annex (Merits) C 729).

855 *See* Management Committee addresses Gazpromneft's involvement in Yuganskneftegaz's 76.79% stake sale tender, Gazprom Press Release (Nov. 30, 2004) Gazprom Website (Annex (Merits) C 729).

856 *See* Decree of the President of the Russian Federation "On Amendments to the List of Strategic Enterprises and Strategic Joint Stock Companies Approved by the Decree of the President of the Russian Federation Dated August 4, 2004 No. 1009" dated December 7, 2004 No. 1502 (Exhibit RME-855); and Order of the Government of the Russian Federation dated December 12, 2004 No. 1590-r (Exhibit RME-856).

the transaction[,]" which, in turn, would exchange them for Gazprom shares.[857] The parties appointed financial advisors to develop valuations of Gazprom and Rosneft to determine the ratio for exchanging Rosneft shares for Gazprom shares.[858] Closing was expected by the end of 2004.[859] In the meantime, foreign ownership of Gazprom shares remained restricted, which was a matter of market concern, putting pressure on the government and the companies to close the deal.[860] When Rosneft acquired Baikal Finance and through it YNG, the exchange ratio was thrown completely out of balance,[861] such that the government would need to take a much larger share of Gazprom in exchange for the 100% stake in the then much larger Rosneft. As a result, the merger failed, and Rosneft remained wholly independent of Gazprom. The plan for the Russian Federation to gain 50% plus one share ownership of Gazprom also failed, and was only accomplished when a new plan was developed and executed months later.[862]

527. In sum, Claimants have failed to establish that Respondent had a "*secret plan*" to use Baikal Finance "*as a conduit for the eventual transfer of Yuganskneftegaz*" to Rosneft. What the record shows, instead, is the transparent plan of Respondent, which the Russian authorities fairly executed, to sell the YNG shares in a manner that would maximize proceeds through a competitive process. Both the starting price and the purchase price achieved were consistent

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857 *See* Draft Gazprom Presentation to Standard & Poor's and Fitch Ratings, Dec. 2004, Slide 18 (Annex (Merits) C 285).

858 *See* Gazprom Has Determined the Advisers for the Deal on the Merge of the Assets of the NK Rosneft Petroleum Company, Gazprom Press Release (Oct. 7, 2004) (Exhibit RME-857); and Draft Gazprom Presentation to Standard & Poor's and Fitch Ratings, Dec. 2004, Slide 18 (Annex (Merits) C 285).

859 *See* Draft Gazprom Presentation to Standard & Poor's and Fitch Ratings, Dec. 2004, Slide 18 (Annex (Merits) C 285).

860 *See Merger Will Be Drawn Out Of Scheme*, Vedomosti, No. 238 (1278), Dec. 27, 2004 (Exhibit RME-692).

861 *See*, *Ibid.*

862 Finally, on July 1, 2005, OAO Rosneftegaz purchased 10.74% of Gazprom shares, and in December 2005, foreign ownership restrictions were abolished. *See* Gazprom's Subsidiaries Complete Transfer of Ownership of Gazprom's 10.74% Stake to Rosneftegaz, Gazprom Press Release, July 1, 2005 (Exhibit RME-858); and *See* Decree of the President of the Russian Federation No. 1519 of December 23, 2005 on the Invalidation of Certain Decrees of the President of the Russian Federation (Exhibit RME-853).

with DKW's valuation, which Yukos itself never challenged, and exceeded other contemporaneous estimates. Claimants have not produced any evidence suggesting that Respondent prevented any bidder from participating in the auction or placing a bid. Thus, as discussed above, if the YNG auction did not achieve the highest result theoretically possible, that was not the result of a conspiracy orchestrated by Respondent, but rather the inevitable consequence of the self-destructive campaign of Yukos' management and controlling shareholders to intimidate and prevent all announced and any other likely bidders and sources of financing from participating in the competitive auction that Yukos at first requested, and then did all it could to thwart.[863]

K. Yukos Management's Stripping of Assets Into Dutch Stichting Structures to Frustrate The Collection of Yukos' Tax Liabilities

528. In 2005—after attempting to sabotage the YNG auction by threatening "*a lifetime of litigation*" to "[w]*hoever buys* [YNG]," [864] and instituting patently abusive bankruptcy proceedings in the U.S. to thwart an open and competitive auction—the Yukos management that Claimants installed to manage their investment implemented two "corporate restructurings" for the avowed purpose of frustrating the Russian authorities' enforcement of the tax assessments. Specifically, they took Yukos' non-Russian assets, which had previously been held through Yukos' wholly-owned Dutch and Armenian subsidiaries Yukos Finance B.V. and Yukos CIS Investment Limited, respectively, and placed them behind the veil of two *stichting administratiekantoor*[865] controlled

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863 Increasing the number of bidders (and by extension the demand) in an auction tends to increase revenues. Likewise, decreasing the number of bidders has the opposite effect. In fact, an additional bidder is worth more to a seller in an auction than the ability to set a reserve price. *See, e.g.,* Paul Klemperer, *Auctions: Theory and Practice,* Princeton University Press (2004), 27 (Exhibit RME-627). ("[a]*n additional bidder is worth more to the seller in an ascending auction than the ability to set a reserve price* [...] [a] *simple ascending auction with no reserve price and N + 1 symmetric bidders is more profitable than any auction that can realistically be run with N of these bidders*") (Exhibit RME-627).

864 *See* ¶ 492 *supra*.

865 A *stichting* is a Dutch "foundation." Pursuant to Article 2:285 of the Dutch Civil Code (Burgerlijk Wetboek), a *stichting* does not have members, shareholders, or other holders of comparable interests (Exhibit RME-709). *See* C. Asser, '*Handleiding tot de beoefening van het Nederlands Burgerlijk Recht*,' Deel II: Vertegenwoordiging en rechtspersoon – De rechtspersoon, achtste druk, W.E.J. Tjeenk Willink, Deventer: 1997, ¶475. (Exhibit RME-723). All management powers are vested in a board of directors, which has complete control and discretion over all matters related to the *stichting*, subject

by Yukos' former senior management. The effect of this scheme was to impoverish Yukos, frustrate the ability of its non-tax and tax creditors to enforce Yukos' obligations to pay its debts, and thereby open the door to the involuntary bankruptcy of Yukos in Russia.[866]

529. The first of these "restructurings," occurring in April 2005, entailed:

(i) the transfer of all of the assets owned by Yukos Finance B.V. ("Yukos Finance") to Yukos International U.K. B.V. ("Yukos International"), a wholly-owned Dutch subsidiary of Yukos Finance, which was in turn wholly owned by Yukos; and

(ii) the subsequent transfer of Yukos Finance's entire shareholding in Yukos International to Stichting Administratiekantoor Yukos International ("Stichting 1") in exchange for depository receipts with respect to those shares.[867]

530. The second restructuring, which took place in September 2005, entailed:

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only to the restrictions set forth in the *stichting*'s articles of association and Dutch law. C. Asser, '*Handleiding tot de beoefening van het Nederlands Burgerlijk Recht*,' Deel II: Vertegenwoordiging en rechtspersoon – De rechtspersoon, achtste druk, W.E.J. Tjeenk Willink, Deventer: 1997, Chapters VIII.3 and VIII.4. (Exhibit RME-724). A *stichting* can act as an *administratiekantoor* or "foundation trust," in which case it issues depository receipts for shares in exchange for shares (or other assets) that are transferred to it. Like in a trust, this structure allows for the separation between legal ownership and beneficial ownership: the *stichting administratiekantoor* is the legal owner of the shares transferred to it and the shares are part of the assets of the *stichting administratiekantoor*, whereas the holders of the depository receipts for shares are the sole beneficial owners of those shares. *See* C. Asser, '*Handleiding tot de beoefening van het Nederlands Burgerlijk Recht*,' Deel II: Rechtspersonenrecht – De naamloze en besloten vennootschap, derde druk, Kluwer, Deventer: 2009, Chapter 10.2; P. Van Schilfgaarde, '*Van de BV en de NV*,' Kluwer, Deventer: 2009, Chapter 7.65. (Exhibit RME-725). In such a structure, the holder of the depository receipts for shares has a right to receive any dividends paid to the *stichting administratiekantoor* with respect to the shares that had been transferred to it.

866 *See* ¶¶ 546-559, *infra*.

867 Pursuant to Article 2 of the Articles of Association of Stichting 1, "[t]*he objects of the Foundation are to acquire and administer shares, on the grounds of the issue of depositary receipts, in Yukos International UK B.V., a private limited liability company, having its registered office in Amsterdam, the Netherlands* [...]*, to exercise the voting right and other rights attached to the shares, to collect the dividends and other payments made in respect of the shares, and to pay those benefits to the holders of depositary receipts*." In re Petition of Eduard K. Rebgun, Case No. 06-B-10775, Declaration of Gerhard H. Gispen (Dkt. No. 32) (Bankr. S.D.N.Y. Apr. 21, 2006), ¶ 17 ("Gispen Declaration") (Exhibit RME-717).

(i) the transfer of all of the shares owned by Yukos CIS Investments ("Yukos CIS") in Yukos Hydrocarbons Investments Limited ("YHIL") to Wincanton Holding B.V. ("Wincanton"), a Dutch company;

(ii) the subsequent transfer of all of Wincanton's shares in YHIL to Small World Telecommunication Holding B.V.[868] ("Small World"), another Dutch company wholly-owned by Wincanton; and

(iii) the final transfer of Small World's entire shareholding in Wincanton to Stichting Administratiekantoor Small World Telecommunication Holdings B.V.[869] ("Stichting 2") in exchange for depositary receipts with respect to those shares.[870]

531. Thus, upon completion of these "restructurings," all of the assets previously owned by Yukos through Yukos Finance were transferred to Stichting 1, and all of the assets previously owned by Yukos through YHIL were transferred to Stichting 2, leaving Yukos Finance, Yukos CIS, and YHIL as empty shells.

532. The creation of Stichting 1 and Stichting 2 (collectively, the "Stichtings") was approved in 2005 by the Yukos management appointed by Claimants.[871] They remain in place today, holding substantial value that was stripped from Yukos to enrich the Oligarchs at the expense of Yukos' creditors, including the Russian Government. The power to administer the Stichtings and

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868 Small World later changed its name to Financial Performance Holdings B.V. *See* Article 2.1 of the Articles of Association of Stichting 2 (June 20, 2006) (Exhibit RME-712).

869 Stichting Administratiekantoor Small World Telecommunication Holdings later changed its name to Stichting Administratiekantoor Financial Performance Holdings. *See* Articles of Association of Stichting 2 (June 20, 2006), 1 (Exhibit RME-712).

870 Pursuant to the Articles of Association of Stichting 2, "[t]*he foundation's objects are to acquire title to shares in Small World Telecommunication Holding B.V. (after amendment Financial Performance Holdings B.V.), a private limited liability company organized and existing under the laws of the Netherlands* [...] *for the purpose of holding and administering those shares, in consideration for which the foundation shall issue depository receipts, to exercise the voting and other rights attaching to those shares, collect the dividends and other distributions paid on the shares and pass those onto the depository receipt holders*." Article 2.1 of the Articles of Association of Stichting 2 (June 20, 2006) (Exhibit RME-712).

871 *See*, *e.g.*, Minutes of the Meeting of the Board of Directors of OAO NK YUKOS (May 19, 2005), 6, Item 1.8 (Exhibit RME-713). *See also* Yukos' Annual General Meeting (June 24, 2004), Item 4 (Exhibit RME-714]).

dispose of their assets is vested solely with their boards,[872] whose members include: (i) Yukos' former senior managers Messrs. David Godfrey, Bruce Misamore, and Steven Theede; (ii) GML's director and a representative of Claimants' in these proceedings, Timothy Osborne;[873] (iii) and Professor Michel De Guillenchmidt, "*who has longtime ties to Yukos*."[874]

533. The explicit purpose of the Stichtings is to:

> "[U]tilize the rights attaching to the shares in a manner which shall best safeguard the interest of the Company and any other subsidiaries of Yukos Oil Company (the 'Parent'), which are together the group of companies to which the Company pertains (the 'Group'), the Group's directors, officers and employees, the Group's legitimate creditors (*i.e.*, those with uncontested claims) and all other recognized shareholders of the Group."[875]

534. At the same time, placing the Stichtings' true purpose in the clearest and unmistakable terms, each of the Stichtings' Articles of Association provides that the Stichtings shall not use:

> "any right attaching to the shares in furtherance of or as a result of any illegitimate claim, judgment or transaction including but not limited to those resulting from or connected with the tax assessments made against Yukos Oil Company and members of the Group in the Russian Federation on or after the fourteenth day of April two thousand four […]."[876]

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872 *See* note 865 supra; *see* also, *e.g.*, Articles 4.1, 5.1, and 9 of the Articles of Association of Stichting 2 ("*The board shall be charged with administering the foundation*," "*shall represent the foundation*," and "*shall have the authority to dissolve the foundation*") (Exhibit RME-712).

873 *See, e.g.*, Transcript of the Hearing on Jurisdiction and Admissibility (Nov. 17, 2008), 44: "*Mr. Tim Osborne* [...] *on behalf of Hulley Enterprises Limited and Yukos Universal Limited*."

874 *See*, *e.g.*, Minutes of the Yukos Board of Directors Executive Committee (Oct. 26, 2005), 2, Item 4 (Exhibit RME-716). The Boards of the Stichtings may appoint or remove their members (*see*, *e.g.*, Article 3.2 of the Articles of Association of Stichting 2, according to which "[t]*he members of the foundation's board shall be appointed and dismissed by the foundation's board*") (Exhibit RME-712).

875 Article 2.2 of the Articles of Association of Stichting 2 [emphasis added] (Exhibit RME-712).

876 *Ibid.*, Article 2.3. *See also In re Petition of Eduard K. Rebgun,* Case No. 06-B-10775, Declaration of Gerhard Gispen (Dkt. No. 32) (Bankr. S.D.N.Y. Apr. 21, 2006) ("Gispen Declaration") (Exhibit RME-717).

535. In short, upon the creation of the Stichtings, Yukos was effectively deprived of valuable assets which it could have used to pay or mitigate[877] a large portion of its overdue taxes.

536. Based on the documents available to Respondent, the value of the assets shielded through the Stichtings could have been up to US$ 8 billion,[878] which would have been more than enough to allow Yukos to discharge in full its overdue taxes and default interest for 2001-2003.[879]

537. Moreover, the creation of the Stichtings and the transfer of Yukos' assets to them constitutes a blatant violation of Russian bankruptcy and criminal

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877 *See* ¶¶ 369-372, 375, 388, 1087-1090.

878 Specifically, there is evidence suggesting that the value of the assets shielded through Stichting 1 exceeded US$ 1.6 billion. These assets included: (i) a 53.7% interest in AB Mazeikiu Nafta, a Lithuanian refinery which Yukos acquired in 2002. Yukos valued its stake in AB Mazeikiu Nafta at around US$ 1.45 billion, and ultimately sold it in 2006 for US$ 1.5 billion (*see* Yukos Oil Company 2002 Annual Report, 75-76 (Annex (Merits) C-26); Outline of Proposed Financial Rehabilitation Plan and Debt Repayment Schedule and/or Offer of Voluntary Arrangement to Creditors (June, 1 2006) ("Proposed Financial Rehabilitation Plan") (Annex (Merits) C-312); Response to Motion of Petitioner to Compel Compliance with Bankruptcy Court Order, Dec. 27 2006, *in re Petition of Eduard K. Rebgun, as Interim Receiver of YUKOS OIL COMPANY, Debtor in Foreign Proceeding*, U.S. Bankruptcy Court Southern District of New York, Case No. 06-B-10775-RDD, ¶¶ 1, 7 (Exhibit RME-718); and (ii) a 49% interest in Transpetrol a.s., a Slovakian oil pipeline operator, which Yukos acquired in 2002. Yukos valued its stake in Transpetrol at $100 million. The stake was ultimately sold in 2009 for $240 million (Yukos Oil Company 2002 Annual Report, 77 (Annex (Merits) C-26); Proposed Financial Rehabilitation Plan, 5 (Annex (Merits) C-312); "*Slovakia buys back oil pipeline firm Transpetrol,*" Reuters, (Mar. 26 2009) (Exhibit RME-719).

The value of the assets shielded through Stichting 2 was even larger, insofar as these assets included those previously owned by YHIL. As discussed in greater detail at ¶¶ 276-277 and note 332 (*see also* Exhibit RME-351) *supra* , those assets included the Cypriot / British Virgin Islands structure through which Yukos exfiltrated from the trading shells proceeds of its "tax optimization" scheme of approximately US$ 6.8 billion. That structure was owned by YHIL, the entity that Yukos' management caused Yukos CIS to shield through Stichting 2 (*see* ¶ 530 *supra*).

879 These taxes amounted to RUB 188.9 billion or US$ 6.6 billion (*see* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 30-3-15/3 (Sept. 2, 2004), 156-159 (Annex (Merits) C-155); Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 165-167 (Annex (Merits) C-175); and Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 143-146 (Annex (Merits) C-190)). As discussed at ¶¶ 1087-1090 *infra*, if Yukos had mitigated its tax liabilities by filing amended returns after receiving the December 29, 2003 tax audit report pursuant to Article 81 of the Tax Code, it would have avoided all the fines as well as VAT for those years. Specifically, Yukos would have avoided, *inter alia*, the VAT assessment for 2001-2003 (totaling RUB 118 billion or approximately US$ 4.2 billion) and the 2001-2003 fines (totaling RUB 182 billion or approximately US$ 6.4 billion).

law, including pursuant to Article 195 of the Russian Criminal Code, which during the relevant period criminalized the:

> "[c]oncealment of property or property liabilities, information about property, its size, location or other information about the property, transfer of property into ownership of other persons, alienation or destruction of the property, as well as concealment, destruction, fabrication of accounting documents and other records reflecting business activities, if such actions are performed by the manager or owner of the debtor entity or by an individual entrepreneur at bankruptcy or in anticipation of bankruptcy and have caused large-scale damages."[880]

538. The 2005 "restructurings" resulted in the "transfer" or the "alienation" to the Stichtings of assets previously owned by Yukos. These "restructurings" were implemented "*in anticipation of bankruptcy*,"[881] and Yukos' management was well aware of the "*large scale damages*" that the "restructurings" would have caused to the Tax Ministry.[882]

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880 (Exhibit RME-720) [emphasis added]. As explained by a distinguished Russian criminal law scholar, Article 195 of the Russian Criminal Code is intended to protect the "*interests of creditors to have their claims satisfied at the expense of the debtor's property*." I.A. Klepitsky, System of Economic Crimes (2005) (Exhibit RME-721). The avowed purpose of the Stichtings was to prevent the Russian authorities from satisfying their tax claims against Yukos, and granting "preferential status" to certain Yukos creditors as opposed to others, depending on Yukos' wishes.

881 This refers to anticipation that the debtor may possibly or inevitably be declared bankrupt (*see* I.A. Klepitsky, System of Economic Crimes (2005) (Exhibit RME-721). Specifically, "*establishment of the intent to commit the crime provided by Article 195(1) of the Criminal Code, taking into account the mechanism of damages infliction incidental to this crime, is tantamount to the establishment of the required crime situation. Criminal intent always requires anticipation of the real possibility of the ensuing of consequences. Therefore, the establishment of the fault in committing this crime always requires figuring out whether the person had foreseen that, by concealing the property, alienating or destructing it, the person will cause damage to the creditors by failing to perform obligations to them, which is tantamount to anticipation of bankruptcy*.") As discussed in more detail at ¶¶ 440-449 *supra*, Yukos management began openly talking of bankruptcy and the financial ruin of the company, thereby acknowledging its anticipation of Yukos' bankruptcy, as early as in Spring 2004, and as discussed at ¶¶ 497-506 *infra*, filed for bankruptcy in the U.S. in December 2004.

882 The "damage" contemplated by Article 195 of the Russian Criminal Code materializes when the debtor fails to satisfy at least some of its creditors' claims as a result of the bankruptcy proceedings: "[t]*he crime shall be considered completed when a claim of the creditor(s) of any order of priority is satisfied in the amount which is less that in the amount of the claim that should have been satisfied, and the losses caused as a result of this may be estimated as large-scale damage*." I.A. Klepitsky, System of Economic Crimes (2005), 3 (Exhibit RME-721). At the relevant time, damages would have been considered "large-scale" if resulting in losses of at least RUB 250,000 (approximately, US$ 8,333); this threshold was recently increased to RUB 1.5

539. In sum, the diversion of Yukos' assets to the Stichtings was yet another example of the Oligarchs' "anything goes" attitude and obstructionist behavior, which resulted in the substantial denuding of Yukos' bankruptcy estate, and, as the Oligarchs intended, ultimately undermining the interests of Yukos' creditors, including but not limited to the Russian tax authorities.[883] It is difficult to conceive of a more compelling expression of the continued self-enriching misconduct of Yukos and the Yukos managers who Claimants appointed to conduct their investment—including current Stichting board members Messrs. Misamore and Theede (also witnesses in these proceedings)—than this further installment of their efforts to avoid paying Yukos' tax bill.

L. The Yukos Bankruptcy Was The Result Of Yukos' Illegal, Obstructionist and Self-Defeating Misconduct

540. As shown below, the bankruptcy and ultimately the liquidation of Yukos was not the aim or the result of a massive, global plot orchestrated by the Russian Government, but rather the inevitable consequence of the consistent and repeated lawless and reckless misconduct of the Oligarchs and the Yukos management they installed to conduct their -- including Claimants' -- investment. Claimants have no one but themselves and their appointed agents to blame for what they now seek to persuade the Tribunal should be blamed on the Russian Federation.

1. Yukos' Management And Controlling Shareholders Forced Yukos Into Bankruptcy

541. It was the obstructionist and predatory conduct of the Oligarchs and their appointed managers, and not a scheme perpetrated by the Russian Federation and Rosneft, that forced Yukos into bankruptcy. The Oligarchs first drove Yukos into serious financial distress, and then failed to use unencumbered

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million (approximately, US$ 50,000). *See* Note to Article 169 of the Russian Criminal Code (Exhibit RME-722). Clearly, the damages resulting from the 2005 "corporate restructurings" far exceeded any of these thresholds.

883 As discussed in greater detail at ¶ 669 below, upon completion of the Yukos bankruptcy proceedings, the unsatisfied liabilities exceeded RUB 220 billion (approximately US$ 9 billion), of which RUB 72.1 billion (approximately US$ 2.9 billion) consisted of claims by the Tax Ministry.

foreign assets to satisfy its lending bank syndicate's debt, and instead frustrated the syndicate's efforts to collect its claim against those assets.

a) The Oligarchs and Yukos' Management Caused The Insolvency Of Yukos

542. Throughout 2003 and thereafter, the Oligarchs and Yukos' management, instead of minimizing and discharging Yukos' tax debt, which they caused it to incur, persisted in the use of tax evasion schemes, burdened the company with further substantial liabilities (chiefly, long and short-term loans and accounts payable),[884] and continued to deplenish the company's operating capital through massive off-shore asset stripping and dividend distribution.[885] As a result of this disastrous strategy, in 2004, international credit rating agencies lowered Yukos' ratings nearly to default grade[886] and Yukos incurred a balance sheet deficit.[887]

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884 In 2003, Yukos' long-term loans rose from nil in the first quarter to approximately RUB 196.6 at the end of 4Q 2003 (approximately US$ 6.59 billion), based on the RUB/US$ exchange rate on Dec. 31, 2003. *See* OAO NK Yukos, RAS Balance Sheets for 1Q2003 (Mar. 31, 2003) (Exhibit RME-735) and for 4Q2003 (Dec. 31, 2003) (Exhibit RME-736). Yukos' short-term loans increased from approximately RUB 183.3 million (approximately US$ 6.2 million) in the last quarter of 2003 to approximately RUB 58.2 billion in the last quarter of 2004 (approximately US$ 2.09 billion), based on the RUB/US$ exchange rates on Dec. 31, 2003 and Dec. 31, 2004 respectively. *See* OAO NK Yukos, RAS Balance Sheets for 4Q2003 (Dec. 31, 2003) (Exhibit RME-736) and for 4Q2004 (Dec. 31, 2004) (Exhibit RME-737). In addition, non-tax accounts payable increased from approximately RUB 49.6 billion (approximately US$ 1.7 billion) as of the end of 2003 to approximately RUB 185 billion (approximately US$ 6.7 billion) as of Dec. 31, 2004, based on the RUB/US$ exchange rates on Dec. 31, 2003 and Dec. 31, 2004 respectively. *See* OAO NK Yukos, RAS Balance Sheets for 4Q2003 (Dec. 31, 2003) (Exhibit RME-736) and for 4Q2004 (Dec. 31, 2004) (Exhibit RME-737).

885 *See* ¶¶ 201-203, 266-277, 350-352 *supra*.

886 *See* Isabel Gorst, *Yukos Chairman Warns of Output Disruption*, Platts Oilgram News (July 6, 2004), 6 (Exhibit RME-739).

887 Yukos' RAS Balance Sheets as of June 30, 2004 showed total liabilities at RUB 637 billion (approximately US$ 21.9 billion) and total assets at RUB 575 billion (approximately US$ 19.8 billion), a deficit of RUB 62 billion (approximately US$ 2.1 billion), based on the RUB/US$ exchange rate on June 30, 2004. *See* OAO NK Yukos, RAS Balance Sheets for 2Q2004 (June 30, 2004) (Exhibit RME-740) and Denis Skorobogatko, *Extract Income and Losses*, Kommersant (Aug. 17, 2004) (Exhibit RME-567). RAS accounts of Yukos as of Sept. 30, 2004 showed total liabilities at RUB 757 billion (approximately US$ 25.9 billion) and total assets at RUB 590 billion (approximately US$ 20.2 billion), a deficit of RUB 167 billion (approximately US$ 5.7 billion). Based on the RUB/US$ exchange rate on Sept. 30, 2004. *See* OAO NK Yukos, RAS Balance Sheets for 3Q2004 (Sept. 30, 2004) (Exhibit RME-741) and *Net Loss of 'Yukos' for the Nine Months Was 182.7 Billion Rubles Against Net Profits of 22.7 Billion Rubles for the Same Period of the Year Prior*, Ria Novosti (Nov. 16, 2004) (Exhibit RME-742).

543. Not surprisingly, the Oligarchs blamed Yukos' self-inflicted insolvency on the Russian authorities[888] and resisted filing for bankruptcy in Russia, to the detriment of the company[889] and contrary to a statutory duty imposed by Russian law.[890] Instead, the Oligarchs caused Yukos to file a Chapter 11 petition in Texas, a jurisdictional sham whose ultimate purpose, as noted, was to obstruct tax enforcement in Russia and to shield the company's assets from creditors.[891]

544. In that petition, Yukos' Chief Financial Officer, Bruce K. Misamore, certified under oath that, as of October 31, 2004, Yukos' total indebtedness amounted to US$ 30.8 billion, a figure greatly exceeding Yukos' total assets, which Mr. Misamore then certified to be US$ 12.3 billion.[892] In the resolution enclosed with the petition, the Management Board of YUKOS-Moscow Ltd. (Yukos' management company) -- composed of Mr. Khodorkovsky's closest accomplices, including Messrs. Theede and Misamore -- formally concluded that "*Yukos Oil Company has a cash deficit in that it does not have the funds to continue to operate and, at the same time, to make payments due on obligations to its creditors*."[893]

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888 *See* ¶¶ 440-449 above.

889 During the meeting of August 19, 2004, Yukos' Board of Directors admitted that "*the Company intends to avoid declaring bankruptcy. B. Misamore stated, that in order to avoid bankruptcy, the Company would need, in the nearest time, to stop paying VAT and the mineral extraction tax*." *See* Minutes No. 120-18 of the Meeting of the Board of Directors of OAO Yukos Oil Company (Aug. 19, 2004) (Annex (Merits) C-210). A discussion of Yukos' duty to file for bankruptcy in Russia can be found at ¶ 446 *infra*.

890 *See* ¶ 446 above.

891 *See* ¶¶ 497-508 above.

892 *See* Official Form –Voluntary Petition to the U.S. Bankruptcy Court Southern District of Texas, Case No. 04-03952, signed by Bruce K. Misamore, Yukos' Chief Financial Officer (Dec. 14, 2004) (Exhibit RME-658). Mr. Misamore subsequently filed, also under oath, additional Yukos financial statements in which he estimated approximately the same shortfall. Those financials (containing data as of Sept. 30, 2004, except to the extent that reference is made to data as of Dec. 31, 2004) show Yukos' tax liabilities as of Dec. 31, 2004 as US$ 23.02 billion. *See In re Yukos Oil Company*, Case No. 04-47742, Docs. No. 143 and 143-1, Bankr. S.D. Tex. (Feb. 9, 2005) (Exhibit RME-659).

893 *See* Yukos-Moscow Limited, Resolution No. 1 of the Management Board (Dec. 10, 2004) (Exhibit RME-657). As noted in the resolution, "*Group Menatep Limited support*[ed] *this management decision*."

545. Once the Texas bankruptcy proceedings were dismissed for lack of jurisdiction in February 2005, the Oligarchs resorted to the Stichting corporate restructurings to accomplish the same goal of shielding Yukos' assets from creditors. As a result, they further impoverished Yukos' estate.[894]

546. At the end of 2005, Yukos' deficit was approximately RUB 497 billion (approximately US$ 17.3 billion).[895] Indeed, the value of Yukos' non-tax liabilities, chiefly intercompany loans and accounts payable to subsidiaries (approximately RUB 549 billion, or US$ 19 billion), significantly exceeded the value of its assets (approximately RUB 288.7 billion, or US$ 10 billion),[896] as is confirmed in a presentation prepared for Yukos' top managers around the end of 2005 or early 2006.[897] In that same presentation, following a detailed analysis of Yukos' financial situation, the author concluded:

> "It must be admitted that Yukos Oil Company OJSC shows all bankruptcy indicia envisaged by Russian law.
>
> Despite the fact that none of the creditors to whom there is an outstanding overdue obligation has not yet taken any steps to initiate bankruptcy proceedings, the management and relevant bodies must undertake relevant actions contemplated by Russian law.
>
> There is no reasonable possibility that Yukos Oil Company OJSC will have sufficient internal resources to settle accrued indebtedness."[898]

547. Nonetheless, the Oligarchs continued to cause Yukos to ignore this recommendation.

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894 *See* ¶¶ 528-539 *supra*.

895 *See* OAO NK Yukos, RAS Balance Sheets for 4Q2005 (Dec. 31, 2005) (Exhibit RME-747). Based on the RUB/US$ exchange rate on Dec. 31, 2005.

896 *See ibid.* (Exhibit RME-747). Based on the RUB/US$ exchange rate on Dec. 31, 2005.

897 *See* Analysis of Financial Condition of Yukos Oil Company OJSC Conclusions and Actions (undated), slide 9 (Exhibit RME-748), showing that as of Dec. 31, 2005 (preliminary numbers), Yukos' non-tax liabilities exceeded the company's assets.

898 *See* Analysis of Financial Condition of Yukos Oil Company OJSC Conclusions and Actions (undated), slide 36 (Exhibit RME-748). In the presentation, it was also reported that "*[b]oth 2004 and preliminary 2005 numbers show that the balance of Yukos's net assets is negative*." *Ibid.*, slide 5.

548. By then, Yukos was long in default to a syndicate of Western banks led by Société Générale S.A. ("the SocGen syndicate" or "the syndicate") on a claim for approximately US$ 472.8 million, plus interest, under a US$ 1 billion loan agreement dated September 24, 2003, between the syndicate and Yukos, guaranteed, *inter alia,* by YNG.[899] The lenders' claim was recognized by a judgment of the High Court of England and Wales dated June 17 and 24, 2005 (the "English High Court Judgment"), which in turn was declared enforceable in Russia by order of the Moscow Arbitrazh Court of December 21, 2005.[900] When Yukos continued to refuse to pay the debt (now judgment) on March 6, 2006, the SocGen syndicate filed an application with the Moscow Arbitrazh Court seeking a declaration of bankruptcy for Yukos.

549. By the end of March 2006, the company's deficit had reached approximately RUB 500 billion (approximately US$ 18 billion)[901] and Yukos had outstanding liabilities not only to the SocGen syndicate, but also to many other creditors, including the Federal Tax Service and Yukos' former subsidiary YNG. As discussed below, the outcome of Yukos' bankruptcy proceedings confirmed, moreover, that Yukos' liabilities exceeded its assets by a substantial margin.[902]

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899 *See* Sale Agreement Relating To Certain Rights and Benefits Arising Under a Credit Agreement Dated September 24, 2003 Between, Amongst Other, "Yukos Oil Company" and Société Générale S.A. *(*Dec. 13, 2005) ("Assignment Agreement") (Annex (Merits) C-300) (noting in its preamble that YNG provided a guarantee with respect to this loan). *See also* Financial and Performance Guarantee between Yuganskneftegaz and Société Générale S.A. (May 24, 2004) (Exhibit RME-581).

900 On December 21, 2005, the Moscow Arbitrazh Court formally recognized the English High Court Judgment and issued a writ of enforcement with respect to the judgment. *See* Order of the Moscow Arbitrazh Court, Case No. A40-53839/05-8-388 (Dec. 21, 2005) (Exhibit RME-749). This order was challenged by Yukos and upheld by the Federal Arbitrazh Court of the Moscow District (Mar. 2, 2006) (Annex (Merits) C-302). On September 28, 2005, the Moscow Arbitrazh Court had previously granted recognition and enforcement of the English High Court Judgment. However, this order had been overturned and sent for reconsideration to the first instance court by the Federal Arbitrazh Court of the Moscow District on December 5, 2005.

901 *See* OAO NK Yukos, RAS Balance Sheets for 1Q2006 (Mar. 31, 2006) (Exhibit RME-750). Based on the RUB/US$ exchange rate on Mar. 31, 2006.

902 *See* ¶ 669 *infra*. *See also* The Receiver's Report on His Activities and on the Results of the Bankruptcy Proceedings for the Period from August 4, 2006 to November 1, 2007 (Nov. 1, 2007), 147 (the "Receiver's Report") (Exhibit RME-751); Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Nov. 15, 2007) (the "Finalization Order"), 19 (Exhibit RME-752); and Yukos Liquidation Balance Sheets (Oct. 31, 2007) (Exhibit RME-753).

550. Yukos was therefore doomed and its ultimate fate had been sealed by the Oligarchs and Yukos' management long before the SocGen syndicate began the bankruptcy proceedings, the only purpose of which was to manage Yukos' admitted insolvency.

b) The Oligarchs Caused Yukos To Fail To Repay The Syndicate And Frustrated The Syndicate's Efforts To Collect Against Yukos' Foreign Assets

551. When the SocGen syndicate petitioned for Yukos' bankruptcy on March 6, 2006, Yukos' debt under the US$ 1 billion loan was overdue[903] and had been so for more than a year.[904] Yukos' default under the loan had been confirmed in the English High Court Judgment. The English High Court had recognized the validity and enforceability of the syndicate's claim and had ordered Yukos to repay immediately all outstanding amounts.[905] Neither Yukos nor any of the guarantors ever voluntarily satisfied this judgment.[906]

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903 Yukos itself admitted as much. In a letter to Société Générale S.A. (Oct. 25, 2004), Yukos claimed that it was unable to pay the overdue instalments because of the freezing order and suggested that Société Générale S.A. seek payment from Yukos' guarantors, including YNG. *See* Letter from Yukos to Société Générale S.A. (Oct. 25, 2004) (Exhibit RME-754).

904 According to the English High Court Judgment, "*[o]n the 31st March Yukos made its first default under the Loan Agreement, defaulting in payment of a monthly installment of interest. [. . .] Yukos' admitted default in payment under clause 19.1 by failing to pay the installments of interest on due date*." *See BNP Paribas v. Yukos Oil Company*, High Court Judgment [2005] EWHC 1321 (Ch) (June 24, 2005), ¶¶ 14, 16 (Exhibit RME-455). Acceleration of payments under the loan agreement resulted from the occurrence of events of default notified to Yukos by the SocGen syndicate on July 2, 2004. The English High Court upheld the validity of that notice as well as the ensuing acceleration of the debt, finding that "*in the circumstances where* [Yukos'] *assets had been frozen by order of a court on the 15th April, on the 29th June* [Yukos] *had suffered judgment in the sum of $ 3.3 bn for tax due in 2000 with the prospect of imminent proceedings to enforce tax claims in similar amounts for subsequent years which prospect had caused Yukos to issue a press release speaking of a resulting threat of insolvency*," a default had occurred, *i.e.*, events having a material adverse effect on Yukos' business and on its ability to perform its obligations under the loan agreement. *Ibid.*,¶ 19.

905 *Ibid.*

906 Yukos USA made a US$ 17.6 million payment in August 2005. *See In re Yukos Oil Company*, Case No. 04-47742-H3-11, Order Regarding Disbursal of Fund in the Registry of the Court, Bankr. S.D. Tex. (Aug. 9, 2005) (Exhibit RME-755). *See* Order of the Moscow Arbitrazh Court, Case No. A40-53839/05-05-8-388 (Dec. 21, 2005) (Exhibit RME-749); *see also* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-306).

552. Mr. Theede attests in his witness statement that Yukos was unable to pay its debt to the syndicate "*given that Yukos' assets had been seized*."[907] This was just another ill-conceived attempt to blame the Russian authorities for the disastrous consequences of the reckless conduct of Yukos' core controlling shareholders and management. The record clearly shows that it was not the seizures imposed by the Russian authorities that caused Yukos to default under the US$ 1 billion loan, but rather that Yukos wilfully defaulted, despite having unencumbered resources which it could have used to discharge its debt with the SocGen syndicate, had it chosen to do so.

553. Indeed, despite the freezes and seizures, Yukos and its affiliate guarantors of the loan remained current on payments to the SocGen syndicate until March 31, 2005, nearly a year after the April Injunction, when Yukos finally defaulted on an installment of interest.[908] Following Yukos' default, the company's own attorney admitted in the proceedings before the English High Court that "*Yukos has assets outside Russia free from the Russian Court's freezing order which could have been, and which could be, exploited to raise money with which to make payments under the Loan Agreement as they become due*."[909]

554. Yukos' counsel was likely referring to those assets which the Oligarchs had stripped away from the reach of the company's legitimate creditors -- including through the use of foreign trust entities, the Stichtings. Notably, it was the corporate restructuring implemented by the Oligarchs through the Dutch Stichtings -- and not the freezes and seizures imposed by

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907 "*Given that Yukos' assets had been seized, the company was unable to pay its debt under the judgment (which had caused Yukos to default in the first place).*" Theede Witness Statement ¶ 29. Mr. Theede also refers to "*an urgent letter that I addressed to the Chief Bailiff requesting the immediate release of Yukos' assets from the freezing order in an amount sufficient to satisfy the debt and thus avert the commencement of the bankruptcy proceedings*." *Ibid.* Russian Federation is not in a position to comment on this alleged proposal at this time because Claimants have failed to submit a copy of it. In the meantime, however, it is clear that Yukos could have "*avert*[ed] *the commencement of the bankruptcy proceedings*" simply by refraining from frustrating enforcement of the banks' claim against its foreign assets — which were valuable and unencumbered — or from making voluntary payments to the Oligarchs' company Moravel, as discussed *infra*.

908 *See generally* the English High Court Judgment (Exhibit RME-455).

909 Mr. Brisby's submission is quoted in the English High Court Judgment. *See ibid.*, ¶ 15 (Exhibit RME-455).

Russian authorities -- that prevented the SocGen syndicate from enforcing its claim against Yukos' "*assets outside Russia*."

555. Before commencing bankruptcy proceedings against Yukos, the SocGen syndicate had attempted to collect its claim against Yukos' assets located in the Netherlands. On April 26, 2005, the syndicate seized Yukos' shares in the Dutch subsidiary Yukos Finance B.V.[910] The syndicate, however, was too late. On April 19, 2005, a few days before the seizure, the Oligarchs -– instead of paying the syndicate -- had implemented a corporate restructuring with the stated purpose of shielding Yukos' foreign assets from the company's prospective bankruptcy creditors. As a result of this restructuring, control over the valuable assets directly or indirectly owned by Yukos Finance B.V. was secured with the Dutch Stichtings, in turn controlled by the Oligarchs.[911]

556. Thus, by the time the SocGen syndicate was able to petition the Amsterdam District Court to sell the Yukos Finance B.V. shares in satisfaction of the English High Court Judgment, the restructuring had *de facto* rendered those shares "*worthless and therefore more or less unsellable*,"[912] and therefore the syndicate's enforcement efforts "*illusory*."[913]

557. While the Oligarchs and Yukos' management deliberately chose not to use Yukos' available resources to repay the debt owed to the SocGen syndicate, they did not hesitate to use those same resources to discharge Yukos' debt vis-à-vis Moravel, a wholly-owned indirect Cypriot subsidiary of Group Menatep Limited. As discussed in greater detail at ¶ 390 above, Yukos' voluntary payments to Moravel (some even before the contractual maturity date)

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910 *See BNP Paribas S.A. et al. v. OAO Yukos Oil Company et al.*, Case No. 320964/H 05-0568 (NM), Decision of the Dist. Ct. of Amsterdam Second Three-Judge Civil Section (Sept. 29, 2005), ¶¶ 1.c, 1.d, 1.e, 1.l and 2.1 (Exhibit RME-756).

911 *See In re: Petition of Eduard K. Regbun, as Interim Receiver of Yukos Oil Company, Debtor in a Foreign Proceedings*, Case No. 06-B-10775 (RDD), Declaration of Allard A. H. J. Huizing, Bankr. S.D.N.Y. (Apr. 21, 2006), ¶ 28 (Exhibit RME-757).

912 *See BNP Paribas S.A. et al. v. OAO Yukos Oil Company et al.*, Case No. 320964/H 05-0568 (NM), Decision of the Dist. Ct. of Amsterdam Second Three-Judge Civil Section (Sept. 29, 2005), ¶ 2.3 (Exhibit RME-756).

913 *See ibid.*, ¶¶ 1.c, 1.d, 1.l, 2.1 and 2.3 (Exhibit RME-756).

made from May 28, 2004 through early 2005 (in large part despite the then-existing restrictions on Yukos' Russian assets) amounted to approximately US$ 944 million. Contemporaneous payments to the SocGen syndicate under the US$ 1 billion loan were not as generous, totalling only US$ 545 million.[914]

558. The balance of principal and interest due under the US$ 1.6 billion loan, amounting to US$ 847.8 million, was repaid in 2008 through the proceeds from the sale of the most valuable asset controlled by the Dutch Stichtings, the Lithuanian refinery Maizeikiu Nafta.[915] No other creditor of Yukos but Moravel was ultimately able to satisfy its claim against those proceeds.[916]

559. By causing Yukos not to repay the SocGen syndicate and by frustrating the syndicate's attempts to collect on its claim against assets located outside Russia, the Oligarchs precipitated the bankruptcy of Yukos in Russia.

2. Claimants Have Failed To Prove That The SocGen Syndicate Petitioned For Yukos' Bankruptcy Acting As A "Cover" For Rosneft

560. On March 9, 2006, the Moscow Arbitrazh Court granted the syndicate's petition and initiated bankruptcy proceedings with respect to Yukos (the "Bankruptcy Proceedings"), having found that the company satisfied the requisite legal indicia of bankruptcy.[917]

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914 This was equal to approximately 54% of the total amount covered by the loan.

915 *See OOO Promneftstroy v. Godfrey et al.*, Case No. 422465/KG ZA 09-569 WT/MV, Judgment of the Dist. Ct. of Amsterdam, Civil Law Sector, Preliminary Relief Judge (May 1, 2009), ¶ 3.2 (Exhibit RME-758).

916 *See OOO Promneftstroy et al. v. Yukos International UK B.V. et al.*, Case No. 388931/KG ZA 08-104 P/CN and No. 389897/KG ZA 08-174 P/CN, Judgment in Preliminary Relief Proceedings, Dist. Ct. of Amsterdam (Mar. 6, 2008), ¶ 6.1 (Exhibit RME-759).

917 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 "B" (Mar. 9, 2006) (Annex (Merits) C-304). Yukos withdrew its appeal of this order, which, therefore, became *res judicata*. More specifically, under the 2002 Russian bankruptcy law, the only requirements relevant to a creditor's right to initiate bankruptcy proceedings against a debtor were: (i) the debtor had failed to discharge its monetary debts within three months of their due date and the defaulted debts exceed RUB 100,000 (approximately US$ 3,500); (ii) the petitioner's claim had been recognized as valid by a court judgment; and (iii) the claim had been filed no earlier than 30 days from submission to the bailiffs of the court judgment for enforcement. *See* Art. 3, 6(2), 7(2), 40, 42 of the 2002 Russian Bankruptcy Law (Exhibit RME-776). If the claim underlying the bankruptcy petition met these requirements (the "insolvency test"), the

561. On March 24, 2006, YNG -- at the time a Rosneft subsidiary -- filed a petition seeking a declaration of Yukos' bankruptcy by the Moscow Arbitrazh Court. The court granted the petition on March 27, 2006, having found again that Yukos satisfied the requisite legal indicia of bankruptcy.[918] These bankruptcy proceedings were subsequently joined with those previously initiated by the SocGen syndicate.[919]

562. On March 29, 2006, the Moscow Arbitrazh Court granted the syndicate's motion seeking to substitute Rosneft for itself in the Bankruptcy Proceedings, recognizing the validity of the assignment of the syndicate's claim to Rosneft under the Assignment Agreement.[920] Although Yukos challenged that ruling, its appeal was dismissed.[921]

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arbitrazh court was required to accept the petition and if it was still outstanding as of the scheduled court hearing, initiate supervision. *See* Art. 33, 39, 40, 42, 48(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776). The bankruptcy petition filed by the SocGen syndicate with the Moscow Arbitrazh Court on March 6, 2006 met all of the above-mentioned requirements. Specifically: (i) the petitioner's claim was for approximately US$ 455,1 million in principal (approximately RUB 12.7 billion, based on the RUB/US$ exchange rate on Mar. 6, 2006), an amount vastly in excess of the RUB 100,000 threshold; the claim became due on or about March 31, 2005 and, in any event, before May 9, 2005 (as confirmed by the English High Court Judgment, ¶ 14 (Exhibit RME-455); therefore, by March 6, 2006, the debt had been overdue for nearly a year, *i.e.*, for longer than the requisite three-month grace period; (ii) the claim had been recognized as valid by the English High Court Judgment as well as by the December 21, 2005 Order of the Moscow Arbitrazh Court enforcing that judgment; and (iii) that ruling had been submitted to the bailiffs for execution on December 29, 2005, *i.e.*, more than 30 days prior to March 6, 2006. Accordingly, the Mar. 9, 2006 order of the Moscow Arbitrazh Court accepting the bankruptcy petition and initiating the Bankruptcy Proceedings was in compliance with Russian law.

[918] *See* Order of the Moscow Arbitrazh Court, Case No. A40-15780/06-88-39 B (Mar. 27, 2006) (Annex (Merits) C-305).

[919] *See* Nikolay Borisov, Irina Reznik, *Yuganskneftegaz Demands Yukos' Bankruptcy Over $1 Million Debt*, Vedomosti (Apr. 3, 2006) (Annex (Merits) C-795). Eventually, the claim upon which the YNG petition was based was admitted to the register of Yukos' creditors. *See* Claimants' Memorial on the Merits, footnote 651 and Register of Creditors' Claims of OAO Yukos Oil Company (Oct. 30, 2007), 34, claim No. 2 (principal amount) and 109, claim No. 2 (fines) (Annex (Merits) C-353).

[920] *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-307). In the same order, the court also acknowledged that Rosneft had paid the purchase price for the assignment on Mar. 14, 2006 and that the SocGen syndicate had duly notified the assignment of its claim to Yukos. *Ibid.*

[921] *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7072-06-A (Sept. 26, 2006) (Exhibit RME-760).

563. Also on March 29, 2006, the Moscow Arbitrazh Court, having found that Yukos still satisfied the requisite legal indicia of bankruptcy and the underlying claim was valid and outstanding,[922] initiated supervision over Yukos and appointed Mr. Eduard K. Rebgun -- a candidate whom Yukos had not vetoed, even though it had the ability to do so -- as interim manager of the company.[923] This ruling too was challenged by Yukos, but was ultimately upheld by the Federal Arbitrazh Court of the Moscow District.[924]

564. Claimants' contention regarding the commencement of Yukos' bankruptcy proceedings is that "[t]he Russian Federation, through State-owned company Rosneft, initiated bankruptcy proceedings against Yukos, using the cover of a consortium of Western banks," since Rosneft allegedly did not want to "appear as the instigator of Yukos' bankruptcy."[925]

565. Claimants have failed to establish that Rosneft caused the SocGen syndicate to file for Yukos' bankruptcy in order not to appear itself as the "instigator" of that bankruptcy. Claimants have also failed to establish that this filing was in violation of Russian law or inconsistent with international practice. As shown below, the motives of the SocGen syndicate in petitioning for Yukos'

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922 Pursuant to Article 48(3) of the 2002 Russian Bankruptcy Law the same "insolvency test" is applicable at this stage as for the purposes of the court's acceptance of the bankruptcy petition. *See* note 917 *supra*. *See also* 2002 Russian Bankruptcy Law, Art. 48(3) (Exhibit RME-776).

923 Under the 2002 Russian Bankruptcy Law, the bankruptcy petitioner (SocGen syndicate) was entitled to select a self-governing organization of bankruptcy managers that under Article 45 (Procedures for Approval of the Interim Manager) of this law was obliged to provide the court and the parties with a list of three candidates that most suited the proposed position. Each of the debtor and the petitioner had a right to veto one of the three candidates so proposed. In case this right was exercised by only one of them, the bankruptcy court should have appointed the interim manager that ranked higher in the self-governing organization's list. *See* Art. 45 of the 2002 Russian Bankruptcy Law (Exhibit RME-776). At the Moscow Abritrazh Court's hearing on March 28, 2006 in compliance with the above provisions of the Bankruptcy Law, Rosneft vetoed one of the candidates proposed by the self-governing organization, Cherkasov. A. A., whose name came first in the list. Yukos did not exercise its veto right and thus the court appointed Mr. Rebgun as the interim manager because "*his candidacy was more highly recommended that that of the other candidates proposed by the self-governing organization*". *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 "B" (Mar. 29, 2006) (Annex (Merits) C-306).

924 *See* Resolution of the Federal Arbitrazh Court for the Moscow District, Case No. KG-A40/7072-06-B (Oct. 20, 2006) (Exhibit RME-761).

925 Claimants' Memorial on the Merits, ¶ 414.

bankruptcy are irrelevant both as a matter of fact and of law. In any event, Claimants' conspiracy theory is contradicted by the facts**.** The syndicate's bankruptcy filing was in accordance with Russian law, as confirmed by the Russian courts, as well as with international practice.

a) The Motives Of The SocGen Syndicate In Petitioning For Yukos' Bankruptcy Are Factually And Legally Irrelevant

566. At the outset, it should be noted that, whatever motives the SocGen syndicate might have had in petitioning for Yukos' bankruptcy, those motives are irrelevant both as a matter of fact and as a matter of law.

567. As a matter of fact, the syndicate's bankruptcy petition was validly filed under Russian law, because Yukos indisputably met the requisite insolvency requirements. In any event, at the time, Yukos was insolvent in relation to other creditors, one of which (YNG) had also already filed for Yukos' bankruptcy. This was not a contingent situation, as Yukos had been insolvent for many months before the SocGen syndicate filed for bankruptcy, and sizeable liabilities were still outstanding upon completion of the Bankruptcy Proceedings.[926] Against these facts, the value of Claimants' economic equity stake in Yukos would have been nil, regardless of the identity and motives of the bankruptcy petitioner.

568. As a matter of law, in many jurisdictions, the motives of a creditor in filing a bankruptcy petition -- even if, *quod non*, they were shown to be suspect or malicious -- are irrelevant to the validity of that petition, provided only that the applicable insolvency requirements are met, as they were in the case of the SocGen syndicate's petition.[927]

569. Because of the important objectives furthered by bankruptcy laws, courts are unsympathetic to attempts by insolvent companies to avoid judicial administration by impugning the motives of persons filing bankruptcy proceedings. Thus, in the United Kingdom, courts have held that:

926 *See* ¶¶ 542-550 *supra*, 669 *infra*.

927 *See* ¶¶ 1492-1494 *infra*.

> "[i]f a petitioner has a sufficient ground for petitioning, the fact that his motive for presenting a petition, or one of his motives, may be antagonism to some person or persons cannot [. . .] render that ground less sufficient. If, on the other hand, he has no sufficient ground, his petition will be an abuse, whether he acted by malice or not."[928]

570. The principle that, if a company is insolvent, bankruptcy proceedings must ensue regardless of the motives of the party initiating the proceedings is widely accepted in other countries.[929]

b) Claimants' Conspiracy Theory Regarding The Assignment Agreement And The Commencement Of Yukos' Bankruptcy Proceedings Is Fanciful

571. Claimants' conspiracy theory is contradicted by the facts. Rosneft's own subsidiary YNG petitioned for Yukos' bankruptcy, thereby giving the lie to Claimants' allegation that it did not wish to appear as the "instigator" of Yukos' bankruptcy. The Assignment Agreement was also not the result of some orchestration by the Russian Federation, as hypothesized by Claimants, but rather a transaction furthering the business interests of both parties.

(1) Rosneft Did Not Fear To "Appear As The Instigator Of Yukos' Bankruptcy"

572. As noted, on March 24, 2006, YNG -- at the time a subsidiary of Rosneft -- filed a petition seeking a declaration of Yukos' bankruptcy by the Moscow Arbitrazh Court. This fact alone disposes of Claimants' contention that the bankruptcy filing by the SocGen syndicate had been orchestrated by the Russian Federation so as to allow Rosneft not to "*appear as the instigator of Yukos' bankruptcy*."[930]

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928 *See Bryanston Finance Ltd v. De Vries*, Court of Appeal, Civil Division, *(No 2)* [1976] Ch 63, 75E (Exhibit RME-1737), cited with approval by Slade L-J in *Coulson Sanderson & Ward Limited v. Ward*, Court of Appeal, Civil Division, [1986] BCC 99, 207, 99, 215 (Exhibit RME-1738) (according to which "*bad motives cannot render an otherwise good winding-up petition groundless.*")

929 *See* ¶¶ 1492-1494 *infra.*

930 Claimants' Memorial on the Merits, ¶ 427. *See also* Order of the Moscow Arbitrazh Court, Case No. A40-15780/06-88-39 B (Mar. 27, 2006) (Annex (Merits) C-305). Claimants misleadingly allege that "*the filing of a separate petition by Yuganskneftegaz enabled Rosneft to be*

573. In any event, it would have made no difference as to the validity and outcome of the bankruptcy proceedings if, instead of the SocGen syndicate, the actual petitioner had been Rosneft (or any other creditor which, at the time, held a claim satisfying the Russian "insolvency test," such as YNG or the Federal Tax Service)[931] because Yukos still would have been insolvent and ultimately its liabilities still would have exceeded its assets.

574. Thus, even if the SocGen syndicate or Rosneft had not taken the initiative, and even if the Russian tax authorities had continued to refrain from putting Yukos into bankruptcy, it was a foregone conclusion that, sooner or later, another creditor would have done so. Indeed, as a matter of law, Yukos' own management should have taken this step long before the SocGen syndicate did so.[932]

(2) The Assignment Of The SocGen Syndicate's Claim Was Lawful And Had A Bona Fide Business Purpose

575. Claimants do not appear to dispute the legality of Rosneft's purchase of the SocGen syndicate's claim. However, Claimants see in that transaction evidence of a sinister plot orchestrated by the Russian Federation to avoid that State-owned Rosneft "*appear as the instigator of Yukos' bankruptcy*."[933] This suggestion is fanciful, and Claimants offer no evidence whatsoever to support it.[934] To the contrary, all of the available evidence confirms that the

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represented twice in the pool of creditors." Claimants' Memorial on the Merits, ¶ 427. In fact, Rosneft and YNG were included in the "pool" of Yukos' creditors not because YNG had filed a separate bankruptcy petition, but because each had valid claims against Yukos.

931 *See* Analysis of Financial Condition of Yukos Oil Company OJSC Conclusions and Actions (undated), slides 26, 28 (Exhibit RME-748). Yukos had many other outstanding liabilities meeting the insolvency test provided for by Russian law, including non-tax claims. *See*, *e.g.*, the following claims: (1) ZAO M-Reyestr's claim in the amount of RUB 2.8 million (claim No. 17, included in Yukos' register of claims on June 14, 2006), (2) OOO Ernst & Young's claim in the amount of RUB 262,060 (claim No. 48 included in Yukos' register of claims on Sept. 14, 2006), (3) OAO Oryolnefteproduct's claim in the amount of RUB 25.7 million (claim No. 5, included in Yukos' register of claims on June 14, 2006). *See* Register of Creditors' Claims of OAO Yukos Oil Company (Oct. 30, 2007) (Annex (Merits) C-353).

932 *See* ¶¶ 440-446 *supra*.

933 Claimants' Memorial on the Merits, ¶ 414.

934 Claimants' fanciful theory relies exclusively on speculations in the press. For example, all of the allegations on this subject in Claimants' Memorial on the Merits, ¶¶ 413-416 are

Assignment Agreement, far from constituting a sinister maneuver, was a lawful, *bona fide*, transparent,[935] arm's length transaction, furthering the respective business interests of all the parties.

576. More specifically, the Assignment Agreement furthered (i) the interest of the SocGen syndicate in obtaining prompt, predictable payment of its long-overdue claim, which it had failed to collect from Yukos outside Russia and which it risked not being able to collect from YNG, in case the latter successfully challenged its guarantee of the syndicate's loan,[936] and (ii) the interest of Rosneft, as the parent company and prospective successor-in-merger of YNG,[937] in avoiding any risk that the syndicate -- in retaliation against Rosneft's refusal to have YNG honor the guarantee of the loan -- might implement its threat of enforcing the cross-default clauses in Rosneft's own borrowings with members of the syndicate, and in maintaining its ability to access Western capital markets in connection with the forthcoming public offering of its shares.

577. Rosneft's genuine and transparent reasons for wanting to purchase the syndicate's claim can be better understood in light of the following background.

578. In May 2004, YNG, then owned by Yukos, had been forced to guarantee the SocGen syndicate's US$ 1 billion loan, as well as Moravel's US$ 1.6

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supported only by press articles. The language used by Claimants is telling in this respect: "*it was reported*" (twice), "*it was believed*," "*speculation*," and "*according to press reports*."

935 The execution of the Assignment Agreement was duly disclosed by Rosneft in its financial statements. *See* Rosneft U.S. GAAP Nine-Month Financials for 2005, 29 (Exhibit RME-698) and Rosneft Consolidated 2005 Financials, 52 (Exhibit RME-762).

936 The SocGen syndicate's concern is confirmed by the language of Article 16.2 of the Assignment Agreement, which provides that Rosneft would undertake to procure "*that OAO Yuganskneftegas shall not* [. . .] *take any steps whatsoever in any jurisdiction to challenge the legality, validity of enforceability of the Guarantee issued in favor of the Selling Parties* [*i.e.*, the SocGen syndicate] *by OAO Yuganskneftegas*." *See* Sale Agreement between Yukos and Société Générale, Art. 16.2 (Annex (Merits) C-300).

937 The then-envisaged merger of YNG into Rosneft was approved by YNG's shareholders on June 2, 2006, only a few months after the execution of the Assignment Agreement, and completed on October 2, 2006 (with the dissolution of YNG and the conversion of YNG's shares into newly issued Rosneft shares). *See Notice of a Material Event*, Rosneft's Disclosure Statements (June 6-7, 2006 and June 17, 2006) (Exhibit RME-763); Extract from the Unified State Register of Legal Entities regarding Yuganskneftegaz (Nov. 5, 2009) (Exhibit RME-764); and Rosneft Oil Co., Annual Report *(*2006), 79 (Exhibit RME-765).

billion loan to Yukos, even though neither guarantee benefited YNG in any way. After Rosneft became the ultimate parent of YNG, Moravel instigated an LCIA arbitration against YNG to recover under the guarantee securing the US$ 1.6 billion loan, which was in all material respects analogous to the guarantee of the syndicate's loan.[938] In parallel, Rosneft challenged the validity of the YNG guarantee of the Moravel loan in Russian courts, seeking to relieve YNG (and Rosneft, as ultimate parent) from Moravel's pending claim under the loan for approximately US$ 662 million (plus interest).[939]

579. Starting from early 2005, the syndicate had repeatedly approached Rosneft to request payment of the outstanding amounts under the YNG guarantee of the loan.[940] Rosneft had rejected that request, considering that guarantee as also having been improperly granted and likely being concerned that a payment under that guarantee would have undermined the credibility of Rosneft's challenge of the parallel guarantee of the Moravel loan. Faced with Rosneft's refusal, "*the banks threatened Rosneft with legal actions and cross default on its own credits because it breached the terms of the credits having accumulated debts because of the acquisition of Yuganskneftegaz*."[941]

580. Thus, Rosneft was facing a serious risk that bank members of the SocGen syndicate would ultimately announce a cross-default under Rosneft's own borrowings from them, thereby causing the acceleration of payments under

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938 *See* "Moravel Investments vs. OAO Yuganskneftegaz" *Law.com - Arbitration Scorecard 2007: Top 50 Contract Disputes* (June 13, 2007), 12 (Exhibit RME-584). *See also* Financial and Performance Guarantee between Yuganskneftegaz and Société Générale (May 24, 2004) (Exhibit RME-581) and Financial and Performance Guarantee between Yuganskneftegaz and Société Générale (May 25, 2004) (Exhibit RME-582). *See also* Assignment Agreement, Preamble (Annex (Merits) C-300).

939 *See* Statement of the Internal Audit Committee about the Audit of the Rosneft Annual Financial Statements (May 3, 2007), 2,3, www.rosneft.com (Exhibit RME-766).

940 *See* Julia Bushuyeva, Tatyana Egorova, *Banks Have Approached Rosneft to Get What They Are Owed by Yukos*, Vedomosti (Jan. 28, 2005) (Exhibit RME-767); *Yuganskneftegaz is Growing More Expensive for Rosneft,* Russian Oil and Gas Report (Feb. 9, 2005) (Exhibit RME-768); *Group Menatep Ready to Discuss Yukos Debt Problem,* Eurasian Business Report (Feb. 14, 2005) (Exhibit RME-769); *Creditors of Yukos are Ready to Persecute the Company in All Courts of the World*, Russian Oil and Gas Report (June 24, 2005) (Exhibit RME-770); and *Yukos is Not Going to Declare Itself Bankrupt*, Russian Oil and Gas Report (June 27, 2005) (Exhibit RME-771).

941 *Rosneft to Pay Off Debts of Yukos*, Russian Oil and Gas Report (Aug. 12, 2005) (Exhibit RME-772).

the respective loans in the amount of at least US$ 1.6 billion.[942] An even greater danger was represented by the risk that the threatened cross-default would have fatally affected Rosneft's ability to access Western capital markets at a critical moment when Rosneft was getting ready for its own IPO. Nor was a judicial challenge of the YNG guarantee of the syndicates' loan an option that was realistically available to Rosneft, given its need to maintain good commercial standing with members of the syndicate, which included many leading Western financial institutions,[943] in view of its forthcoming IPO.

581. The Assignment Agreement represented the solution to Rosneft's dilemma.[944] In exchange for the undertaking to purchase the syndicate's claim, Rosneft obtained from members of the syndicate a waiver of the cross-default"clauses under its own borrowings.[945] Therefore, by amicably settling the banks' claim against YNG, Rosneft avoided acceleration of payments and maintained its ability to access Western capital markets in connection with its

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942 According to Rosneft's U.S. GAAP Nine-Month Financials for 2005, "[c]*ertain loan agreements contain a number of covenants, which the Company is obliged to comply with. Those covenants include the Company's obligations to maintain certain financial ratios at an agreed level. As a result of raising finance for the purchase of OJSC Yuganskneftegaz and the consolidation of assets and liabilities of OJSC Yuganskneftegaz with the Company's assets and liabilities, certain covenants were violated.* [...] *As of December 31, 2004, the long- term portion of the debt outstanding under the loan agreements, for which covenants have been violated, amounted to US$ 1,661 million*." *See* Rosneft U.S. GAAP Nine-Month Financials for 2005, 21 (Exhibit RME-698).

943 The Syndicate included several major European and American financial institutions such as Société Générale S.A., Citibank N.A., BNP Paribas S.A., Commerzbank AG, Deutsche Bank AG, and ING Bank N.V. *See* Assignment Agreement (Annex (Merits) C-300). According to the press, at that time, Rosneft was negotiating a further US$ 1 billion loan from substantially the same banks. *See* Ekaterina Derbilova, *Rosneft Will Pay for Yukos*, Vedomosti (Dec. 27, 2005) (Exhibit RME-773); *see also Rosneft President Sergei Bogdanchikov Visits China as Part of a Russian Government Delegation*, Rosneft Press Release (Mar. 22, 2006) (Exhibit RME-774).

944 The stated purpose of the Assignment Agreement was to prevent the SocGen syndicate from "*tak*[ing] *any steps to enforce any of the rights or remedies against any Obligor (including, for the avoidance of doubt, OAO Yuganskneftegas)*" without Rosneft's consent, in exchange for an undertaking by Rosneft to procure "*that* [YNG] *shall not* [. . .] *take any steps whatsoever in any jurisdiction to challenge the legality, validity or enforceability of the Guarantee issued in favor of [the SocGen syndicate] by OAO Yuganskneftegas*." *See* Assignment Agreement, Art. 16.1 and 16.2 (Annex (Merits) C-300).

945 As explained by Rosneft in its financials, "*[t]he creditors' approvals of waiver on certain other covenants were granted on condition that prior to April 30, 2006 the Company presents to the creditors reasonable evidence of settlement of* […] *the guarantee claim of Societe Generale S.A. with respect to a U.S.$ 1,000 million loan*." See Rosneft U.S. GAAP Nine-Month Financials for 2005, 21 (Exhibit RME-698).

forthcoming IPO -- its overriding objective -- while at the same time preserving its pending challenge of the YNG guarantee of the Moravel loan.

582. Of course, Rosneft had a legitimate interest in ensuring that, once it purchased the SocGen syndicate's claim, not only would that claim be enforceable in Russia, but also that it could be enforced in a way that could maximize Rosneft's prospects of recovery from a presumably insolvent debtor, *i.e.*, through bankruptcy proceedings.[946] It should therefore not be surprising that Rosneft, in exchange for prompt payment of the full amount of the assigned claim, required that the SocGen syndicate take all necessary steps to ensure that the claim, once assigned to Rosneft, had at least a chance of becoming a collectible claim in bankruptcy (namely, obtaining an *exequatur* of the English High Court Judgment by Russian courts, starting proceedings to enforce that judgment in Russia and filing a bankruptcy petition against Yukos). Rosneft itself could have taken those steps following the assignment of the claim. Its requested assistance of the SocGen syndicate avoided further delays and unnecessary risks in the collection of the overdue claim.[947]

583. Contrary to Claimants' allegation,[948] the assignment of the claim and the payment of the purchase price by Rosneft were not conditioned upon the syndicate's bankruptcy filing. Pursuant to the Assignment Agreement, the transfer of the claim to Rosneft was effective upon payment of the purchase price,

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946 Rosneft was certainly aware that the syndicate's claim was not readily collectible outside Russia, as the syndicate's attempts to enforce the claim against Yukos' Dutch assets had shown. Rosneft was also aware that Yukos assets in Russia were already seized in assistance of the enforcement of the tax authorities' claims, which enjoyed priority. *See* Art. 78(2) of the Russian Enforcement Law 1997 (Exhibit RME-775). Rosneft therefore knew that it had little chance (if any) to collect against Yukos' Russian assets with any degree of certainty, except in the context of bankruptcy proceedings.

947 *See* Assignment Agreement, Art. 3.1 (Annex (Merits) C-300). Under Russian bankruptcy law applicable at the time, both judicial confirmation and prior enforcement of the petitioner's claim were required for the admission of a creditor's bankruptcy petition. *See* Art. 3, 6(2), 7(2), 40, 42 of the 2002 Russian Bankruptcy Law (Exhibit RME-776). The SocGen syndicate had already obtained judicial confirmation of its claim against Yukos, whereas Rosneft would have been required to seek judicial confirmation of the assigned claim before applying for Yukos' bankruptcy, with the risk of exposing such filing to Yukos' dilatory tactics.

948 Claimants incorrectly assert that "*the payment of U.S.$ 455 million by Rosneft was predicated upon the initiation of Yukos' bankruptcy proceedings by the banks*." Claimants' Memorial on the Merits, ¶ 419. *See also* Theede's Witness Statement, ¶ 29.

which was "irrevocably" due on April 28, 2006, irrespective of any such filing.[949] Acceptance of the syndicate's bankruptcy petition by the Moscow Arbitrazh Court before that date simply accelerated Rosneft's existing obligation to pay.[950] This fact provides further confirmation, if any were needed, that Rosneft's overriding priority in entering into the Assignment Agreement was not to hide behind the SocGen syndicate with respect to Yukos' bankruptcy, but rather to avoid a cross-default under its own borrowings and maintain its ability to access Western capital markets in connection with its forthcoming IPO.

c) The Syndicate's Bankruptcy Filing Was In Compliance With Russian Law And International Practice

584. As confirmed by the Moscow Arbitrazh Court, the syndicate's petition satisfied the insolvency test under Russian bankruptcy law applicable at the time, which was based on the debtor's inability to discharge a debt exceeding approximately US$ 3,500 within three months of its due date.[951]

585. Nothing in Russian law in this regard concerning the initiation of bankruptcy proceedings is at odds with international practice. In a number of other jurisdictions, the so-called "illiquidity test" (*i.e.*, the debtor's inability to pay its debts as they become due) is sufficient to initiate bankruptcy proceedings.[952]

3. Once The Bankruptcy Proceedings Were In Place, The Oligarchs Continued To Shield Yukos' Foreign Assets From The Bankruptcy Creditors And Attempted To Further Pillage Yukos' Bankruptcy Estate By Filing Sham Bankruptcy Claims

586. Yukos' management remained in office under the supervision of the interim manager, whose primary tasks were to preserve the debtor's property, prepare an interim evaluation of the debtor's financial position, and

949 *See* Assignment Agreement, Art. 1.1, 2.1, 2.3.1 (Annex (Merits) C-300).

950 *See ibid.* (Annex (Merits) C-300).

951 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 9, 2006) (Annex (Merits) C-304).

952 *See* ¶ 1491 *infra*.

form the register of Yukos' creditors (the "Bankruptcy Register")[953] comprising the claims that had been timely submitted to,[954] and approved by, the Moscow Arbitrazh Court.[955] At their first meeting, registered creditors were entitled to determine, by majority vote, whether the next stage of the bankruptcy proceedings would be financial rehabilitation, external management, or liquidation.[956]

587. Claimants contend that the Moscow Arbitrazh Court "ensured that the claims belonging to creditors related to Yukos or to Yukos' shareholders would not be registered in the Register of Yukos Creditors' Claims,"[957] unlike the claims by the Federal Tax Service and YNG.[958]

588. As shown below, the multi-billion dollar claims by Yukos Capital, Moravel, and other Yukos-related entities identified by Claimants were shams and represented just another attempt by the Oligarchs to further pillage Yukos' bankruptcy estate, after having successfully stripped all of the company's foreign assets and frustrated Mr. Rebgun's efforts to recover those back to the bankruptcy estate. Further, the claims by the Federal Tax Service and YNG were well-founded legally and factually and, in turn, arose from misconduct on the part of the Oligarchs, through Claimants.

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953 The duties of the bankruptcy interim manager are set out in Article 67(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

954 Pursuant to Article 71(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), claims are timely submitted for the purposes of the first meeting of creditors with the bankruptcy court within 30 days of the date of publication of information on introduction of supervision (in the Yukos bankruptcy, Apr. 1, 2006).

955 Pursuant to Article 71(1) of 2002 Russian Bankruptcy Law, timely filed claims "*are included in the register of creditors' claims on the basis of an order of an arbitrazh court on the inclusion of such claims into the register of creditors' claims*." Pursuant to Article 71(6) of the same law, "*[i]f necessary for completion of the review of creditors' claims submitted by the established deadline, an arbitrazh court may instruct the interim manager to postpone the first creditors' meeting*." *See* Art. 71, 2002 Russian Bankruptcy Law (Exhibit RME-776).

956 *See* Art. 74, 2002 Russian Bankruptcy Law (Exhibit RME-776).

957 Claimants' Memorial on the Merits, ¶¶ 440.

958 *See ibid.*, ¶¶ 431-439.

a) The Oligarchs Successfully Implemented Their Plan To Shield Yukos' Foreign Assets From The Bankruptcy Creditors

589. When Mr. Rebgun was appointed as Yukos' interim manager on March 29, 2006, the Oligarchs and Yukos' management were actively implementing the asset stripping plan which they had devised in 2005 with the avowed purpose of "protecting" their own "interests."[959] The Oligarchs were thus in the process of monetizing, to their exclusive benefit, the foreign assets of Yukos International U.K. B.V., which they had successfully managed to shield from Yukos' creditors, including the SocGen syndicate, as discussed above. In particular, by the end of March 2006, Yukos International U.K. B.V., which was controlled by the Oligarchs through the Dutch Stichting, had already sold its investments in Davy Process Technology Limited and in Davy Process Technology (Switzerland) AG, and "*was in the process of disposing of or liquidating its remaining investments*,"[960] which included a stake in the Slovakian crude oil pipeline operator Transpetrol a.s. and a very valuable stake in the Lithuanian refinery AB Maizeikiu Nafta.[961]

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959 The decision to sell Yukos' remaining "*non-core and non-strategic assets*" was taken by the Oligarchs, through Claimants, on May 19, 2005, simultaneously with the approval of the corporate restructuring through the Dutch *Stiching* and in furtherance of that restructuring, whose stated purpose was "*to protect interests of* [. . .] *Yukos* [. . .] *shareholders*," including by allowing the Oligarchs to monetize Yukos' "*non-core and non-strategic assets*" and appropriate the resulting proceeds, shielding them from the Russian tax authorities and the other creditors of Yukos. *See* Minutes No. 120-04 of OAO NK Yukos Board of Directors Meeting (May 19, 2005), Items 1.6 and 1.8 (Exhibit RME-713). In the same resolution, the Oligarchs also approved *ex post facto* "*earlier sales of non-core and non-strategic assets of the Company* [Yukos] *that were approved by the Board of Directors on February 11, 2005*." *See ibid.*, Item 1.7. Regrettably, the full extent of their machinations cannot be presented now because the remainder of the minutes is not available: Yukos' Board of Directors resolved that "*the contents of Appendices* [. . .] *are confidential and may not be disclosed to any third parties without the written approval of the Company's President because the Appendices contain commercial secrets of the Company*." *Ibid.*, Item 3.

960 *See* Annual Report of Yukos International U.K. B.V. (Dec. 31, 2006), 3 (Exhibit RME-777). *Ibid.*, 10.

961 Already in March 2006, the Oligarchs, through Claimants, were negotiating the sale of Yukos International U.K. B.V.'s interest in the Lithuanian refinery AB Maizeikiu Nafta and in Transpetrol. *See* Catherine Belton, *Banks Want Yukos Ruled Bankrupt*, Moscow Times (Mar. 13, 2006) (Exhibit RME-778); Carter Tellinghuisen and Stephen Bierman, *Final Nail: Bankruptcy Suit Sends Yukos Into Death Throws*, Nefte Compass (Mar. 16, 2006) (Exhibit RME-779); *Yukos Shareholder Challenges Theede's Appointment as President*, Prime-TASS Energy Service (Apr. 21, 2006) (Exhibit RME-780). The Oligarchs, through Yukos International U.K. B.V., entered into

590. Faced with this scenario, the newly-appointed Mr. Rebgun rushed to seek the cooperation of Russian and foreign courts to preserve Yukos' property and stop the ongoing asset dissipation on the part of the Oligarchs, as he was required to do under Russian bankruptcy law.[962] Accordingly, Mr. Rebgun obtained from the Moscow Arbitrazh Court an order imposing additional restrictions on Yukos' ability to enter into certain transactions involving the disposition of its assets or its subsidiaries' assets, without the consent of the interim manager.[963] Mr. Rebgun also obtained from the U.S. Bankruptcy Court for the Southern District of New York an order requiring that the proceeds from the imminent sale of the Lithuanian refinery owned by Yukos International U.K. B.V. be placed in a segregated bank account and distributed to Yukos' creditors upon the order of a Dutch court.[964]

591. The initiatives of Mr. Rebgun, however, failed to stop the Oligarchs from appropriating the proceeds from the sales of the assets owned by Yukos International U.K. B.V. and effectively shielded behind the Dutch Stichting. According to their plans, the Oligarchs pocketed the entire sum -- equal to at least US$ 1.8 billion.[965]

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the agreement for the sale of the Lithuanian refinery AB Mazeikiu Nafta on May 26, 2006. *See In re: Petition of Eduard K. Regbun, as Interim Receiver of Yukos Oil Company, Debtor in a Foreign Proceedings*, Case No. 06-B-10775 (RDD), Response to Motion of Petitioner to Compel Compliance with Bankruptcy Court Order [Orlen S.A.], Bankr. S.D.N. Y. (Dec. 27, 2006), 2 (Exhibit RME-718).

962 *See* Art. 67(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

963 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 B (Mar. 29, 2006) (Annex (Merits) C-308). This order was challenged by Yukos and upheld on appeal. *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7072-06-B (Oct. 20, 2006) (Exhibit RME-761).

964 *See In re: Petition of Eduard K. Regbun, as Interim receiver of Yukos Oil Company, Debtor in a Foreign Proceedings*, Case No. 06-B-10775 (RDD), Order, Bankr. S.D.N.Y. (May 26, 2006) (Annex (Merits) C-310).

965 Specifically, US$ 71 million resulted from the sale of Davy Process Technology Ltd., US$ 4.6 million resulted from the sale of Davy Process Technology (Switzerland) AG, US$ 1,492 million resulted from the sale of AB Mazeikiu Nafta and US$ 240 million resulted from the sale of Transpetrol A.S. *See* Annual Report of Yukos International U.K. B.V. (Dec. 31, 2006), 10 (Exhibit RME-777) and Beata Balagova, *Transpetrol Shares Return to Slovakia*, Slovak Spectator (Apr. 6, 2009) (Exhibit RME-781).

592. In particular, as noted, the proceeds from the sale of the Lithuanian refinery (approximately US$ 1.5 billion) were used to satisfy the claims from Claimants' affiliate Moravel (amounting to US$ 847.8 million, equal to the balance of the sums outstanding under the US$ 1.6 billion loan)[966] and from Yukos Hydrocarbons Investments Limited, in turn controlled by *Stichting* FPM (amounting to US$ 129 million).[967] The remainder of the money that had been placed in the segregated bank account has been recently released to Yukos International.[968] Not a penny has ended up with any of the bankruptcy creditors.[969] All of the funds have gone to entities controlled by, or under common control with, Claimants.

593. All attempts by the interim manager to trace Yukos' foreign assets and restore them back into the bankruptcy estate were unsuccessful due to the opacity of Yukos' corporate structure and the lack of cooperation from the company's management. Mr. Miller noted in this respect that:

> "under the structures put in place at OAO NK Yukos, OAO NK Yukos held no direct investments in these international companies, so there was no information about the companies in OAO NK Yukos' statutory accounting records. Additionally, as I understand, most of the information about the ownership structure, including the control mechanisms, and on the companies themselves, was maintained outside of Russia. As a result, this critical information may not have been available to external managers that entered OAO NK Yukos during the bankruptcy proceedings. Without this information, they may not have been

966 *See OOO Promneftstroy v. Godfrey et al.*, Case No. 422465/KG ZA 09-569 WT/MV, Judgment of the Dist. Ct. of Amsterdam, Civil Law Sector, Preliminary Relief Judge (May 1, 2009), ¶ 3.2 (Exhibit RME-758).

967 *See ibid.*, ¶ 2.11 (Exhibit RME-758).

968 *See* Gilbert Kreijger, *Update 1–Yukos Unit Wins $ 1.2 Bln Refinery Proceeds Case*, Reuters (Jan. 7, 2011) (Exhibit RME-782).

969 Proceeds from the sales of the other assets belonging to Yukos International U.K. B.V., were also never made available to Yukos' Russian creditors. *See In re: Petition of Eduard K. Regbun, as Interim Receiver of Yukos Oil Company, Debtor in a Foreign Proceedings*, Case No. 06-B-10775, Supplemental Declaration of Eduard K. Regbun, as Interim Receiver of Yukos Oil Company, Bankr. S.D.N.Y. (May 24, 2006), 13 (Exhibit RME-734).

able to exercise control or perhaps even identify these subsidiaries."[970]

594. Mr. Miller further noted that:

"a significant portion if not a majority of Yukos' liquid assets (cash, marketable securities, etc.) were held under this sort of structure [*i.e.*, a trust-like structure such as the Stichting]. This included most of the operational companies. Accordingly, many of those companies that realized the benefits (profits) from Yukos' transfer pricing policy […] were held under this structure and therefore may not have been visible to the external manager of OAO NK Yukos."[971]

595. This opacity, compounded by the withholding of relevant information, effectively enabled Yukos' managers and controlling shareholders to maintain all of Yukos' foreign resources, which were very significant, beyond the reach of Mr. Rebgun and the bankruptcy creditors.

b) The Oligarchs, Through Claimants, Attempted To Further Pillage Yukos' Bankruptcy Estate By Filing Sham Bankruptcy Claims

596. While the interim manager was not able to prevent the Oligarchs from appropriating the proceeds of asset stripping transactions to the detriment of the bankruptcy creditors, the Moscow Arbitrazh Court was able to neutralize the Oligarchs' attempts to further pillage Yukos' bankruptcy estate through sham bankruptcy claims.

597. As discussed in detail in Section VI.G.9(c) below the claims by Yukos Capital, Moravel, Glendale Group Limited ("Glendale") and other Yukos-related entities identified by Claimants at paragraphs 440-448 of their Memorial on the Merits were shams because they originated from, and in turn implemented, abusive schemes in furtherance of the Oligarchs' interests, as recognized by Russian courts upon a review of the merits of the claims, regardless of the identity of the creditor. Claimants have failed to establish

970 Protocol of the Witness Interview of Doug Miller (May 8, 2007) (Exhibit RME-17). [emphasis added].

971 *Ibid.*, Protocol of the Witness Interview of Doug Miller (Exhibit RME-17). [emphasis added].

otherwise. Claimants' charges of discrimination on the part of the Moscow Arbitrazh Court are contradicted by the facts. While the Moscow Arbitrazh Court rejected sham intercompany claims, it included in the Bankruptcy Register intercompany claims that were valid.[972]

598. In sharp contrast with the Oligarchs' attempts to have claims from Yukos Capital, Glendale, and some other Yukos-related entities admitted to the Bankruptcy Register is the position that Yukos' managers and controlling shareholders took in the "Outline of Proposed Financial Rehabilitation Plan and Debt Repayment Schedule and/or Offer of Voluntary Arrangement to Creditors" (the "Rehabilitation Plan").

599. This document included a proposal that "to reflect the true economic picture of the Company, Yukos will use its position as ultimate owner of all its subsidiaries to order that none of them file or pursue any intercompany claims against Yukos," at the time quantified as US$ 13.7 billion.[973]

600. There could not be a more explicit acknowledgment of the otherwise evident fact that neither Yukos Capital, nor Glendale, nor any of the other Yukos-related claimants, had a valid claim against Yukos or could independently exercise any discretion as to the amounts allegedly owed to them. In fact, all of these claims related to funds that always belonged either to Yukos itself or to its production subsidiaries as demonstrated in Section VI. G.9(c) above. Yukos Capital, Glendale, and the other Yukos-related claimants in the Bankruptcy Proceedings played the role of mere instrumentalities and corporate buffers in the hands of the Oligarchs and their advisors.

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972 *See* ¶¶ 1521-1543.

973 Rehabilitation Plan (June 1, 2006), 2 (Annex (Merits) C-312). The Rehabilitation Plan goes on to explain the proposed mechanics: "*US$ 13.7 billion of Intercompany Claims will not be asserted in the Russian Bankruptcy Case of Yukos. (1) Yukos will take all necessary steps to vote Yukos' shares to ensure (i) that no subsidiary of Yukos files or pursue an Intercompany Claim in the Yukos Russian Bankruptcy Case and (ii) that any such claims already filed will be withdrawn. (2) At the end of the Russian Bankruptcy Case, Yukos will merge all subsidiaries that have Intercompany Claims against Yukos into itself, thus extinguishing their Intercompany Claims against Yukos.*" [emphasis added]. *Ibid.*, 8. Following the corporate restructuring through the Stichtings in 2005, it became disputed whether a number of the intercompany creditors, such as Yukos Capital, could still be considered subsidiaries of Yukos, and therefore subject to its parent control. [emphasis added].

601. The first purpose of procuring inclusion of these claims into the Bankruptcy Register was to secure the Oligarchs' control of the vote on Yukos' liquidation or rehabilitation at the first creditors' meeting, thereby ensuring that the company and its Russian assets -- finally unencumbered[974] -- would remain in their hands. As a matter of fact, this purpose could not have been achieved even if the Moscow Arbitrazh Court had included in the Bankruptcy Register all of the timely-filed claims of Yukos-related entities. If admitted, these claims would not have altered the majority at the creditors' meeting, and thus the outcome of the vote and, more generally, of the Bankruptcy Proceedings.[975] Rather, these claims would have resulted in even greater liabilities, which would have still exceeded Yukos' assets.

602. The second purpose was to further strip the bankruptcy estate during the liquidation phase, to the detriment of legitimate creditors.[976] But because Yukos' assets were insufficient to satisfy creditor claims, adding more claims from Yukos' insiders would have only added to the deficit, and could not have led to recovery by Claimants in their capacity as Yukos' shareholders.

603. In numerous countries, claims from affiliated companies, if included in the bankruptcy register of claims, are automatically subordinated to the claims from the creditors.[977] Moreover, in numerous jurisdictions, transactions carried out in anticipation of bankruptcy may be rescinded.[978]

c) The Claims From The Federal Tax Service And YNG Included In The Bankruptcy Register Originated From The Oligarchs' Own Misconduct

604. The Moscow Arbitrazh Court included in the Bankruptcy Register claims from the Federal Tax Service and Yukos' former subsidiary YNG totalling

974 *See ibid*, 5 (Annex (Merits) C-312).

975 *See* ¶ 1524 *infra*.

976 As a matter of Russian law, equity interests the Oligarchs had in Yukos through Claimants were subordinate to claims of Yukos' creditors included in the Bankruptcy Register.

977 *See* ¶ 1499 *infra* .

978 *See* ¶ 1498 *infra.*

"*U.S.$ 17.40 billion*" and "*U.S.$ 10.69 billion*," respectively,[979] upon a substantive review of the relevant merits.

605. Those claims invariably arose from the reckless and often lawless conduct of Yukos' managers and controlling shareholders. They should bear the blame for having exposed Yukos to multi-billion (in US$) tax liabilities and having abused the company's corporate power against its subsidiary YNG, causing it multi-billion (in US$) damages. Claimants' attempt to once again shift the blame for their own misconduct on the Russian authorities is outrageous.

4. The Oligarchs, Through Claimants, Further Attempted To Secure Their Interests -- Not The Interests Of Yukos' Creditors -- By Proposing An Untenable Rehabilitation Plan, Which The Creditors Reasonably Rejected

606. Following the examination of all timely-filed claims by the Moscow Arbitrazh Court, Yukos' registered creditors attended their first meeting on July 20-25, 2006 to consider, *inter alia*, whether to accept the Rehabilitation Plan offered by Claimants or to initiate receivership proceedings, as recommended by Mr. Rebgun upon concluding that Yukos' solvency could not be restored.[980]

607. All registered creditors and the representatives of the debtor had an opportunity to review the Rehabilitation Plan and the analysis of Yukos' financial situation (along with relevant enclosures) prepared by Mr. Rebgun at his offices during the week preceding the meeting (and for five full days, from July 20, 2006 until July 25, 2006).[981]

608. At the meeting, the official representative of Claimants -- Mr. Tim Osborne, attending via video-conference along with Yukos' counsel, Messrs. Zack Clement and David Godfrey[982] -- presented the Rehabilitation Plan,[983]

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979 Claimants' Memorial on the Merits, ¶¶ 430-439.

980 *See* Protocol of the First Meeting of the Creditors of Yukos Oil Company (July 20-25, 2006) (the "Protocol of the Creditors' Meeting") (Annex (Merits) C-319).

981 *See ibid. See also* Notice of the First Creditors' Meeting of OJSC Yukos Oil Company (June 28, 2006) (Annex (Merits) C-316). *See also* ¶¶ 613-614 *infra*.

982 *See* Protocol of the Creditors' Meeting, 4 (Annex (Merits) C-319).

983 *See* Rehabilitation Plan (Annex (Merits) C-312).

which was discussed along with Mr. Rebgun's analysis of Yukos' financial situation. Yukos' management's proposal was overwhelmingly rejected by the creditors, with 93.87% voting against it.[984] The creditors were also in near-unanimity (99.56%) in rejecting a proposal that would have placed Yukos under external management.[985] The creditors instead voted in favor of filing a petition with the Moscow Arbitrazh Court to formally declare Yukos bankrupt and initiate receivership proceedings, requiring the receiver to sell Yukos' assets in discharge of Yukos' creditors' claims.[986]

609. On August 4, 2006, pursuant to the creditors' petition, the Moscow Arbitrazh Court formally declared Yukos bankrupt, authorized the initiation of receivership proceedings over Yukos, ultimately resulting in its liquidation, and appointed Mr. Rebgun as Yukos' receiver.[987]

610. Claimants contend that "*[t]he Russian Federation ensured the rejection of Yukos' proposed financial rehabilitation plan*,"[988] with the assistance of (i) Mr. Rebgun, who allegedly failed to disclose bankruptcy materials to the registered creditors and representatives of the debtor in anticipation of the meeting and presented to the creditors an analysis that "*did not contemplate any measure for the restoration of Yukos' financial situation*" and "*significantly undervalued Yukos' assets*,"[989] (ii) the registered creditors, who elected to reject the Rehabilitation Plan disregarding the "*overwhelming evidence that Yukos was*

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984 *See* Protocol of the Creditors' Meeting, 14 (Annex (Merits) C-319).

985 *See ibid.*, 15 (Annex (Merits) C-319).

986 *Ibid.*, 17. Yukos challenged the decision of the creditors' meeting in court, which the Moscow Arbitrazh Court dismissed. *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 30, 2006) (Exhibit RME-784).

987 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 4, 2006) (Annex (Merits) C-324). Yukos' appeal of this decision was denied. *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-11597/2006-GK (Sept. 26, 2006) (Exhibit RME-785) .

988 Claimants' Memorial on the Merits, § II.G.3.

989 Claimants' Memorial on the Merits, ¶¶ 453-457, 459.

solvent,"[990] and (iii) the Moscow Arbitrazh Court, which "*rushed*" to approve "*almost all of the proposals*" adopted by the creditors' meeting.[991]

611. As shown below, Claimants' contentions regarding Mr. Rebgun's actions in preparation for the meeting are completely inaccurate. Those actions fully complied with Russian law. Further, the Rehabilitation Plan was a blatant and untenable attempt on the part of the Oligarchs to secure their own interests over those of the creditors. Accordingly, the creditors' decision to reject the plan was reasonable and taken in accordance with Russian law, which vests full discretion with the creditors, consistently with international practice.

a) The Preparation Of The First Meeting Of Yukos' Creditors Was Proper

612. On June 8, 2006, the Moscow Arbitrazh Court adjourned the creditors' meeting to complete a review of "*all the submitted creditors' claims*,"[992] as required under Russian law.[993] As of that date, filed claims that were being reviewed by the court included claims not only from the Federal Tax Service -- as suggested by Claimants[994] -- but also from other creditors, including entities related to Yukos.[995]

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990 *See ibid.*, ¶¶ 458, 464.

991 *See ibid.*, ¶ 465.

992 *See* Motion by the Interim Manager Rebgun Submitted to the Moscow Arbitrazh Court to Adjourn Judicial Proceedings (June 21, 2006) (Exhibit RME-786).

993 As noted, pursuant to Article 71(6) of the Russian Bankruptcy Law, "*[i]f necessary for completion of the review of creditors' claims submitted by the established deadline, an arbitrazh court may instruct the interim manager to postpone the first creditors' meeting.*" *See* Art. 71(6) of the 2002 Russian Bankruptcy Law (Exhibit RME-776). The Moscow Arbitrazh Court did so on June 8, 2006. *See The Court Ruled to Postpone First Meeting of Yukos' Creditors,* Lenta.ru (June 8, 2006) (Exhibit RME-787).

994 *See* Claimants Memorial on the Merits, ¶¶ 432, 454.

995 These included Sibintek-Leasing, Yukos-Moscow, Research Institute of Aviation Industry Economy and Yukos Capital. *See The Court Ruled to Postpone First Meeting of Yukos' Creditors*, Lenta.ru (June 8, 2006) (Exhibit RME-787). *See also* Order of the Moscow Arbitrazh Court of July 17, 2006 (July 19, 2006) (Annex (Merits) C-332). In order for the claim to be considered by the Moscow Arbitrazh Court for the purpose of the first meeting of creditors, Yukos Capital had to submit its claim "*within 30 days after the date of publication of the announcement of the institution of supervision,*" which was April 1, 2006. *See* 2002 Russian Bankruptcy Law, Art. 71(1) (Exhibit RME-776).

613. Mr. Rebgun reconvened the meeting. In the relevant notice, Mr. Rebgun referred to the procedure for creditors to familiarize themselves with the materials to be considered at the meeting,[996] as required under Russian law and practice.[997] In particular, Mr. Rebgun informed the creditors and the debtor that they could review a copy of both the Rehabilitation Plan and his financial analysis, with their enclosures, at his office in the week preceding the creditors' meeting, for six days, and for a total of 40 hours.[998] Moreover, a copy of the Rehabilitation Plan and the financial analysis were provided to the creditors and Yukos on July 20, 2006 at registration for the meeting. Considering that the meeting was postponed from July 20 to July 25, 2006 (with no substantive

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996 *See* Art. 13(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776). The conduct of Mr. Rebgun was also in compliance with the order issued by the New York bankruptcy court, requiring Mr. Rebgun to "*attach to his report to the Creditors in the pending insolvency proceeding in Russia, the Company's outline of a proposed plan of reorganization*" and to "*take reasonable steps to facilitate the Company's appearance at the Creditors' Meeting* [. . .] *so as to permit the Company to make a presentation to Creditors regarding the Plan.*" *See In re: Petition of Eduard K. Regbun, as Interim receiver of Yukos Oil Company, Debtor in a Foreign Proceedings*, Case No. 06-B-10775 (RDD), Order, Bankr. Court S.D.N.Y. (May 26, 2006), 6 (Annex (Merits) C-310).

997 *See, e.g.*, Professor M. V. Telukina, *Concept and Procedures for Implementation of Financial Rehabilitation in Relation to Insolvent Debtor*, Yuridicheskiy Mir, No. 6, 2003 (Exhibit RME-788). While discussing the interim manager's obligation to ensure that the creditors have access to relevant materials, Professor Telukina notes as follows: "*It appears that with the aim to perform such an obligation the bankruptcy manager shall inform each of the creditors about the place (and possibly, time), where the documents related to financial rehabilitation can be available for familiarization.*" *See also* Resolution of the Federal Arbitrazh Court of the Far East District, Case No. A73-1013k/2009 (A73-11066/2008) (Nov. 16, 2009) (Exhibit RME-789).

998 "*The representatives of the participants in the Creditors' Meeting may consult the materials to be considered by the First Creditors' Meeting (including the Financial rehabilitation Plan provided by the Debtor's shareholders) from July 14 through July 19, 2006, from 10:00 a.m. to 5:00 p.m. on business days (or from 10:00 a.m. to 4 p.m. on weekends).*" *See* Notice of the First Creditors' Meeting of Yukos Oil Company (June 28, 2006) (Annex (Merits) C-316). The minutes of the creditors' meeting confirm that "*the participants had an opportunity to review [the financial rehabilitation plan] during the period from July 14 to July 19, 2006; a copy of the plan and the attached materials were issued to each participant in the meeting in the course of registration.* […] *The participants in the meeting had an opportunity to review the financial analysis materials from July 14 to July 19, 2006, and to review the Section 'Analysis of the Possibility of the Debtor's Break-Even Activity' (Exhibit No. 4), which was brought into compliance with the form established by Governmental Resolution during the adjournment, on July 24, 2006, from 10:00 a.m. to 10:00 p.m.* […] *The participants in the meeting had an opportunity to review, before the meeting, the financial analysis materials prepared by the Interim Receiver (248 pages, plus exhibits on 47 pages), including the Section 'Analysis of the Possibility of the Debtor's Break-Even Activity.'*" *See* Protocol of the Creditors' Meeting (Annex (Merits) C-319).

decisions being made on July 20), the creditors and the debtor had another five full days to examine these documents.[999]

614. Contrary to Claimants' allegations,[1000] these procedures did not inhibit Yukos' ability to challenge the analysis prepared by Mr. Rebgun, and Yukos did in fact challenge the results of this analysis.[1001]

615. Further, the purpose of the analysis of Yukos' financial situation prepared by Mr. Rebgun was to provide the creditors with a preliminary assessment of "*the possibility/impossibility of restoring the solvency (paying capacity) of the debtor*"[1002] and, based on this assessment, a "*justification of introduction of a particular bankruptcy procedure*."[1003] A proposal regarding "*measure*[s] *for the restoration of Yukos' financial situation*"[1004] was outside the scope of that analysis, being rather Yukos' purpose in presenting its Rehabilitation Plan.

616. The purpose and context of Mr. Rebgun's analysis informed the valuation criteria adopted therein. Because under Russian law the options

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999 *See* Protocol of the Creditors' Meeting (Annex (Merits) C-319). Creditors and the debtor had July 24, 2006 to familiarize with an addition to the financial analysis prepared by Mr. Rebgun at the request of the creditors at the July 20, 2006 meeting.

1000 Claimants contend that in anticipation of the meeting, Mr. Rebgun failed to circulate a copy of the Rehabilitation Plan to the registered creditors and a copy of his financial analysis to the representatives of the debtor, thereby preventing Yukos from challenging the analysis. *See* Claimants' Memorial on the Merits, ¶¶ 453, 459. Mr. Theede also complains that Mr. Rebgun's financial analysis neither mentioned nor included the Rehabilitation Plan. *See* Theede Witness Statement, ¶ 33. In fact, a copy of the Rehabilitation Plan was made available for consultation by the creditors and the debtor's representative, along with a copy of the financial analysis and the enclosures of both.

1001 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 30, 2006) (Exhibit RME-784). In its application seeking to invalidate the decision of the first meeting of creditors, Yukos attacked the evaluation of its assets made by Mr. Rebgun, once again alleging the accuracy and validity of its Rehabilitation Plan. *See* Application Seeking to Invalidate the Decision of the Meeting of Creditors (July 31, 2006) (Exhibit RME-790).

1002 *See* Analysis of the Debtor's Financial Situation, 8 (Annex (Merits) C-318). Pursuant to Article 70(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776): "*[t]he analysis of the financial situation of a debtor is conducted* [. . .] *with the purpose of determining the possibility or impossibility of restoring the (solvency) payment capacity of the debtor.*"

1003 *See* Resolution of the Government of the Russian Federation No. 367 "On Approving the Rules for Conducting Financial Analysis by Arbitrazh Manager" (June 23, 2003) (Exhibit RME-792).

1004 Claimants' Memorial on the Merits, ¶¶ 453-457, 459.

available for the vote of the creditors (in particular receivership and rehabilitation) were subject to a limited duration,[1005] Mr. Rebgun reasonably anticipated that the sales of Yukos' assets in liquidation would have taken place under accelerated circumstances. [1006] Accordingly, as Mr. Rebgun explained to the creditors, to estimate potential proceeds from the sale of Yukos' assets, he adjusted the market value estimates prepared by Yukos-appointed personnel[1007] "*taking account the fact that the liquidation value is less than the market value due to the limited period of putting the object up for sale*."[1008] In the same vein, because under Russian law any profit arising from sales proceeds is taxed at 24%,[1009] Mr. Rebgun reasonably factored into his analysis, and explained to the creditors,

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1005 Pursuant to Article 124(2) of 2002 Russian Bankruptcy Law (Exhibit RME-776), "*[r]eceivership is introduced for 1 year. The term of receivership may be extended at the request of a party to the bankruptcy proceedings for up to 6 months.*" Pursuant to Article 80(6) of the same law (Exhibit RME-776), "*[f]inancial rehabilitation is introduced for a term not exceeding 2 years.*"

1006 This was also true for Claimants' repayment schedule under the Rehabilitation Plan. The document proposed distributions to creditors of cash generated from the sales of Yukos' assets, with the first such distribution scheduled for as early September 30, 2006. *See* Rehabilitation Plan, 6 (Annex (Merits) C-312).

1007 As Mr. Rebgun explained at the creditors' meeting, "*[i]n the course of the estimate of the assets, the independent appraisers' estimates prepared upon the instructions of OAO "YUKOS Oil Company" itself were used in full as the basis of the calculations. I would like to emphasize that the appraisers were selected by OAO "YUKOS Oil Company" itself. Pursuant to the reports and appraisal agreements between OAO "YUKOS Oil Company" itself and the appraisers, the market value of the appraisal objects was estimated.*" Protocol of the Creditors' Meeting, 11 (Annex (Merits) C-319). Mr. Theede, who claims that he "*was not informed of any market appraisals that Mr. Rebgun had carried out to arrive at his strongly discounted valuation of Yukos' assets*," is therefore simply misinformed. Theede's Witness Statement, ¶ 30. Moreover, all of the valuation criteria applied by Mr. Rebgun are illustrated in detail in the analysis itself. *See* Extracts from the Analysis of Financial Condition of Yukos Oil Company (Exhibit RME-791). In any event, under Russian law, Mr. Rebgun, in his capacity as bankruptcy interim manager, was not required to carry out a "market value appraisal" of the debtor's assets. Mr. Rebgun's analysis was performed in accordance with the applicable Resolution of the Government of the Russian Federation No. 367 (June 23, 2003). *See* Resolution of the Government of the Russian Federation No. 367 "On Approving the Rules for Conducting Financial Analysis by Arbitrazh Manager" (June 23, 2003) (Exhibit RME-792) and Protocol of the Creditors' Meeting, 10 (Annex (Merits) C-319). All Mr. Rebgun was required to do pursuant to this Resolution in respect of the valuation of long-term financial investments was to opine on the "*possibility of sale of long-term financial investments on market terms.*" As noted above, Mr. Rebgun rightfully assumed that "*market terms*" here implied a distress sale, which naturally mandated liquidation discounts.

1008 Protocol of the Creditors' Meeting, 11 (Annex (Merits) C-319).

1009 Pursuant to Article 247 of the Russian Tax Code (Exhibit RME-793), "*[t]he tax base for profit tax is considered to be profit realized by a taxpayer. Profit for the purposes of this Chapter is considered to be: for Russian organizations–income received reduced by expenses made, [both] determined in accordance with this Chapter.*" *See also* Konnov Report, ¶¶ 29-30.

that any potential profits from the sale of Yukos' assets would also be taxed,[1010] as in fact they were.[1011] The same approach should have been adopted in the Rehabilitation Plan as to asset sales it contemplated. Based on the foregoing methodology, Mr. Rebgun assessed the value of Yukos' assets at RUB 581.4 billion (US$ 21.6 billion).[1012]

617. Mr. Rebgun performed his analysis in accordance with Russian law. The valuation criteria he adopted were consistent with standard Russian practice, requiring the valuation of assets to be sold in a limited timeframe.[1013] Russian law and practice are in turn consistent with the laws and practice existing in several other jurisdictions, requiring that the valuation of the debtor's assets be carried out at liquidation value (or even book value), in addition to market value.[1014]

618. Based on his analysis, Mr. Rebgun concluded that "the current activities of OAO Yukos Oil Company may be carried out without losses, but the aggregate proceeds from the sale of property and proceeds from the current activities would not cover its obligations to the creditors"[1015] and that,

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1010 "*In order to estimate the amount of possible proceeds from the sale of the participatory interests in the charter capitals of legal entities, the Interim Receiver took into account the profit tax payable thereon, i.e., 24% of the difference between the assumed sale price and the initial acquisition value of such shares by the debtor, which in all cases (except for investment into OAO Sibneft) was considered to be equal to zero.*" *See* Protocol of the Creditors' Meeting, 10 (Annex (Merits) C-319).

1011 *See* ¶¶ 666-667 below.

1012 Based on the RUB/US$ exchange rate on July 13, 2006. After the 24% tax, the value was RUB 476.9 billion (US$ 17.75 billion). *See* Analysis of the Debtor's Financial Situation, 7 (Annex (Merits) C-318). This value is significantly higher than the value of RUB 284.9 billion (approximately US$ 10.60 billion) attached to Yukos' assets in the Analysis of Financial Condition of Yukos Oil Company OJSC Conclusions and Actions (undated), slide 9 (Exhibit RME-748). Based on the average RUB/US$ exchange rate on July 2006. This renders, Mr. Theede's criticism of Mr. Rebgun's valuation of Yukos' assets all the more misplaced. *See* Theede Witness Statement, ¶ 30.

1013 *See, e.g.*, Resolution of the Federal Arbitrazh Court of the Ural District, Case No. F09-6804/06-C6 (Aug. 10, 2006) (Exhibit RME-794). *See also* Resolution of the Federal Arbitrazh Court of the West Siberian District, Case No. F04-5935/2004 (A75-3959-34) (Aug. 30 2004) (Exhibit RME-795) where the court approved the use of liquidation value for the purposes of a distress sale at an enforcement auction as complying with Russian laws on valuation: "*the market value of the real property was estimated on the basis of the assumption that it would be sold within a limited period of time, i.e., the liquidation value.*"

1014 *See* 1500 below.

1015 *See* Protocol of the Creditors' Meeting, 11 (Annex (Merits) C-319).

accordingly, it was impossible to restore Yukos' solvency within the time limits required by Russian law.[1016] The outcome of the Bankruptcy Proceedings ultimately confirmed that Mr. Rebgun was right.[1017]

619. Claimants also charge that Mr. Rebgun "*effectively prevented* [Mr. Osborne, the official representative of Yukos' shareholders] *from attending the meeting in person in Moscow by refusing to guarantee his safety*."[1018] Mr. Rebgun did not do anything to imperil Mr. Osborne's safety. If Mr. Osborne was at risk from others -- a matter of his own assertion -- it is apparent that guaranteeing anyone's safety is outside the authority and powers of a bankruptcy interim manager.[1019] Mr. Rebgun did all that was within his powers and ensured that Yukos' representatives could and did attend the meeting.[1020]

1016 *See* Analysis of the Debtor's Financial Situation, 8 (Annex (Merits) C-318).

1017 In sharp contrast with the allegations Claimants currently make, Yukos' top officials publicly recognized Mr. Rebgun's outstanding professional performance in relation to Yukos. For example, the Chairman of Yukos' Board of Directors, Mr. Victor Gerashenko, said on June 19, 2007 in his interview with Gazeta.ru: "*Eduard Konstantinovich* [Rebgun] *is an experienced specialist and a man of principle, and in this sense I believe that Yukos has been quite lucky to have him as, first, interim receiver, and subsequently, as receiver.*" *See Ask Victor Gerashenko*, Gazeta.ru (June 19, 2007) (Exhibit RME-796). Commenting on Mr. Rebgun's activities as Yukos' bankruptcy manager, Mr. Gerashenko also noted that "*[e]verything he does is done within the law*." *See ibid.* Indeed, Mr. Rebgun acted as an independent bankruptcy manager in furtherance of his powers and duties under the 2002 Russian Bankruptcy Law. His independence is exemplified by his challenge of the YNG auction on behalf of Yukos. The first instance judgment in this case was issued on February 22, 2007, *i.e.*, long after Mr. Rebgun was appointed Yukos' receiver. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007) (Exhibit RME-680). Mr. Rebgun appealed this decision to the court of appeals (*see* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007- GK (May 30, 2007) (Exhibit RME-681)) and subsequently to the cassation court (*see* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007) (Exhibit RME-797)). Moreover, although Claimants portray Mr. Rebgun as opposing exclusively claims from Yukos' subsidiaries seeking inclusion in the Bankruptcy Register, that is simply not true. *See* Claimants' Memorial on the Merits, ¶ 445. In fact, Mr. Rebgun routinely filed objections to claims that he thought lacked proper standing, whether filed by a Yukos subsidiary or not. For example, he objected to the entire amount of YNG's US$ 5.55 billion claim. As evidenced by the text of the relevant decision of the Moscow Arbitrazh Court that Claimants themselves annexed to their Memorial, "*the bankruptcy receiver objects to the petitioner's claim in the stated amount being included*." [emphasis added]. *See* Order of the Moscow Arbitrazh Court (Oct. 12, 2006), 2 (Annex (Merits) C-343).

1018 Claimants' Memorial on the Merits, ¶ 460.

1019 "'*I'm Not the Prosecutor General to Give Such Guarantees,' Rebgun Rebuffed*." *Group Menatep Top Manager Won't Come Here*, Kommersant (July 19, 2006) (Annex (Merits) C-813).

1020 *See* Protocol of the Creditors' Meeting (Annex (Merits) C-319).

b) Yukos' Proposed Rehabilitation Plan Furthered The Interests Of The Oligarchs Over Those Of The Bankruptcy Creditors And Was Not A Viable Alternative To The Liquidation Of Yukos

620. Yukos' proposed Rehabilitation Plan (which, in reality, was merely an outline) was yet another attempt by the Oligarchs to further their own interests over those of the bankruptcy creditors. While the plan did not ensure full -- let alone timely -- satisfaction of the registered claims, it was carefully designed to (i) secure unencumbered assets admittedly worth two-thirds of the total value of the company to the exclusive control of the Oligarchs, thereby enabling them to comfortably siphon the remaining funds out of Russia, away from Russian authorities (just as they had previously done with Yukos' foreign assets[1021]), and (ii) to preserve the value of Yukos' stock.

621. In particular, according to this outline, two-thirds of the company's assets, the "core assets," which according to the plan had an estimated value of US$ 20.6 billion, would be left unencumbered in the hands of the Oligarchs.[1022] The creditors would receive only a right to a "cash pool" -- as opposed to cash -- to be funded in the future, if possible, through uncertain revenues resulting from the sale of ancillary assets (which according to the plan had an estimated value of US$ 10.4 billion), successful awards that the company might obtain in unidentified litigations, and Yukos' future earnings or refinancing. Funds from this future pool would be repaid to the creditors in uncertain and protracted long installments.[1023] As a result, and most importantly for the Oligarchs and

1021 *See* ¶¶ 528-539 *supra*.

1022 The Rehabilitation Plan expressly stated that "*the freeze and 'seizure' orders issued by the Moscow Court bailiffs shall be vacated in order to carry out the purposes of this Plan*." *See* Rehabilitation Plan (June 1, 2006), 5 (Annex (Merits) C-312).

1023 More specifically, the Rehabilitation Plan contemplated three categories of claims with corresponding different treatments: (1) the "Core Russian Claims" (*i.e.,* all claims other than those under (2) and (3) below, having an aggregate estimated value of approximately US$ 14.6 billion) would be repaid by March 15, 2008 out of a cash pool funded from the sale of ancillary assets (having an estimated value of US$ 8.9 billion) and by "*any Litigation Awards that Yukos might obtain in pending international arbitrations and litigation in Russian Courts*" [emphasis added]; any "*remaining claims,*" not exceeding US$ 5.4 billion, would be paid out by June 15, 2008 "*via the cash flow generating capacity of the remaining Yukos Core Assets;*" (2) claims by GML subsidiary Moravel and the SocGen syndicate (having an estimated value of US$ 1.2 billion) would be satisfied out of the proceeds from the sale of the Dutch assets

Claimants, the Rehabilitation Plan would "*preserve an enterprise value that will make the Yukos common stock worth over 15 billion*,"[1024] without any assurance that creditors would in fact be paid in any reasonable period of time.

622. This proposal, however, was premised on a number of implausible and partisan assumptions, including that:

(i) Yukos would succeed in most or all pending, but unidentified, litigation proceedings (from which the plan depended on recovery of US$ 18 billion);

(ii) Yukos would exercise its parent-company powers in causing its subsidiaries[1025] not to assert some US$ 13.7 billion of intercompany claims, a bogus proposal because the aggregate amount of intercompany claims actually filed for inclusion in the Bankruptcy Register was far below the amount indicated in the plan;[1026]

(iii) Yukos' foreign assets would be kept shielded from distribution to the creditors (but for two "Dutch assets," whose value was

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(having an estimated value of US$ 1.5 billion); and (3) intercompany claims (having an estimated value of US$ 13.7 billion) would not be asserted per order of Yukos in its capacity as "*ultimate owner of all of its subsidiaries*." *See* Rehabilitation Plan (June 1, 2006), 1-2 (Annex (Merits) C-312).

1024 *Ibid.*, 8 (Annex (Merits) C-312).

1025 By the time the Rehabilitation Plan was drafted, a number of Yukos' subsidiaries, such as Yukos Capital, were already ostensibly under the control of the Stichtings.

1026 For example, the actual amount of claims from Yukos' affiliates ZAO Khakasnefteproduct, ZAO Insurance Company Progress and ZAO Tomsk-Petroleum-und-Gas filed with the Moscow Arbitrazh Court for inclusion in the Bankruptcy Register totalled RUB 3.04 million (approximately equal to US$ 112.36, based on the RUS/US$ exchange rate on July 20, 2006) as opposed to the US$ 9.3 billion indicated by Claimants' own expert, Mr. Wilson, and by the latter himself considered as being inaccurate. *See* Exhibit G to Exhibit C (Third Declaration of Mr. Wilson) to Rehabilitation Plan (June 1, 2006) (Annex (Merits) C-312). *See also* Application by ZAO Khakasnefteproduct seeking admission of its claim to the Bankruptcy Register (Apr. 24, 2006) (Exhibit RME-798); Application by ZAO Insurance Company Progress seeking admission of its claim to the Bankruptcy Register (Apr. 28, 2006) (Exhibit RME-799); and Application by ZAO Tomsk-Petroleum-und-Gas seeking admission of its claim to the Bankruptcy Register (Apr. 26, 2006) (Exhibit RME-800).

reserved to GML's affiliate Moravel and the SocGen syndicate);[1027] and

(iv) the creditors would not be given any control over the sale of Yukos' ancillary assets.

623. Further, the duration of the debt repayment schedule provided in the Rehabilitation Plan was contrary to Russian law.[1028]

624. Also, the valuations set forth in the Rehabilitation Plan were either devoid of technical support (such as the estimated yearly earnings) or did not match the appraisals enclosed with the plan.[1029]

625. Most importantly, this proposal clearly did not ensure the bankruptcy creditors that their claims would be fully repaid within the mandatory two year less one month deadline.[1030] As of the date of the creditors' meeting, the amounts of the tax and YNG claims included in the Bankruptcy Register were significantly higher than the amounts contemplated in the Rehabilitation Plan.[1031] Conversely, the prospective amounts in the "cash pool" would necessarily be significantly less than projected -- even accepting Yukos'

1027 *See* Rehabilitation Plan (June 1, 2006), 8 (Annex (Merits) C-312). At the time of the proposal, the two Dutch assets identified in the plan were already subject to restrictions imposed by foreign courts in favor of Moravel and the SocGen syndicate.

1028 The proposed debt repayment schedule for taxes and other statutory duties did not meet the requirements of Article 84(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), that creditors are to be paid within two years less one month.

1029 For example, the 20% Sibneft stake was valued at US$ 4.2 billion in the Rehabilitation Plan and at US$ 3.6 billion by Mr. Wilson; the Lithuanian refinery AB Mazeikiu Nafta was valued at US$ 1.45 billion in the Rehabilitation Plan and at US$ 352-528 million by Mr. Wilson. *See* Rehabilitation Plan (June 1, 2006), 4, and Exhibit 3 to Exhibit B thereto (Annex (Merits) C-312).

1030 As noted, pursuant to Article 80(6) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), financial rehabilitation could not exceed 2 years.

1031 The Rehabilitation Plan considered tax claims for a total amount of US$ 11.5 billion whereas, at the time of the creditors' vote, registered tax claims totalled US$ 12.6 billion. Moreover, the Rehabilitation Plan considered only one claim from YNG in the amount of US$ 2.45 billion whereas, at the time of the creditors' vote, main registered claims from YNG totalled US$ 4.4 billion. *See* Rehabilitation Plan (June 1, 2006), 1, 3 (Annex (Merits) C-312) and Summary of Claims of the Russian State and State-Owned Companies Included in the Register of Yukos Creditors' Claims, 1st and 5th column (Annex (Merits) C-594). *See also* Claimants' Memorial on the Merits, ¶ 436.

own valuations -- and insufficient to satisfy actual claims.[1032] As a result, not even the overly generous earnings supposedly to be generated by Yukos' "Core Assets" in two years would be sufficient to satisfy the outstanding "remaining claims."

626. In sum, the Oligarchs were proposing to the creditors an unsound, unattractive, and ultimately unlawful plan, as a result of which the Oligarchs would retain two-thirds of the company's assets, and preserve the value of their stock, while leaving to the creditors a mere right to uncertain proceeds from the sale of ancillary assets whose estimated value was facially insufficient to repay their claims, let alone within the requisite two-year less one month deadline. Any residual possibility for the Russian creditors to satisfy their claims was either through cash flow generated by the assets retained and managed by the Oligarchs, or by "Reducing Russian Tax Claims on Appeal," or by "Obtaining a Large Litigation Award" in unidentified litigations.[1033] None of these was a reliable option, and even less so in light of the fact that the proposal was made by individuals whose fraudulent and obstructionist behavior left them with no credibility in the eyes of the Russian creditors whose trust they were now seeking.

627. It is therefore not surprising that the creditors overwhelmingly rejected a plan that did not provide a satisfactory resolution of their claims, and was therefore against their best interests.

c) The Creditors Rightly Voted For, And The Moscow Arbitrazh Court Rightly Approved Of, The Liquidation Of Yukos, In Accordance With Russian Law And International Practice

628. Claimants contend "[t]hat 16 of the 24 admitted creditors [. . .] voted in favor of the rehabilitation of Yukos while the Russian Federation and

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1032 For example, the Rehabilitation Plan did not take into account that most, if not all proceeds from the sale of Yukos' "*Russian Ancillary Assets*" would be subject to a 24% profit tax. Accordingly, the money ultimately available for distribution to the creditors would have been significantly lower than the US$ 8.9 billion contemplated in the plan.

1033 *See* Rehabilitation Plan (June 1, 2006), 6-7 (Annex (Merits) C-312).

Rosneft rushed to bankrupt the Company is in itself a powerful confirmation of the Russian Federation's true design."[1034]

629. At the outset, it should be noted that the identity and number of creditors who voted for the introduction of receivership proceedings (and against Yukos' rehabilitation plan)[1035] are irrelevant as a matter of Russian law, which simply requires that there be a vote by the majority of the creditors, determined on the basis of one-ruble-one-vote, rather than one-creditor-one-vote.[1036] Not surprisingly, an identical approach to voting is followed in other countries.[1037]

630. Moreover, of the 15 creditors voting for rehabilitation, 14 were controlled by Yukos, which amply explains their vote.[1038]

631. The creditors' decision, as approved by the court, was not unique to the Yukos case. Statistics published by the Supreme Arbitrazh Court of the Russian Federation show that in 2006, creditors in pending bankruptcy proceedings opted for the rehabilitation of the debtor company only in 21 instances, while supervision was initiated in respect of 10,174 debtors. Also notably, in 2006 only 39 proceedings led to the restoration of the debtor's solvency, while as many as 76,447 debtors were declared bankrupt and entered liquidation proceedings.[1039]

1034 Claimants' Memorial on the Merits, ¶ 464.

1035 The decision of the Yukos creditors' meeting was supported by the vote of four creditors who held an aggregate of 93.87% of all the votes. The creditors holding the remaining number of votes either voted against (15 creditors) or abstained (four creditors). The decision of the creditors' meeting to opt for receivership proceedings, as opposed to financial rehabilitation, was definitively upheld by an Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 30, 2006) (Exhibit RME-784).

1036 *See* Art. 12(1), 12(3) and 15(2) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

1037 *See* ¶ 1502 *infra*.

1038 At the meeting, 14 creditors (Yukos' subsidiaries and affiliates) were represented by the same individual, Mr. V.S. Muravyov, acting in the capacity of an attorney. *See* Protocol of the Creditors' Meeting (Annex (Merits) C-319). Those circumstances suggest that Mr. Muravyov represented the interest of Yukos' majority shareholders and management in escaping the inevitable winding-up of the company. [emphasis added].

1039 *See* Statistical Reports of the Supreme Arbitrazh Court on Performance of Arbitrazh Courts of the Russian Federation (2006-2007) (Exhibit RME-801).

632. Moreover, in Russia,[1040] as elsewhere,[1041] the vote for the liquidation or rehabilitation of the debtor is within the full discretion of the creditors, and the bankruptcy court has very limited powers of review. This disposes of Claimants' contention that the Moscow Arbitrazh Court's decision of August 4, 2006 was "*predictable*" as it "*approved almost all of the proposals adopted*" at the creditors' meeting.[1042]

5. Claimants Have Failed To Establish That The Bankruptcy Auctions Were Held Contrary To Russian Law Or International Practice, Or That They Produced Unfair Results

633. Following the August 4, 2006 decision of the Moscow Arbitrazh Court declaring Yukos bankrupt and initiating receivership proceedings, in October 2006, Mr. Rebgun held a public tender to select an independent

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1040 Under Article 73 and Article 75(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), the vote of the creditors' meeting for any of receivership, rehabilitation, or external management of the debtor company is discretionary and the court is under a general obligation to follow the decision of the creditors' meeting. If the creditors request receivership, the court is required to declare a debtor bankrupt and initiate receivership proceedings so long as (i) the debtor has an outstanding monetary claim that has been due for more than three months (the aforementioned "insolvency test"), and (ii) the shareholders of the debtor have not requested the court to introduce financial rehabilitation or external management attaching a bank guarantee securing the proposed repayment plan. *See* Art. 53 and 75(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776). *See also* Resolution of the Federal Arbitrazh Court of the North-Western District, Case No. A56-6798/2007 (Feb. 24, 2009) (Exhibit RME-802). Yukos' shareholders never filed such an application for financial rehabilitation or external management with the court. As a result, the court's decision to declare Yukos bankrupt and initiate receivership proceedings as requested by the creditors' meeting was not only authorized, but also mandated under Russian law. *See* Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 4, 2006) (Annex (Merits) C-324).

1041 As in Russia, the vote of the creditors' meeting for receivership, rehabilitation, or external management is generally discretionary in other jurisdictions, too. *See* ¶ 1501 *infra*.

1042 Claimants' Memorial on the Merits, ¶ 465. Claimants allege that the date of the hearing on August 1, 2006 was in violation of Article 72(1) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), which requires a minimum period of ten days between the creditors' meeting and the court's hearing. *See ibid.* This allegation is irrelevant as a matter of fact, and incorrect as a matter of law: the ten-day period is calculated from the first day of the creditors' meeting, before any adjournment (*i.e.* July 20, 2006). *See* Resolution of the Tenth Arbitrazh Appellate Court, Case No. A41-K2-5360/06 (Nov. 20, 2006) (Exhibit RME-1803). In addition, according to Russian court practice, there are no legal consequences that follow even if the 10 day mandate is not honored. *See, e.g.*, Resolution of the Federal Arbitrazh Court of the Volgo-Viatskiy District, Case No. A79-1602/2005 (Nov. 9, 2005) (Exhibit RME-803). Finally, Yukos itself did not raise this challenge when it appealed the Moscow Arbitrazh Court's decision of August 4, 2006. *See* Resolution of the Ninth Appellate Court, Case No. 09AP-GK (Sept. 26, 2006) (Exhibit RME-785).

appraiser to inventory and value the company's assets. The winner of the tender was a consortium composed of well-regarded independent appraisers,[1043] with ZAO Roseko acting as the general contractor (the "Roseko consortium"). From October 2006 to July 2007, the Roseko consortium carried out an evaluation of Yukos' assets, submitting a first *tranche* of appraisal reports on January 19, 2007.[1044] On February 20, 2007, the committee of Yukos' creditors adopted a procedure for the holding of public auctions for the sale of the company's properties, which were subsequently divided into 20 separate lots.[1045]

634. In the meantime, in keeping with their trademark practice, the Oligarchs, through Claimants and Yukos' former management, continued to threaten years of litigation against any company that sought to purchase Yukos' property in the receivership auctions. On February 15, 2007, a month before the first bankruptcy auction was held, an attorney for Mr. Khodorkovsky warned that "*we will go on a campaign day and night that ensures that any company that buys those assets will pay the price*."[1046] As with the YNG auction, these threats likely dissuaded many companies from participating in the auctions. Again, on March 26, 2007, on the eve of the first bankruptcy auction, Tim Osborne, director of GML, warned that:

> "the company would go after Western businesses that have benefited from the break-up of Yukos. [. . .] Anybody buying

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1043 In 2006, the members of the Roseko consortium ranked among the top tier of local appraisers in Russia. For example, based on data from publicly available sources, as of 2006, ZAO ROSEKO had the following ratings in Russia: No. 3 in Expert RA Rating for 2007 (by revenue when performing assessment of businesses and securities) and No. 6 in Dengi weekly rating for 2002. *See* Expert RA Rating for 2007 (Exhibit RME-805) and Dengi No. 27 (July 14, 2003) (Exhibit RME-806). In addition, ZAO Rossiyskaya Otsenka was ranked No. 2 by the Russian Appraisers Chamber for 2005 and ZAO NP Consult was ranked No. 3 for 2005-1H2006 by RBC rating. *See* Russian Appraisers Chamber Rating for 2005 (Exhibit RME-807) and Federal Integrated Rating of Appraisers in Russia for 2005-1H 2006 (Exhibit RME-808).

1044 *See* Anna Firsova, *Yukos Is Worth Less Than Its Debt*, Gazeta.ru (Jan. 19, 2007) (Exhibit RME-809). By Jan. 19, 2007, the Roseko consortium had submitted reports evaluating 15 of the 20 lots.

1045 *See* Finalization Order (Exhibit RME-752). *See also* Receiver's Report, 28-29 (Exhibit RME-751) (including information on Yukos' property inventory and on the process and results evaluation of Yukos' property).

1046 *See* Miriam Elder, *Gazprom, Norrilsk to Bid for Yukos*, Moscow Times (Feb. 15, 2007) (Exhibit RME-810).

> these assets at auction should think long and hard about it. We say that Yukos was stolen by the Russian Federation and anybody that buys its assets at auction are receiving stolen goods."[1047]

635. From March 27, 2007 to August 15, 2007, 17 public auctions of Yukos' assets were held by the Russian Federal Property Fund, the competent body appointed by the Yukos creditors committee (the "Bankruptcy Auctions").[1048] All of the auctions (i) were open to foreign and domestic participants, (ii) began with starting prices equal to or greater than the appraised market values of the auctioned assets, and (iii) generated sales proceeds in excess of the starting bid price, totalling approximately RUB 860 billion (approximately US$ 34.8 billion).[1049] With the financial backing of a consortium of international banks,[1050] Rosneft and its affiliates won nine of the 17 auctions, and later purchased the assets from two lots won by other bidders.

636. Claimants contend that the Bankruptcy Auctions were "frequently involving only two bidders […], at times lasting only a few minutes, and almost always won by Rosneft […] at below market prices."[1051] Claimants have failed to adduce any credible evidence to support their charges[1052] and those charges are factually misleading or incorrect.

637. All of the Bankruptcy Auctions -- including those won by Rosneft -- were public auctions, open to all bidders and held in compliance with the stringent requirements imposed by Russian law, which sought to maximize

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1047 *See* David Robertson, *Shareholder Says Yukos Auction is Sale of Stolen Property*, The Times (Mar. 26, 2007) (Exhibit RME-811).

1048 *See* Finalization Order (Exhibit RME-752). *See also* Receiver's Report, 28-29 (Exhibit RME-751). Three auctions were cancelled for lack of a minimum number of participants.

1049 Based on the average RUB/US$ exchange rate on Nov. 1, 2007. *See ibid.*, 31-40 (Exhibit RME-751), and Finalization Order, 2 (Exhibit RME-752).

1050 In March 2007, Rosneft announced that it had secured US$ 22 billion to finance its bids for Yukos assets in the receivership auctions. Some of the international banks in the consortium of lenders included ABN AMRO, Barclays, BNP Paribas and Citibank. *See Resolutions of the Rosneft Board of Directors*, Rosneft Press Release (Mar. 20, 2007) (Annex (Merits) C-837).

1051 Claimants' Memorial on the Merits, ¶ 613. *See also* ¶¶ 472-480, 823.

1052 Claimants cite only press articles, which do not demonstrate the validity of Claimants' allegations, but simply mimic the same charges made by Mr. Khodorkovsky and his allies at the time.

proceeds and had been widely publicized well in advance. Russian auction requirements are significantly more demanding than those of other countries. The Bankruptcy Auctions -- including those won by Rosneft -- also produced very substantial proceeds, exceeding fair market value appraisals and estimates, including by Yukos' own management and experts. Rosneft and its affiliates won most (though not all) of the Bankruptcy Auctions, not as a result of the exercise of State prerogatives or any intervention by the State in Rosneft's favor, but simply because they submitted the highest bids.

a) The Bankruptcy Auctions Were An Open And Competitive Process, Conducted In Accordance With Russian Law And International Practice

638. The Bankruptcy Auctions were organized and conducted in accordance with the demanding requirements of Russian law, which were aimed at maximizing participation and, as a result, proceeds. In particular, for each of the Bankruptcy Auctions:[1053]

(i) the auctioned assets were evaluated at market value[1054] by a consortium of independent appraisers that had been selected through an open tender process;[1055]

(ii) the starting price for the auctioned assets was set by decision of the committee of Yukos' creditors and was in each case at least equal to the appraised market value; [1056]

1053 *See* Art. 130, Art. 139, Art. 110 and Art. 111 of the 2002 Russian Bankruptcy Law (Exhibit RME-776) and Art. 447 of Civil Code of the Russian Federation (Exhibit RME-812).

1054 This excludes promissory notes, which were not previously appraised by the Roseko consortium and were sold at their nominal value.

1055 *See* Receiver's Report, 21-22 (Exhibit RME-751), and Finalization Order, 3 (Exhibit RME-752).

1056 *See*, *e.g.*, (i) in relation to auction No. 7: ROSEKO Appraisal Report No. 02U0701-1242-06 (Jan. 19, 2007) (Exhibit RME-813) and Minutes No. 8 of the OAO NK Yukos Creditors' Committee Meeting (Mar. 23, 2007) (Exhibit RME-814); (ii) in relation to auction No. 8: ROSEKO Appraisal Report No. 02U0701-1218-06 (Jan. 19, 2007) (Exhibit RME-815) and Minutes No. 8 of the OAO NK Yukos Creditors' Committee Meeting (Mar. 23, 2007) (Exhibit RME-814); (iii) in relation to auction No. 15: ROSEKO Appraisal Report No. 02U0701-1216-06 (Mar. 15, 2007) (Exhibit RME-816) and Minutes No. 12 of the OAO NK Yukos Creditors' Committee Meeting (May 2, 2007) (Exhibit RME-817).

(iii) an announcement of the auction, setting forth all the information required by law, including the starting price, was published at least 30 days prior to the auction (and those announcements received widespread publicity in Russia and abroad);[1057]

(iv) participation in the auctions was not restricted in any way; the auctions were open to foreign bidders as well as Russian ones;[1058]

(v) the requisite minimum number of participants was met;[1059] and

(vi) all participants complied with the relevant participation requirements and paid the required deposits.[1060]

639. Russian auction procedures are notably more demanding than those of many other countries. In particular, in the United Kingdom, France, Germany and the United States:

(i) auction sales are not mandated and receivers are free to sell assets belonging to the bankruptcy estate on a negotiated, one-on-one basis; and

(ii) even when auctions are conducted, specific requirements seldom limit receivers' broad discretion in determining the applicable

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1057 *See*, *e.g.*, Moscow Tender, Bulletin of the Operative Information Issued Fifty Two Times a Year, No. 17/2007/40 (Feb. 22, 2007) (Exhibit RME-818) (announcing the auction of lot No. 1); Rossiyskaya Gazeta, No. 45 (4308) (Mar. 3, 2007) (Exhibit RME-819) (announcing the auction of lot No. 2); and Moscow Tender, Bulletin of the Operative Information Issued Fifty Two Times a Year, No. 29/2007/76 (Apr. 7, 2007) (Exhibit RME-820) (announcing the auction of lot No. 11). *See also Yukos for Sale,* Expert Online (Feb. 22, 2007) (Exhibit RME-821); *Yukos to Sell Its Stake in Rosneft*, Spotlight, Vedomosti (Feb. 22, 2007) (Exhibit RME-822); and Irina Reznik, Vera Surzhenko, *Yukos' Receiver Wants to Sell 20% in GazpromNeft, ArticGas and Urengoil in One Lot,* Vedomosti (Mar. 5, 2007) (Exhibit RME-823).

1058 *See*, *e.g.*, Moscow Tender, Bulletin of the Operative Information Issued Fifty Two Times a Year, No. 17/2007/40 (Feb. 22, 2007) (Exhibit RME-818) (announcing the auction of lot No. 1); Rossiyskaya Gazeta, No. 45 (4308) (Mar. 3, 2007) (Exhibit RME-819) (announcing the auction of lot No. 2) ; and Moscow Tender, Bulletin of the Operative Information Issued Fifty Two Times a Year, No. 29/2007/76 (Apr. 7, 2007) (Exhibit RME-820) (announcing the auction of lot No. 11) .

1059 When this condition was not met, the relevant assets were combined with other lots and sold at subsequent auctions. *See* Receiver's Report, 28-31 (Exhibit RME-751).

1060 *See ibid.*, 40-46 (Exhibit RME-751).

parameters (including whether or not to set a starting price for the auctioned assets). Typically, receivers are only required to seek the best sale price reasonably achievable under the circumstances.

640. Similar rules also apply in Canada, Italy, Spain and Sweden.[1061]

641. Claimants voice specific criticisms regarding the participation in two of the Bankruptcy Auctions. None is meritorious.

642. Claimants refer to speculation in the press that participation in the auction of Lot No. 1 (which included a block of Rosneft shares) by a TNK-BP subsidiary was intended "*to curry favor with the Kremlin by legitimizing the process*."[1062] Giving the lie to Claimants' conspiracy theory, the TNK-BP subsidiary drove the price up by nine increments.[1063] As stated by TNK-BP's spokesman, "*if we hadn't participated, Rosneft would have got the shares far cheaper. We lodged $1.5 billion just to participate, and you don't do that if you're not interested*."[1064]

643. Claimants' complaint about the auction of Lot No. 2 is equally baseless. This lot, which included an interest in OAO Gazprom Neft, formerly Sibneft, and various Siberian gas fields, was won by a subsidiary of Italy's ENI (the minority shareholder being Italy's ENEL)[1065] -- a very awkward fact from Claimants' perspective, since it contradicts their theory that this entire matter should be viewed as the re-nationalization of Yukos' assets to be placed in the hands of Rosneft. Claimants have therefore had to hypothesize an *ad hoc* subplot involving Gazprom (since even Claimants concede that Rosneft was not

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1061 *See* ¶¶ 1504 *infra*.

1062 Claimants' Memorial on the Merits, ¶ 474.

1063 Each bid increment was of RUB 260 million (approximately US$ 9.9 million based on the RUB/US$ exchange rate on Mar. 27, 2007). *See* Minutes on the Results of the Sale Auction of Yukos Lot No. 1 Assets (Mar. 27, 2007) (Exhibit RME-824).

1064 *See* Mikhail Yenukov, *Rosneft Outbids TNK-BP in Yukos Carve-Up Auction*, Reuters (Mar. 27, 2007) (Annex (Merits) C-840).

1065 ENI and ENEL are both publicly-traded companies subject to disclosure requirements under the securities laws of Italy and the U.S. (where both companies at that time were listed on the N.Y. Stock Exchange) that would have precluded participation in a covert understanding of the sort suggested by Claimants.

involved) to find a place for ENI and ENEL in their broader conspiracy theory. Accordingly, Claimants suggest that the ENI subsidiary won Lot No. 2 simply to serve as Gazprom's nominee for a brief interval after which Gazprom would acquire the assets -- a charge that is based on mischaracterizing certain call option agreements that ENI had entered into with Gazprom, its historic partner in gas matters.

644. In reality, the auction for Lot No. 2 was highly competitive, and ENI's subsidiary won only after 26 bid increments for a price of US$ 5.83 billion, roughly US$ 376 million higher than the minimum bid.[1066] The charge that this multi-billion transaction was mere window-dressing is not only unsupported by any evidence, but it is contradicted by the reality of ENI's strategic business interest in acquiring upstream gas properties in Russia and other producing countries. The purchase of Lot No. 2 implemented a Strategic Partnership Agreement entered into by ENI and Gazprom in November 2006.[1067] Under this agreement, the two companies established an alliance whereby ENI would grant Gazprom access to its rich downstream market in exchange for an ability to enter Russia's upstream natural gas sector.[1068] The purchase of Lot No. 2 was "*an additional step in implementing the Strategic Partnership Agreement*" in that it enabled ENI to enter "*into the Russian upstream market as a major player* [...], *capitaliz*[ing] *on its strategic positioning in midstream and downstream gas to support the expansion of its upstream activities*."[1069] ENEL (ENI's joint venture partner) benefited as well from the acquisition, which "*represent*[ed] *Enel's entrance into the upstream natural gas sector, as part of the company's strategy of expanding its access to*

1066 *See* Minutes on the Results of the Sale Auction of Yukos Lot No. 2 (Apr. 4, 2007) (Exhibit RME-825).

1067 *See Eni and Gazprom Sign Strategic Agreement*, ENI Press Release, http://www.eni.com/en (Nov. 14, 2006) (Exhibit RME-847).

1068 *Ibid.* ENI's acquisition of gas property included in Lot No. 2 was keyed on its alliance with Gazprom, as these gas assets are essentially worthless unless Gazprom grants access to its gas pipeline network. *See* Catherine Belton, *Eni and Enel to Cede Control of Yukos Gas Assets,* Financial Times (Apr. 5, 2007), 24 (Annex (Merits) C-852); Gabriel Kahn, *Enel Uses Every Tool to Tap Russia–Strategy Is to Cut in Gazprom, Hit Political Chords, Control Gas Supply,* Wall St. J. (Nov. 8, 2007), 10 (Exhibit RME-826). *See also Gazprom Implements Option for Acquiring a 20% Stake in Gazprom Neft,* Gazprom Press Release (Apr. 7, 2009) (Annex (Merits) C-884).

1069 *See Eni Announces $ 5.83 Acquisition of Yukos Assets. Major First Step into Russian Upstream Market,* ENI Press Release, http://www.eni.com/en (Apr. 4, 2007) (Exhibit RME-848).

international resources of gas supply."[1070] Thus, ENI and ENEL purchased Lot No. 2 to serve their own commercial interests, and not to curry favor with Gazprom.

645. Also at odds with any conspiracy theory is the fact that while, under certain call option agreements between Gazprom and ENI, Gazprom had a call option on the OAO Gazprom Neft shares and on 51% of the gas assets in Lot No. 2, ENI did not have a corresponding put vis-à-vis Gazprom. This means that ENI (and its Italian partner) bore the full risk of loss of the purchase price, *i.e.*, US$ 5.83 billion, not to mention the commercial risk associated with operation of the assets themselves, in the event that Gazprom, at its sole option, decided not to exercise the call. It is inconceivable that public companies ENI and ENEL would have agreed to bear such great commercial risk to themselves as a matter of whimsy and not because of a serious interest in these assets to exploit for their own commercial interests.

646. Claimants' speculations are also contradicted by the fact that Gazprom's option did not cover 49% of the auctioned gas assets, which ENI and ENEL irrevocably and unconditionally have owned since the date of the purchase at auction.[1071] This confirms the commercial objectives of the purchasers to add upstream assets to their portfolios. Moreover, when Gazprom exercised its call option, the exercise price was more than the current market value of the assets being sold.[1072] The exercise price in the contract was for the purchase price plus a fixed rate of return, whereas the market price of the assets had declined as a result of declining world hydrocarbon prices. This is a further reflection of the commercial nature of the option, balancing upside and downside risks.

1070 *See Enel Announces 852 Million Dollar Acquisition of Yukos Assets*, ENEL Press Release, http://www.enel.com/en (Apr. 4, 2007) (Exhibit RME-849).

1071 *See Gazprom Completes Acquisition of 51 per Cent Stake in SeverEnergia*, Gazprom Press Release (Sept. 23, 2009) (Annex (Merits) C-892); Irina Malkova, Elena Mazneva, *An Italian Deal*, Vedomosti (Apr. 8, 2009) (Exhibit RME-828) and *Enel, Eni and Gazprom sign new agreement on Severenergia,* ENEL Press Release, http://www.enel.com/en (May 15, 2009) (Exhibit RME-850).

1072 *See* Carola Hoyos, *Gazprom In $ 4.2 bn Deal with Eni Over Neft Asse*t, Financial Times (Apr. 8, 2009) (Exhibit RME-827). *See also* Irina Malkova, Elena Mazneva, *An Italian Deal*, Vedomosti (Apr. 8, 2009) (Exhibit RME-828).

647. That the lot contained more assets than the minimum ENI and ENEL sought, and that they were willing nonetheless to buy the entire lot and at such a premium to the minimum bid based on market prices (and a further premium to eventual market values), simply vindicates Mr. Rebgun's wisdom in grouping assets for sale so as to attract buyers willing to pay the highest price for the entirety of the estate.

648. In reality, if participation in the Bankruptcy Auctions were deemed disappointing, especially by foreign companies, that was not attributable to the receiver (or the Russian Federation), but once again to the threats of the Oligarchs to sue any successful bidder and the banks financing its bid,[1073] as they had done in connection with the YNG auction two years earlier.[1074] Thus, although several foreign companies were reported to be interested,[1075] not many non-Russian bids were submitted, and in the end, only a limited number of the Bankruptcy Auctions was won by bidders controlled by a foreign investor.[1076]

649. By once again frightening prospective foreign bidders, the Oligarchs immeasurably decreased the price competition that additional bidders would have brought, and they reduced the total auction proceeds, virtually ensuring that nothing would be left over for shareholders (including Claimants) once the company was dissolved.

1073 *See* Miriam Elder, *Gazprom, Norilsk to Bid for Yukos*, Moscow Times (Feb. 15, 2007) (Exhibit RME-810) and David Robertson, *Shareholder Says Yukos Auction is Sale of Stolen Property*, The Times (Mar. 26, 2007) (Exhibit RME-811).

1074 *See* ¶¶ 492-506 above.

1075 *See* Nadia Rodova, *Chevron Said Eyeing Remaining Assets of Russia's Yukos*, Platts Oilgram News (Feb. 12, 2007), 1 (Exhibit RME-829). *See also* Rachel Graham, *TNK-BP in Hunt for Remaining Yukos Assets. Depends if Package Is 'Fragmented': Senior Company Official*, Platts Oilgram News (Nov. 20, 2006), 6 (Exhibit RME-830), and Anna Shiryaevskaya, *U.S. Majors Eyeing Yukos Assets: Russian Ambassador*, Platts Oilgram News (Feb. 9, 2007) (Exhibit RME-831).

1076 OOO EniNeftegaz, a subsidiary of Ente Nazionale Idrocarburi–ENI S.p.A., acting with the support of ENEL S.p.A., the Italian electrical utility, won auction No. 2; OOO Monte-Valle, a company reportedly owned by a foreign individual investor, won auction No. 4, and OOO Promnefstroi won auction No. 19. *See* Receiver's Report, 29-31 (Exhibit RME-751). Predictably, ENI and ENEL were threatened by a spokesman for Yukos' core shareholders. On April 5, 2007, "*Tim Osborne, head of Yukos majority shareholder GML, formerly known as Group Menatep, warned that Eni and Enel could be open to lawsuits from shareholders.*" *See* Miriam Elder, *Yukos Assets Go to Eni and Enel*, Moscow Times (Apr. 5, 2007) (Exhibit RME-832).

b) Despite The Campaign Of Intimidation Unleashed By The Oligarchs, The Bankruptcy Auctions Produced Very Large Proceeds, Exceeding Fair Market Value Appraisals And Estimates, Including By Yukos' Own Management And Expert

650. Claimants' contention that the assets of Yukos were sold at below market prices is factually incorrect for several reasons.

651. First, as noted, for each of the Bankruptcy Auctions, the starting price was set at least equal to the market value that had been determined by the Roseko consortium using an asset-specific methodology[1077] and without applying any "*liquidation discount*."[1078] Differing valuations that Mr. Rebgun allegedly expressed[1079] would have had no bearing on the setting of the auction starting prices. Further the methodology and conclusions of the Roseko consortium, as well as the resulting transactions, were never challenged by any of Yukos, its creditors, or shareholders (including Claimants), even though they would have had standing to do so.[1080]

1077 The Roseko consortium conducted a detailed examination of all of the assets in question before evaluating them. The inventory and evaluation work of the Roseko consortium lasted many months and resulted in the production of thousands of pages in inventory and appraisal reports assessing the market value of each of the inventoried assets. *See* Receiver's Report, 21-28 (Exhibit RME-751).

1078 *See* Claimants' Memorial of the Merits, ¶ 471.

1079 Claimants' allege that "*[o]n January 19, 2007, Mr. Rebgun declared that his appraisers had valued Yukos' assets at U.S.$ 22 billion. However, it was later revealed that the appraisals in fact resulted in a valuation of Yukos' assets at U.S.$ 33 billion.*" *See* Claimants' Memorial on the Merits, ¶ 469. In fact, Mr. Rebgun was correct, as acknowledged by the head of the Roseko consortium, who refuted the US$ 33 billion valuation reported in the press, confirming that the aggregate value of the assets appraised by that time was US$ 22 billion. *See* Andrey Filatov, *How Much Does Yukos Cos*t, Lenta.ru (Jan. 22, 2007) (Exhibit RME-833) (reporting that "*[m]eanwhile, Eugenii Neiman, head of the consortium of appraisal companies, did not confirm the information about the value of YUKOS' assets that had appeared in the media. According to him, the market value of the company amounting to USD 33 billion 'has no relation whatsoever to the results of evaluation.' 'It is some sort of a set of random figures,' he pointed out.*") Claimants further contend that, before the first auction on March 27, 2007, Mr. Rebgun revised his valuation of the Yukos assets "*to an amount between U.S.$ 25.6 billion and U.S.$ 26.8 billion.*" *See* Claimants' Memorial on the Merits, ¶ 471. Again, Claimants' contention is groundless: when the Roseko consortium arrived at the US$ 22 billion figure in January 2007, some assets still remained to be evaluated. *See* Anna Firsova, *Yukos is Worth Less Than Its Debt*, Gazeta.ru (Jan. 19, 2007), 1 (Exhibit RME-809).

1080 *See* Art. 130(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

652. Second, the aggregate proceeds of the Bankruptcy Auctions -- approximately US$ 34.8 billion[1081] -- exceeded both the market value appraisals and the corresponding starting prices. In several cases, the final sale price was significantly higher than the appraisal-linked starting price as a result of bidding competition.[1082]

653. Indeed, the aggregate results achieved by the Bankruptcy Auctions also exceeded the estimate of US$ 31 billion made in the Rehabilitation Plan,[1083] as well as the underlying contemporaneous valuation by Claimants' own expert, Mr. Wilson, which projected an average value of US$ 30.4 billion.[1084] Likewise, the auction results exceeded most of the fair market value estimates made during the run-up to the auctions, including estimates by Atlant Invest (US$ 15-20

1081 Based on the RUB/US$ exchange rate on Nov. 1, 2007. *See* Receiver's Report, 31-40 (Exhibit RME-751), and Finalization Order, 2 (Exhibit RME-752).

1082 For example, at auction No. 13, the starting price (RUB 22.1 billion, equal to approximately US$ 858.4 million, based on the RUB/US$ exchange rate on May 11, 2007) was exceeded by more than four times, the sale price being RUB 100.1 billion (approximately US$ 3.9 billion); at auction No. 4, the starting price (RUB 2.6 billion, equal to approximately US$ 102.3 million, based on the RUB/US$ exchange rate on Apr. 17, 2007) was exceeded by approximately 38%, the sale price being RUB 3.6 billion (approximately US$ 138.1 million); at auction No. 12, the starting price (RUB 7.7 billion, equal to approximately US$ 301.1 million, based on the RUB/US$ exchange rate on May 10, 2007) was exceeded by approximately 60%, the sale price being RUB 12.5 billion (approximately US$ 484.8 million). *See* Receiver's Report, 31-40 (Exhibit RME-751) and Minutes on the Results of the Yukos Lot No. 13 Assets Sale Auction (May 11, 2007) (Exhibit RME-834); Minutes on the Results of the Yukos Lot No. 4 Assets Sale Auction (Apr. 17, 2007) (Exhibit RME-835); and Minutes on the Results of the Yukos Lot No. 12 Assets Sale Auction (May 10, 2007) (Exhibit RME-836).

1083 *See* Rehabilitation Plan (June 1, 2006), 3 (Annex (Merits) C-312).

1084 In the declaration submitted as Exhibit B to the Rehabilitation Plan, Mr. Wilson valued Yukos' non-YNG assets in the range of US$ 19.288-US$ 33.616 billion and the YNG preferred shares at US$ 3.96 billion. The resulting aggregate average is US$ 30.4 billion (US$ (19.288 + 3.96) billion + US$ ((33.616 + 3.96) billion / 2). *See* First Declaration of Wayne R. Wilson Jr., (Apr. 19, 2006) and Exhibit 3 thereto, submitted as Exhibit B to the Rehabilitation Plan (June 1, 2006) (Annex (Merits) C-312). In the declaration submitted as Exhibit C to the Rehabilitation Plan, Mr. Wilson revised his valuation of Yukos' Russian assets at approximately US$ 29.6 billion. *See* Exhibit D to the Third Declaration of Wayne R. Wilson Jr. (May 18, 2006), submitted as Exhibit C to the Rehabilitation Plan (June 1, 2006) (Annex (Merits) C-312). On May 1, 2009, Mr. Wilson slightly revised his valuation of the Yukos assets, acknowledging that the appraisal by the Roseko consortium "*closely aligns with the results of my valuation*." *See Yukos Oil Company v. Russia*, ECHR, App. No. 14902/04, Annex 1 - Report of Wayne R Wilson Jr, Submissions on Just Satisfaction (May 1, 2009), 7 (Exhibit RME-837).

billion),[1085] Aton (US$ 18.5-20.1 billion),[1086] MDM Bank (US$ 24.5 billion),[1087] and UBS (US$ 29.9 billion)[1088].

654. Third, the bankruptcy receiver was under a duty to sell the assets at auction in accordance with Russian law, which he did. He was not, however, under an obligation to ensure that the auctions produced any particular price level, so long as the minimum price that had been set on the basis of the assets' appraised market value was achieved (or exceeded), as it was in each of the Bankruptcy Auctions.[1089]

655. The foregoing also disposes of Claimants' specific criticisms regarding the allegedly discounted purchase price for four of the 17 lots (namely, Lots Nos. 1, 2, 10, and 11).[1090]

1085 *See* Atlant Invest – Atlant Invest Research Department, *Yukos JSC* (Oct. 23, 2006), 1 (Exhibit RME-838).

1086 *See* Anna Firsova, *Yukos Is Worth Less Than Its Debt*, Gazeta.ru (Jan. 19, 2007), 1 (Exhibit RME-809).

1087 *See* MDM Bank - Russian Equity Research / Oil & Gas Sector, *Yukos's Fire Sale: Implications for Potential Buyers Vary* (Mar. 21, 2007), 2 (Exhibit RME-839).

1088 *See* UBS Investment Research, *Yukos. Quantifying the End Game* (Mar. 31, 2006), 5 (Exhibit RME-840).

1089 *See* Receiver's Report, 28-31 (Exhibit RME-751).

1090 In particular:

(i) As for Lot No. 1 (consisting of a 9.44% stake in Rosneft, resulting from the share swap of the YNG preferred shares, and some promissory notes issued by YNG), Claimants allege that the auction price of approximately US$ 7.59 billion "*represented a 10% discount from the market price of Rosneft's shares.*" *See* Claimants' Memorial on the Merits, ¶ 474. The only source cited by Claimants in this regard consists of press articles (Annex (Merits) C-840), (Annex (Merits) C-841) and (Annex (Merits) C-844). But it is not at all surprising that a large block of largely illiquid shares that could not confer control would sell at a discount to the market price for the small volume of shares traded on any given day in the market. In any event, as it turns out, the purchase price of US$ 7.59 billion exceeded the low end of the valuation range (US$ 7.44 billion) provided by Claimants' own expert, Mr. Wilson, on May 1, 2009. *See Yukos Oil Company v. Russia*, ECHR, App. No. 14902/04, Annex 1 - Report of Wayne R Wilson Jr, Submissions on Just Satisfaction (May 1, 2009), 7 (Exhibit RME-837).

(ii) As for lot No. 2 (consisting of a 20% stake in Gazprom Neft, formerly Sibneft, and 100% stakes in gas companies Arctic Gas, Urengoil and Neftegaztechnologia), Claimants allege that the purchase price of approximately US$ 5.83 billion was a "*knockdown price.*" *See* Claimants' Memorial on the Merits, ¶ 483. The only source cited by Claimants in this regard is a press article (Annex (Merits) C-850). As it turns out, the purchase price of US$ 5.83 billion exceeded the low end of the valuation range of the respective assets composing the lot (US$ 5.51 billion) provided by Claimants' own expert, Mr. Wilson, on May 1, 2009. *See Yukos Oil Company v.*

656. In sum, Claimants have failed to establish that the Bankruptcy Auctions, taken as a whole, produced proceeds that were lower than the estimated fair value of Yukos' auctioned assets.

c) Rosneft Won Most (Not All) Of The Bankruptcy Auctions Not Because Of State Prerogatives Or State Intervention

657. Claimants suggest that the fact that Rosneft (or Rosneft affiliates) won the majority of the Bankruptcy Auctions was the result of the Russian Federation's "*general plan for the renationalization of Yukos*."[1091] This argument -- a classic *non sequitur* -- is unsustainable for several reasons.

658. First, as discussed in paragraph 1471 below, Rosneft (as well as any other State-owned companies) is not the Russian Federation, and Claimants have failed to establish that Rosneft exercised governmental authority or that it acted on the instruction of, or under the direction or control of, the Russian Federation.

659. Second, nothing in Russian law or international practice prevents a company -- whether it is 100% privately held, partially State-owned, or 100% State-owned -- from having an equal opportunity to participate in a public auction on the same terms as other bidders. In fact, a prohibition against its

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Russia, ECHR, App. No. 14902/04, Annex 1 - Report of Wayne R Wilson Jr, Submissions on Just Satisfaction (May 1, 2009), 7 (Exhibit RME-837).

(iii) As for lot No. 10 (consisting of a 100% stake in Tomskneft as well as the Angarsk and Achinsk refineries), Claimants allege that the purchase price of approximately US$ 6.82 billion represented a 36% discount from the fair market value. *See* Claimants' Memorial on the Merits, ¶ 479; *see also* Kaczmarek Report, ¶ 512. As it turns out, the purchase price of US$ 6.82 billion exceeded the low end of the valuation range of the respective assets composing the lot (US$ 6.47 billion) provided by Claimants' own expert, Mr. Wilson, on May 1, 2009. *See Yukos Oil Company v. Russia*, ECHR, App. No. 14902/04, Annex 1 - Report of Wayne R Wilson Jr, Submissions on Just Satisfaction (May 1, 2009), 7 (Exhibit RME-837).

(iv) As for lot No. 11 (consisting of a 100% stake in Samaraneftegaz and three refineries in the Samara region), Claimants allege that the purchase price of approximately US$ 6.40 billion represented a 37% discount from the fair market value. *See* Claimants' Memorial on the Merits, ¶ 480; *see also* Kaczmarek Report, ¶ 516. As it turns out, the purchase price of US$ 6.40 billion exceeded the low end of the valuation range of the respective assets composing the lot (US$ 6.20 billion) provided by Claimants' own expert, Mr. Wilson, on May 1, 2009. *See Yukos Oil Company v. Russia*, ECHR, App. No. 14902/04, Annex 1 - Report of Wayne R Wilson Jr, Submissions on Just Satisfaction (May 1, 2009), 7 (Exhibit RME-837).

1091 Claimants' Memorial on the Merits, ¶¶ 477, 482.

participation would run contrary to the objective of maximizing proceeds so as to minimize the amount of unsatisfied claims.

660. Third and most importantly, Rosneft and its affiliates won most (though not all) of the Bankruptcy Auctions,[1092] not as a result of the exercise of State prerogatives or any intervention by the State in Rosneft's favor, but simply because, in auctions that were open to any bidder, Rosneft and its affiliates submitted the highest bids. In other words, Rosneft won its auctions under conditions and circumstances that rendered totally irrelevant the fact that it was a State-controlled company. It won what any other private bidder, Russian or non-Russian, could have won under the same circumstances.

661. That Rosneft or its affiliates were prepared to outbid the competition for certain lots demonstrates the efficacy of the auctions and is explained by sound commercial and business reasons, rather than Claimants' unsupported conspiracy theory. Once Rosneft acquired YNG, it made eminent business sense for Rosneft to pursue certain other Yukos assets that formerly supported YNG in an integrated operation, because Rosneft could realize synergies by re-uniting those other assets under common management.[1093]

1092 Rosneft and two of its subsidiaries (Neft-Activ and RN-Razvitie) won nine of the Bankruptcy Auctions (lots No. 1, 5, 9, 10, 11, 14/3, 17, 18/16/6 and 20; in two cases, several lots were auctioned together). Bidders not affiliated with Rosneft won the auctions for lots No. 2, 4, 7, 8, 12, 13, 15 and 19. *See* Receiver's Report, 28-31 (Exhibit RME-751). It would appear that the winner of lot No. 13 (a company called Prana) re-sold to Rosneft a portion of the assets purchased at this auction, and not all of them, as asserted by Claimants. *See* Claimants' Memorial on the Merits, ¶ 477 and footnote 754. *See Rosneft Acquires Assets From Prana*, Rosneft Press Release (July 2, 2007) (Annex (Merits) C-871).

1093 For example, in winning the auction for Lot No. 11 (for RUB 165.5 billion), Rosneft in essence re-united refining and distribution assets in Samara with YNG's own operations as was first done at Yukos' inception. By way of background, Yukos was created in 1993 as the holding company for *inter alia*: YNG; the Samara-based oil complex formed by Kuibyshevsky NPZ (an oil refinery); Syzranskiy NPZ (an oil refinery); Samaraneftekhimproekt (a research and development firm); Novokuibyshevsky NPZ (an oil refinery); and Samaranefteprodukt (supplier/seller of oil products). These five companies were sold in lot No. 11. In 1995, prior to Yukos' notorious privatization (pursuant to which Menatep assumed control over Yukos), the following State-owned, Samara-based companies were folded into Yukos: Samaraneftegaz (an oil producer); Samaranefteproduktavtomatika (supplier/seller of oil products); Samaraneftekhimavtomatika (supplier/seller of oil products); and Srednevolzhskiy NII po neftepererabotke (a research and development firm). These four companies were also sold in lot No. 11. *See* Government of the Russian Federation, Resolution of the Council of Ministers "On Creation of an Open Type Joint Stock Company Oil Company Yukos" No. 354 (Apr. 15, 1993) (Exhibit RME-1) and Resolution "On

Rosneft was also able to redress an imbalance that had developed between its production and refining capacities.[1094] Indeed, the power of this commercial logic helped persuade a syndicate of international banks to provide US$ 22 billion in financing to Rosneft to fund its bidding in the auctions.[1095]

662. Last but not least, it should again be emphasized that all of the winning bids by Rosneft or its affiliates were at least equal to the appraised market value of the auctioned assets and, in most of the cases, the winning bids were substantially higher than appraised market value.

6. Yukos Was Liquidated Because The Bankruptcy Estate Was Not Sufficient To Satisfy All Of Yukos' Liabilities

663. By order dated August 8, 2007, the Moscow Arbitrazh Court extended Yukos' receivership proceedings by three months, until November 4, 2007.[1096] The claims admitted into the Bankruptcy Proceedings through this latter date amounted to RUB 948,992,157,516 (approximately, US$ 38.5 billion).[1097] These claims included claims filed after closure of the Bankruptcy Register on October 12, 2006 (so called "late" claims).

664. Claimants offer the implausible argument that "through the concerted actions of the receiver and the Moscow Arbitrazh Court" and "[i]n order to prevent any distribution of the proceeds from Yukos' receivership to Yukos' shareholders, the Russian Federation conveniently resorted to the

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Improvement of the Yukos Oil Company Structure" No. 864 (Sept. 1, 1995) (Exhibit RME-842). In short, Yukos was initially organized as two producing companies -- YNG and the smaller Samaraneftegaz -- feeding an oil refining/distributing complex centered in Samara. This reflected earlier Soviet practice, and the oil pipeline network was accordingly designed to foster the flow of oil amongst these entities and then onward distribution. *See* Rosneft IPO Prospectus, Pipeline Maps (July 14, 2006), 127 *et seq.* (Annex (Merits) C-380).

1094 The Achinsk and Angarsk refineries in Siberia, sold in Lot No. 10, processing YNG's crude, were of particular importance to Rosneft. *See Rosneft Subsidiary Neft-Aktiv Wins Auction for Lot 10 of YUKOS Assets*, Rosneft Press Release (May 3, 2007) (Annex (Merits) C-859).

1095 *See Resolutions of the Rosneft Board of Directors,* Rosneft Press Release, Mar. 20, 2007 (Annex (Merits) C-837).

1096 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35-B (Aug. 8, 2007) (Annex (Merits) C-360).

1097 *See* Finalization Order (Exhibit RME-752). Based on the RUB/US$ exchange rate on Nov. 1, 2007.

provisions of Russian law allowing the filing of claims in bankruptcy proceedings even after the closure of the Register of Creditors' Claims" and "fabricated" further liabilities "to ensure that the liquidation of Yukos as originally envisaged would be achieved."[1098] That the receiver andcCourt followed Russian law is hardly a basis for complaint, and once again Claimants' conspiracy theory is flatly contradicted by the facts. [1099]

665. In fact, "late" claims in the Bankruptcy Proceedings consisted chiefly of claims by the Federal Tax Service for 24% profit taxes on the proceeds arising from the Bankruptcy Auctions themselves.[1100] The underlying taxes were assessed on August 24, 2007, and the claims were included in the Bankruptcy Register on October 22, 2007.[1101] It is therefore preposterous for Claimants to allege that Mr. Rebgun requested, and the Moscow Arbitrazh Court granted, an extension of receivership proceedings in order to allow the filing of these claims "*in pursuance of the Russian Federation's plan*" to "*prevent any distribution of proceeds* […] *to Yukos' shareholders*."[1102] Receivers routinely file, and bankruptcy courts routinely grant, extensions of receivership proceedings, especially in complex and sizeable bankruptcy matters such as this one.[1103]

1098 Claimants' Memorial on the Merits, ¶¶ 486-492.

1099 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35-B (Aug. 8, 2007) (Annex (Merits) C-360).

1100 These claims were valid and validly filed in the Bankruptcy Proceedings. *See* Konnov Report, ¶¶ 29-30. Pursuant to Art. 142(4) of the Russian Bankruptcy Law, any claim submitted after closure of the register of claims (in the case of Yukos, on Oct. 12, 2006), as well as any claim for mandatory payments arising after the commencement of receivership (irrespective of when it was filed against the debtor), is validly filed as a "late" claim and recorded on a separate list. "Late" claims are satisfied after full satisfaction of timely claims included in the register of bankruptcy claims. *See* Art. 142(4) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

This treatment is consistent with the practice in other jurisdictions, where claims can be validly filed until completion of the bankruptcy proceedings. *See* ¶¶ 1506-1507 *infra*.

1101 *See* Federal Tax Service Claim of Aug. 24, 2007 No. 52-17-10/19965 (Case No. A40-11836/06-88-35 "B") (Exhibit RME-843) and Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 "B" (Oct. 22, 2007) (Exhibit RME-844).

1102 Claimants' Memorial on the Merits, ¶¶ 486, 487, 492.

1103 *See* ¶ 1505 *infra*. As noted, pursuant to Article 124(2) of the 2002 Russian Bankruptcy Law (Exhibit RME-776), "*[r]eceivership is introduced for 1 year. The term of receivership may be extended at the request of a party to the bankruptcy proceedings for up to 6 months*." *See, e.g.*, Ruling of the

666. "Late" profit tax claims -- far from having been belatedly "*fabricated*" by the tax authorities "*to ensure that the liquidation of Yukos as originally envisaged would be achieved*"[1104] -- are by their nature standard late claims in any bankruptcy proceedings because they almost always arise (unless the debtor's assets are sold at book value, yielding no profit at all), and only upon consummation of the auctions generating the taxed proceeds. Indeed, Mr. Rebgun had anticipated these claims more than one year earlier when assessing Yukos' viability, but the taxes could not then have actually been included in the Bankruptcy Register.[1105]

667. Because of the size of the profits arising from the Bankruptcy Auctions, these claims were also very sizable and absorbed the majority of the bankruptcy estate residue, proportionately to any other "late" claims.[1106] The tax "late" claims (as well as other "late" claims) remained partially unsatisfied.[1107]

668. Further, under international practice, the treatment afforded to these "late" tax claims in the Yukos bankruptcy was considerably less favorable than they would have received in other countries.

669. The Yukos bankruptcy estate was used entirely to satisfy creditors' claims.[1108] However, because creditor claims exceeded auction proceeds by a

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Supreme Arbitrazh Court of the Russian Federation, Case No. VAS-3154/06 (Dec. 17, 2010) (Exhibit RME-845) (stating that "*[b]y the decision of the Arbitrazh Court of the Krasnoyarsk Region of February 22, 2006* [...] *receivership was initiated.* [...] *The term of receivership was extended several times by rulings of the court (last time until February 21, 2010).*")

1104 Claimants' Memorial on the Merits, ¶ 824.

1105 *See* Protocol of the Creditors' Meeting (Annex (Merits) C-319).

1106 Claimants allege that, unlike the Federal Tax Service, "*[t]he other ten subsequent creditors received almost nothing.*" *See* Claimants' Memorial on the Merits, ¶ 491. In reality, all late creditors received 68.3% of the amount of their claims. *See* Finalization Order, 12 (Exhibit RME-752). If minor creditors received trivial amounts, this was not due to any discrimination but simply to the fact that the amount of their claims was also trivial if compared to the amount of the late tax claims.

1107 *See* Finalization Order, 12 (Exhibit RME-752). In any event, if the Moscow Arbitrazh Court had terminated receivership proceedings leaving a surplus of assets, this would have been irrelevant to the ultimate fate of Yukos and Claimants. The unsatisfied "late" creditors could have initiated new bankruptcy proceedings, which would have led to the same outcome as the actual, extended proceedings.

1108 *See* Finalization Order (Exhibit RME-752).

significant margin, nothing was available for distribution to the holders of last-in-line equity interests, such as Claimants. In the end, liabilities totalling no less than RUB 227.1 billion (approximately US$ 9.2 billion), of which RUB 72.1 billion (approximately US$ 2.9 billion)[1109] consisted of claims by the Russian Federal Tax Service, remained unsatisfied.[1110]

670. On November 15, 2007, the Moscow Arbitrazh Court formally acknowledged the completion of Yukos' receivership, and closed Yukos' bankruptcy proceedings.[1111] On November 21, 2007, Yukos was cancelled from the Russian companies' register, and ceased to exist.[1112]

671. Ultimately, the liquidation of Yukos followed from the disastrous strategy adopted by the Oligarchs and Yukos' management, in furtherance of their own interests over those of the company and of creditors. It was not the Russian Federation, through the Russian authorities, that caused the liquidation of Yukos. That liquidation was the inevitable consequence of persistent tax abuses and massive asset stripping on the part of the Oligarchs, compounded by repeated decisions to avoid, rather than meet their obligations.

M. The Searches And Seizures, Criminal Investigations And Criminal Prosecution Of Former Yukos Managers Were Prompted By Yukos' Underlying Criminal Behavior, And Proceeded In Accordance With Russian Law

672. The Counter-Memorial has thus far detailed a consistent pattern of behavior on the part of Yukos, Claimants, and the Oligarchs, punctuated by corruption, deception, concealment, and obstruction. It should thus not be surprising that their conduct attracted not only tax investigations, but also criminal investigations and prosecutions. And in the face of the Oligarchs' characteristic obstructive behavior, and their association with serious violent

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1109 Based on the RUB/US$ exchange rate on Nov. 15, 2007.

1110 *See* Receiver's Report, 147-150 (Exhibit RME-751); Finalization Order, 18 (Exhibit RME-752); and Yukos Liquidation Balance Sheet (Oct. 31, 2007) (Exhibit RME-753).

1111 *See* Finalization Order (Exhibit RME-752).

1112 *See Yukos Oil Firm Formally Ceases to Exist*, RIA Novosti (Nov. 22, 2007) (Exhibit RME-846).

crimes, it should also not be surprising that the investigations would need to make use of the full range of prosecutorial tools to get to the truth.

673. Although Claimants spill much ink on alleged breaches of due process in relation to criminal investigations and prosecutions, they are of only remote, if any, relevance, to the claims that may properly be asserted by Claimants in these arbitrations. As shown below, the Tribunal should not allow them to divert the Tribunal's attention from the relevant facts.

1. Yukos Carried Out A Campaign Of Obstruction Aimed At Thwarting The Authorities' Attempts To Gather Evidence

674. As the facts presented above indicate, in 2003-2004 Yukos was conducting an aggressive and effective campaign of obstructing the investigating authorities' efforts. Yukos' legal and security departments had developed a sophisticated and cynical method of dealing with these investigations.

675. First, Yukos used its political influence, including if necessary corrupt methods, to pressure individual investigators to terminate or suspend investigations. The history of the corrupt activities of Yukos' security department in this respect are but one example. In cryptic but unmistakable terms, by Alexei Golubovich, a Menatep shareholder and Director of Strategic Planning at Yukos, stated as follows when he was questioned by the General Prosecutor's Office in December 2006:

> "Q: And what about Nevzlin's role?
>
> A: One could read more about Nevzlin's role in Internet than I can tell. I think there were a few reasons why Nevzlin was the second person and had this share: first, from the beginning he was with Khodorkovsky as the partner dealing with different things - mass media control, security and so on [...]
>
> [...] he was responsible as they say for public relations in general, that is to say he coordinated other people responsible for deputies, officials and so on, i.e. you are responsible for work with Council of Ministers and you - for State Duma and, for example, with the Moscow Mayor's Office, and you and somebody else - with Governors and I tell all of you how to work with them. For instance with this Governor you will work in the following way,

> with these deputies - in that way and I distribute the budget for the expenses connected with this work [...]
>
> [...] my impression is that Khodorkovsky tried to authorise Nevzlin with settlement of questions connected with struggle against business rivals in courts, with impact upon rivals through administrative resource, that is to say, attraction of officials to side with you, use of security measures in competition struggle, collection of discreditable materials or its use, influence through press, as he tried to be as far as possible of this."[1113]

676. Second, Yukos managed its financial affairs on a "need to know" basis, with only relatively few senior managers ever seeing the full picture or understanding how Yukos' affairs were really run.[1114] Practically all those senior managers left Russia in late 2004 in order to avoid questioning, leaving only relatively junior employees who were able to assist the investigators in only limited ways.

677. Third, Yukos managers told other employees to leave Russia to prevent investigators from obtaining incriminating evidence. Alla Karaseva, an accountant at Yukos and the general director of Forest Oil, one of the sham trading companies that Yukos registered in Lesnoy, told investigators in January 2008 that she was telephoned by her supervisor in mid-July 2003 and told that "*I needed to go to Cyprus for a couple of weeks and that the ticket there had already been purchased in my name.*"[1115] She duly complied and the "*couple of weeks*" turned into a stay of more than six months, during which she, along with three other Yukos employees, were housed at Yukos' expense.[1116] Even after Ms. Karaseva left Cyprus she returned not to Russia but to Ukraine, where again she was housed in a rental apartment paid for by Yukos.[1117] At all times she followed the

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1113 Russian Federation General Prosecutor's Office, Protocol of Interrogation of Alexei Golubovich (Dec. 12, 2006), 3-4 **(**Exhibit RME-71**)**. [emphases added]

1114 *See e.g.* ¶ 271.

1115 Investigative Committee under the Prosecutor's Office of the Russian Federation, Protocol of Interrogation of Alla Karaseva (Jan. 25, 2008), 1 **(**Exhibit RME-412**)**.

1116 *Ibid.*, 3.

1117 *Ibid.*

instructions of Yukos' security service, which made the necessary arrangements, and handed her money, travel documents, and so on.[1118]

678. The three other Yukos employees were Vladislav Kartashev, Alexei Spirichev, and Irina Chernikova,[1119] who were general directors of other sham Lesnoy companies -- Mitra, Business Oil, and Vald Oil. Their absence from Russia during 2004 and 2005 meant that none of them could be called as witnesses at the trial of Messrs. Khodorkovsky and Lebedev. That, in turn, led Messrs. Khodorkovsky and Lebedev to argue in their defense that they "*did not use* [and were not] *in control of*"the companies Business Oil, Mitra, Vald Oil, Forest Oil, Alkhanay, Perspektiva Optimum, Investprojekt and "*never met Spirichev, Kartashev, Chernikova or Karaseva.*"[1120]

679. Fourth, those Yukos witnesses who did appear for questioning were told by Yukos' legal team and its security service exactly what to say. Prior to her forced departure to Cyprus, Ms. Karaseva, who three years later was forced by Yukos to depart the country, had been questioned by the local tax police in Lesnoy in 2001. Ms. Karaseva described the instructions Yukos management gave her prior to her questioning:

> "Kuchusheva, Golub's "right-hand" person, gave me a list of the questions to be posed to me and instructed me on how to answer them. […] And the instructions were rather clear, for example, to say that I myself took a decision to pay taxes owed by LLC Forest Oil in promissory notes, but in reality this was not the case [...]"[1121]

680. Ms. Golub was a senior Yukos manager in Moscow, not Lesnoy. In another example of their attempts to obfuscate, in 2001, Ms. Golub wrote to Dmitry Gololobov of Yukos' legal department, asking him to consider submitting a letter of complaint to the Prosecutor General a in the name of a managing director of one or another of the sham trading companies that had been

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1118 *Ibid.*

1119 *Ibid.*

1120 First Criminal Sentence (May 16, 2005), 1, 3 (English and Russian) **(**Exhibit RME-414**)**.

1121 Investigative Committee under the Prosecutor's Office of the Russian Federation, Protocol of Interrogation of Alla Karaseva (Jan. 25, 2008), 2 **(**Exhibit RME-412**)**.

registered in Lesnoy.[1122] The draft complaint was intended to convey to the Prosecutor General that the Lesnoy tax investigation was without foundation -- but without disclosing that it had been drafted by Yukos' management, and arranged by Yukos' legal department.

681. Fifth, Yukos systematically destroyed its own documents to thwart investigators' efforts. Its senior management, as well as its security services, issued edicts obliging staff to destroy any non-essential material, and then policed compliance with these edicts. Alexei Kurtsin, a mid-level employee of Yukos-Moscow, described this to investigators:

> "Q: Were oral or written instructions given by the leadership of OAO NK Yukos during 2003-2004 relating to the company about destruction of hard copy documents or electronic files?
>
> A: At the beginning of 2003 Lebedev, who was one of the principal shareholder-beneficiaries of OAO NK Yukos, was arrested, and the first searches were carried out in relation to the criminal case in, I think, an archive of the company. Soon after that an oral instruction was given from the leadership of the company, which was passed on to me by the deputy manager Zhagrov and given to him by the manager of OOO Yukos Moscow T.I. Glazunova. At that time I was working under Zhagrov. He gathered together all our group and said that searches had been carried out so it was necessary to destroy superfluous unofficial documents relating to the affairs of the company, both in electronic and paper form. From his words it was apparent that every employee had to establish which documents should be destroyed, and that superfluous documents which were found in a probable search might be used by the investigating organs against the interests of the company and its owners. […]
>
> We were also reminded that the security service would be checking what notes remained on our desks. There was information circulating in the office about so-called "night raids" organized by individuals from the security service, who were checking whether documents or notes had been left by employees on their desks. […]
>
> By "official documents" I mean rules, orders, minutes and board meetings, shareholder meetings and other documents without which the company cannot operate and which it is impossible to

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1122 Letter from I. Golub to D. Gololobov with Draft Complaint (Exhibit RME-415).

> hide. But here we are talking about unofficial documents, such as lists of approvals required attached to documents, instructions given in notes passing to and fro, documentation accompanying the creation of official documents which was supposed to be destroyed once the document had been created. Those documents contained the names of the implementing individuals, schemes for the realization of certain projects, possible information about particular budgets. […]"[1123]

2. The Searches And Seizures Were Intended To Gather Evidence, Not "Destroy" Yukos

682. Claimants make a number of sweeping allegations about the searches and seizures of Yukos carried out during the criminal investigations in 2003 and 2004. They allege that the goal of these searches was not to gather evidence but rather "*to disrupt and destabilize Yukos' operations with a view to facilitating the destruction of the Company.*"[1124] As is true of any search in a criminal investigation, the searches of Yukos' premises no doubt had some disruptive effect. But Claimants offer no evidence to support their contention that the searches were conducted improperly. As has been shown, Yukos' efforts at obstruction made it particularly difficult for investigators to gather information they were entitled to have.

683. Claimants also assert that the searches "*were conducted in violation of the most basic requirements of due process and procedural propriety.*"[1125] These allegations are gross distortions, as is demonstrated below.

a) The Timing Of The Searches Was Not Dictated By Other Events

684. Claimants contend that the timing of searches "*was often chosen to coincide with key actions related to the destruction of Yukos.*"[1126] This is a fanciful assertion. The only principal example given is a search carried out on July 3, 2004

1123 Main Investigative Department of the Investigation Committee in the Office of the State Attorney of the Russian Federation, Protocol of Interrogation of Alexei Kurtsin (Mar. 24, 2010), 2, 3 **(**Exhibit RME-416**)**.

1124 Claimants' Memorial on the Merits, ¶ 152.

1125 *Ibid.*, ¶ 569.

1126 *Ibid.*, ¶ 152.

at Yukos' headquarters, which happened to be three days after the commencement of enforcement proceedings by the court bailiffs.[1127] Yet no explanation is given as to what possible advantage the Prosecutor General or the court bailiffs might have obtained by coordinating their activities in this way. Claimants also note that searches were carried out on October 3, 2003, "*the same day that the press announced the completion of the YukosSibneft merger,*"[1128] implying that the searches were somehow in retaliation for the announcement. But there is no evidence of government hostility to the proposed merger at the time, and any search requires a significant amount of planning, making it inconceivable that the search would have been prompted by Yukos' press release.

b) There Was Nothing Improper In The Actions Of The Russian Authorities When They Conducted Searches And Seizures

685. Claimants' description of the searches and seizures is misleading in many respects ad cannot withstand scrutiny.

686. Russian law provides for strict safeguards to afford due process, all of which were fully complied with during the July 11, 2003 search of Yukos' Moscow headquarters, about which Claimants take issue[1129]:

(i) Article 164(3) of the Russian Code of Criminal Procedure (the "RCCP") stipulates that investigation procedures (such as searches) may be conducted at night when "*the procedure cannot be postponed.*"[1130] The search protocols set out the reasoning of the investigators as to why the search could not, in this case, be postponed until the next day. Specifically, the search on July 11,

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1127 *Ibid.*, ¶ 154.

1128 *Ibid.*, ¶ 161. Claimants provide an unintentionally amusing description of the October 3, 2003 searches as "*raids on* [...] *entities more or less remotely related to Yukos.*" On this day the authorities searched the offices of GML Management Limited at the address of Zhukovka village, 112, a company which can hardly be described as "*remotely related to Yukos.*"

1129 Claimants' Memorial on the Merits, ¶¶ 153, 570.

1130 Specifically, investigations are permitted between the hours of 10 p.m. and 6 a.m. in these circumstances. *See* Russian Code of Criminal Procedure, Art. 5(22) **(**Exhibit RME-424**)**.

2003 started at 11:25 a.m.,[1131] and at 9:45 p.m. the investigators discovered an office with many computers in it, despite having been told by Yukos representatives that there were no computers in the building. The investigators were concerned that computer files could be destroyed once the investigators had departed. The decision was therefore taken to continue the search and review of the computer files.[1132]

(ii) Under Article 182(4) of the RCCP, a search warrant must be produced before the search begins.[1133] This requirement was complied with during the search of July 11, 2003, as proven by the signature of a Yukos employee on the warrant.[1134]

(iii) Article 170 of the RCCP provides that two witnesses shall be present during a search. The search protocols of July 11, 2003 demonstrate that this requirement was also satisfied.[1135]

(iv) Article 182(13) of the RCCP provides that all seized items shall be described in a protocol with their quantity, individual features and

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1131 Search Protocol Issued by Investigators Fedosov A.E. and Vasiliev A.L. (July 11, 2003), 1 **(**Exhibit RME-425**)**.

1132 Search Protocol Issued by Investigators Fedosov A.E. and Vasiliev A.L. (July 11, 2003), 1-2, 6 **(**Exhibit RME-429**)**.

1133 *See* Russian Code of Criminal, Art. 182(4) (July 7, 2003) (Exhibit RME-424).

1134 *See* Warrant for the Search of Premises Located at Dubininskaya St.., 17A, Moscow (July 9, 2003), 2 (showing signature of Yukos security service employee) **(**Exhibit RME-426**)**; *See also* Warrant for the Search of Premises Located at Dubininskaya St., 31A, Moscow (July 3, 2004), 6-7 (showing signatures of two Yukos employees) **(**Exhibit RME-427**)**; Warrant for the Search of Premises Located at Lenina St., 26, City of Nefteyugansk (Sept. 22, 2004), 2-3 (showing signature of YNG deputy head of legal division) **(**Exhibit RME-428**)**. When the investigators approached the Yukos building at Dubininskaya St.., 17A on July 11, 2003, Yukos employees resisted the investigators' attempt to enter the building. *See* Search Protocol Issued by Investigators Fedosov A.E. and Vasiliev A.L. (July 11, 2003), 1-3 **(**Exhibit RME-429**)**.

1135 Search Protocol Issued by Investigators Fedosov A.E. and Vasiliev A.L. (July 11, 2003), 1, 2 **(**Exhibit RME-429**)** (identifying the names of the two witnesses present during the search); *ibid.*, 2 (confirming that an additional two witnesses were present during the search when the initial two witnesses were in another location). *See also* Search Protocol Issued by Investigator Rusanova T.B. (July 3, 2004), 1 (Exhibit RME-430) (identifying the names of the two witnesses present during the search); Search Protocol Issued by Investigators (September 25, 2004), 1 (identifying the names of the two witnesses present during the search) (Exhibit RME-431).

(if possible) value being noted.[1136] The materials seized on July 11, 2003 and at other times were properly listed and allowed for identification of specific seized items.

687. The fact that the July 3, 2004 search was conducted on a Saturday rather than a business day does not support Claimants' accusations of impropriety. Russian procedural law does not bar the authorities from conducting searches on weekends.[1137] The search of a 22-story office building[1138] with at least hundreds of employees on a working day would require substantially more governmental resources and would have been significantly more disruptive of Yukos' business.

688. Claimants also wrongly contend that the search warrants were too broad and vague in scope.[1139] To the contrary, the searches were carried out on the basis of warrants that specified the investigation to which the search related and the kind of information sought. By way of example, the first search of July 11, 2003 was conducted in accordance with a warrant issued on July 9, 2003 by the investigator Mr. Bezuglyi.[1140] In the warrant the investigator specifies (i) that the search relates to the criminal case relating to the unlawful acquisition of the Apatit shares, (ii) the specific companies involved in the acquisition, and (iii) that the employees of these companies were employed by Bank Menatep at the same time and were controlled by the Bank's President Mr. Lebedev.[1141] Because Bank Menatep had by that time been liquidated, documents related to its activities and to the activities of those companies under its control could be located in Yukos' archives at Dubininskaya St., 17A, Moscow.[1142]

1136 *See* Russian Code of Criminal, Art. 182(13) (July 7, 2003) (Exhibit RME-424).

1137 *See* Russian Code of Criminal Procedure, Art. 164 (Exhibit RME-424).

1138 *Two companies will be fighting over Yukos's 22-storey office building in downtown Moscow*, RIA Novosti (Nov. 5, 2007) (Exhibit RME-432).

1139 Claimants' Memorial on the Merits, ¶ 570.

1140 Warrant for the Search of Premises Located at Dubininskaya St., 17A, Moscow (July 9, 2003) (Exhibit RME-426).

1141 *Ibid*., 1-2..

1142 *Ibid*., 2.

689. Similarly, the October 5, 2005 search at the offices of Open Russia, about which Claimants also complain,[1143] was authorized by a warrant setting out the reasons for the search. The warrant explains that Open Russia was the receiver of funds stolen from Yukos production subsidiaries in a total amount of US $18.4 million, and that the purpose of the search was to locate documents and information about the transfers of these funds from GML to Open Russia.[1144] The search was conducted in accordance with Russian law, as is evidenced by the search protocol: two witnesses and the chief accountant of Open Russia were present, and a detailed list of documents seized was made.[1145] A copy of the protocol was provided to the chief accountant of Open Russia.[1146]

c) The Searches And Seizures Caused No Unnecessary Disturbance To Yukos

690. Claimants submit that *"the impact of... searches and seizures on Yukos' operations was substantial."*[1147] Yet statements made by Yukos' own personnel at that time contradict this assertion. For example, the day after the search of July 11, 2003, Yukos lawyer Albert Mkrtychev said that *"nothing of huge importance was taken."*[1148] Claimants also refer to a press report about the search conducted on July 3, 2004, which quotes a Mr. Shadrin (a Yukos spokesman) as stating that *"officials seized vital computer servers during the raid."*[1149] Yet Claimants also provide another article quoting the same Mr. Shadrin as confirming that servers had not been taken, and that *"police had not ... seized vital equipment."*[1150]

1143 Claimants' Memorial on the Merits, ¶ 164.

1144 Warrant for the Search of Open Russia's Premises (Oct. 5, 2005), 1-3 (Exhibit RME-433).

1145 Search Protocol Issued by Investigators (Oct. 6, 2005), 3-9 (Exhibit RME-440).

1146 *Ibid.*, 11.

1147 Claimants' Memorial on the Merits, ¶¶ 156, 157.

1148 Igor Semenenko, *Prosecutors Search Yukos Office for 17 Hours*, Moscow Times (July 14, 2003), 1 (Annex (Merits) C-641).

1149 Tom Parfitt, *Special Forces Raid Russian Oil Firm's Headquarters*, The Daily Telegraph (July 4, 2004), 1 (Annex (Merits) C-690).

1150 *Yukos Raided, Banks Declare it in Default*, GAZETA.RU (July 5, 2004) (Annex (Merits) C-691).

691. Claimants' accusation that the authorities "*blocked the operation of the computer system and cut off the telephone lines*"[1151] when conducting a search in the office of M-Reestr is contradicted by their own evidence. Following the search, Yukos' spokesperson "*declared to Vedomosti that Yukos saw no associated risks, and that the register was back up and running by Friday evening.*"[1152]

692. Claimants' contention that "documents and computer hard drives […] were not returned, and copies were not provided to Yukos, here too in violation of Russian law,"[1153] is misplaced:

(i) Under Articles 81(3)(5) and 84(3) of the RCCP, documents and other items which serve as evidence in a criminal case must be kept together with the case file while the convicted persons serve their sentence, and during a certain period thereafter.[1154]

(ii) Under Article 81(3)(5) and 84 (3) of the RCCP, seized documents and other items (or copies thereof) may be provided to the owners upon request.[1155] Claimants have presented no evidence that the authorities refused to satisfy such requests, if any, without good reason.

1151 Claimants' Memorial on the Merits, ¶ 160.

1152 *Yukos Repurchases its Shares*, Vedemosti (July 7, 2003), 2 (Annex (Merits) C-638). The same evidence rebuts the claim that the authorities "*cut off the telephone lines,*" as there is no mention of the purportedly cut off lines in the article, but only a complaint by one of the register's clients that "*they weren't answering the phones.*" *Ibid*.

1153 Claimants' Memorial on the Merits, ¶ 573.

1154 This is in accordance with the Order of the Supreme Court of Russia No. 70 dated 01.06.2007 "*On adoption of a list of documents, produced by the courts of general jurisdiction, with the terms of their storage*" (Section 2.9, List of Terms, section 5/B) and Article 86(3) of the RCCP **(**Exhibit RME-424**))**.

1155 Russian Code of Criminal Procedure, Art. 81(3)(5) and 84(3) (Exhibit RME-424).

d) The Searches Respected The Advocate's Privilege When Applicable

693. Contrary to Claimants' sweeping assertions,[1156] the searchers respected the advocates' privilege when it was applicable.

694. One issue the searchers found was that Yukos management tried to hide behind the veil of advocate's privilege by placing documents in offices made to appear like those of advocates conveniently located in Yukos' or Menatep's own office building. For example, another lawyer for Yukos, Mr. Dyatlev, though registered with the law firm "Kaganer and Partners"[1157] located at Bogoroditskyi val, 6, bildg. 1, seemed to have had an "*additional*" office at Kolpachny pereulok, 5, Moscow[1158], in one of the main buildings where "*the companies of the Yukos key shareholder - Group Menatep - were located*."[1159]

695. The search protocols confirm that investigators fully respected advocate's privilege during the searches, and did not continue to search when there was clear evidence that a certain office was occupied by an advocate. On July 3, 2004, for example, two investigators searching the Yukos Moscow headquarters independently from each other came to the offices of two Yukos lawyers, with a sign on each office clearly indicating that it belonged to an "advocate." Both investigators recorded in the search protocols that "*it was established that office* […] *was owned by advocate* […] *therefore search procedure was impossible*."[1160]

1156 Claimants' Memorial on the Merits, ¶ 579.

1157 European Court of Human Rights, Mikhail Borisovich Khodorkovsky v. The Russian Federation (Application No. 11082/6), Witness Statement of Denis Dyatlev (Aug. 22, 2006), ¶ 4 (Annex (Merits) C-443).

1158 *Ibid.*, ¶¶ 22-23.

1159 *Russian Property Fund Has Sold Khodorkovsky's Castle*, lenta.ru (Aug. 8, 2005) (Exhibit RME-437).

1160 Search protocol of July 3, 2004 issued by investigator Plotnikov D.A., 2 (Exhibit RME-447). *See also* Search protocol of July 3, 2004, issued by investigator Alyshev V.N., 8 (Exhibit RME-448). This latter protocol by the investigator Alyshev V.N. also proves that Yukos indeed operated sham companies from its headquarters; the investigator found documents related to Fargoil and stamps of both Yukos and Fargoil carrying the name of the same employee, a certain Vlasov A.G. *See*, Search protocol of July 3, 2004, issued by investigator Alyshev V.N., 2-7, 11 (Exhibit RME-448).

3. Claimants' Allegations Of Violations Of Due Process In The Criminal Trial Of Messrs. Khodorkovsky And Lebedev Are Unjustified

696. Claimants make many sweeping assertions as to alleged violations of due process in the criminal investigations and trials, but they also rely on the witness statement of Mr. Schmidt, who is, of course, an advocate acting for Mr. Khodorkovsky, and whose statement is therefore just special pleading.[1161] Mr. Schmidt also often fails to cite relevant law or set out clearly the relevant facts.

697. In order properly to answer every random allegation made by Claimants, Respondent would need to include an entire memorial within this memorial.

698. For illustrative purposes, however, Respondent addresses three particular areas on which Claimants focus.

a) Svetlana Bakhmina

699. The arrest, interrogation, trial, and subsequent imprisonment of Svetlana Bakhmina, a Yukos in-house lawyer, are put forward as supposed examples of a "*massive and methodical intimidation campaign*" against Yukos' top managers.[1162]

700. In particular, Claimants insinuate that the investigators "offered to release Ms. Bakhmina if Mr. Gololobov, who had been her superior in the Yukos legal department, returned from London."[1163] The only "evidence" cited for this accusation is a newspaper article which itself quotes another newspaper article from Kommersant, which (apparently) quotes "unidentified" investigators who made this suggestion.[1164] Ms. Bakhmina herself, however, has contradicted this allegation in a press interview:

1161 Witness Statement of Yuri Schmidt, Sept. 15, 2010 ("Schmidt Witness Statement"), ¶ 8.

1162 Claimants' Memorial on the Merits, ¶ 134.

1163 *Ibid*, ¶ 135.

1164 *Yukos Lawyer, a Mother of Two, Gets 7 Years*, The Washington Post (Apr. 20, 2006), 2 (Annex (Merits) C-800).

> "[Question] Perhaps they decided to use you as a hostage in the hope, for example, that your bosses would return from London? Or as a means to bring pressure on Khodorkovsky?
>
> [Answer] We can only guess, because no-one discussed that with me, of course."[1165]

b) Use of Metal/Glass "Cages"

701. Mr. Schmidt states that Messrs. Khodorkovsky and Lebedev were "exhibited to the public through a metal cage."[1166] He then states that, during the cassation instance and throughout their second criminal trial, Messrs. Khodorkovsky and Lebedev were kept in a "heavy glass cage," which had the effect of forcing their lawyers to speak to them through a "small hole."[1167] Thus, he says, privileged conversations "could be heard by anyone because of the hidden microphones."[1168]

702. All Russian criminal defendants sit during court proceedings in an enclosed space which is protected by either metal bars or thick (bullet-proof) glass. Mr. Schmidt's suggestion that his clients were singled out for special treatment is deliberately misleading.[1169]

703. Second, a special panel through which defendants may speak to their counsel is provided for by law, and Mr. Schmidt was able to make use of this. He was in the same position as any Russian advocate. As for "the hidden microphones," Mr. Schmidt gives no details of what he is referring to.[1170]

1165 "The Arrest Was Rather Spontaneous," Vedomosti, 4 (May 21, 2009) (Exhibit RME-438).

1166 Schmidt Witness Statement, ¶ 32.

1167 *Ibid.*

1168 *Ibid.*

1169 An allegation that use of a glass enclosure infringed a defendant's right to a fair trial was expressly rejected by the European Court of Human Rights in *Ashot Harutyunyan v. Armenia*, ECHR Application No. 34334/04, Judgment (June 15, 2010), ¶¶ 137-40 (Exhibit RME-439).

1170 Schmidt Witness Statement, ¶ 32.

c) Location Of Messrs. Khodorkovsky's And Lebedev's Imprisonment

704. Claimants allege that Messrs. Khodorkovsky and Lebedev were unlawfully and deliberately sent to serve their sentences in remote parts of Russia where conditions are particularly harsh. Indeed, they even insinuate that the location chosen for Mr. Khodorkovsky was selected based on its "*high concentration of radioactive elements.*"[1171] As support, Mr. Schmidt cites the Russian law that required convicted persons be transferred to penal colonies situated in the regions closest to their places of residence or conviction.[1172] But Russia was, in practice, unable to comply with this provision, given its need to reduce overcrowding pursuant to judgments from the European Court of Human Rights,[1173] and it was for this reason that the law was changed in 2007. Article 73.2 now provides that:

> "[…] In the absence of a correctional facility of the appropriate type in the subject of the Russian Federation at the place of habitation or place of judgment, or in case of the impossibility of placing convicts in the available institutions, convicts shall be sent, by agreement with the appropriate higher management organs within the penal system, to correctional facilities located in the territory of another subject of the Russian Federation where there are conditions for their placement."[1174]

N. PwC Withdrew Its Audit Opinions Following Confirmation That Yukos' Senior Management Had For Years Lied To PwC's Audit Team, Not Because Of Any Purported "Harassment" By The Russian Federation

705. Finally, there is no basis for Claimants' self-serving accusation that PwC withdrew its audit opinions for Yukos because it was *"harassed"* by the Russian Federation.[1175] Rather, it is indisputable that PwC acted as it did only

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1171 Claimants' Memorial on the Merits, ¶ 115; Schmidt Witness Statement, ¶¶ 45, 47, citing article 73.2 of the Criminal Enforcement Code of the Russian Federation, in the form in which it was drafted in 20005, included this requirement.

1172 Schmidt Witness Statement, ¶¶ 45, 47.

1173 *Kalashnikov v. Russian Federation*, ECHR Application No. 47095/99, Judgment (July 15, 2002), ¶¶ 102-103 (Exhibit RME-436)

1174 Criminal Enforcement Code of Russia, Artic. 73(2) (Exhibit RME-362).

1175 Claimants' Memorial on the Merits, ¶¶ 143-151.

because it confirmed that Yukos had lied to it for years about matters that were material to PwC's audit opinions and its certifications of Yukos' financial statements. Further, by lying to PwC, Yukos effectively lied to all those who reasonably relied upon PwC's certifications, including Yukos' creditors and the investing public.

706. PwC audited Yukos' financial statements from 1995 to 2004, and certified that the company's financial statements for the years 1999 to 2002 were prepared in accordance with U.S. generally accepted accounting principles ("GAAP").[1176] PwC's unqualified audit opinions for those years were issued notwithstanding the firm's longstanding and oft-expressed concern that information provided by Yukos' senior management was neither complete nor accurate. In 2003, PwC concluded that it no longer had confidence in management's representations required to audit the company's financials.[1177] As a result, PwC did not review the company's post-second quarter 2003 GAAP financials and refused to sign an audit opinion for Yukos' 2003 annual GAAP financial statements.[1178]

707. Three years later, PwC's concerns were confirmed. In May and June 2007, Douglas Miller, the firm's lead auditor on the Yukos engagement, was presented with direct evidence that he had been deceived by Yukos' senior management. Aware that those same managers -- including Messrs. Khodorkovsky and Lebedev -- were then relying on PwC's unqualified audit opinions as evidence in pending judicial proceedings, PwC concluded that it needed to withdraw all of its outstanding opinions. In a letter sent to Eduard Rebgun, Yukos' bankruptcy receiver, PwC explained that the firm believed "*that we can no longer rely upon the Statements of the Management, which we had relied upon*

1176 *See* Record of Interrogation of PwC Director Douglas Robert Miller in Moscow, Russia ("Miller Interrogation Record") (May 4, 2007), 33 (Exhibit RME-137). The Miller Interrogation Records are the minutes of Mr. Miller's meetings with the Russian Federation's Office of the Prosecutor General in May and June 2007.

1177 *See* Miller Interrogation Record (May 4, 2007), 17-18 (Exhibit RME-137). *See also* Miller Interrogation Record (May 11, 2007), 8-10 (Exhibit RME-869).

1178 *See* Miller Interrogation Record (May 4, 2007), 33 (Exhibit RME-137).

throughout our audits."[1179] Under the circumstances, PwC stated that its prior audit opinions "*should no longer be relied upon as trustworthy*" and that "*[t]his should be immediately communicated*" to the individuals and regulatory authorities who were, or might be, relying upon them.[1180] The letter was signed by Mr. Miller.

708. A question can be raised as to whether PwC waited too long to withdraw its audit opinions. What cannot be disputed is that Yukos senior management's repeated and intentional misrepresentations, which began as early as in 1999, fully justified PwC's 2003 decision to cease auditing Yukos' financial statements and its 2007 decision to withdraw all of its prior audit opinions.

709. PwC's decision to withdraw its prior audit opinions was not taken in response to pressure allegedly brought to bear by the Russian Federation, and the firm did not receive any regulatory forbearance or other relief from the Russian Federation in return for the withdrawal of its audit opinions.[1181] To the contrary, the evidence shows that (i) PwC had substantial concerns about the credibility of representations made by Yukos' senior management as far back as 1998, (ii) these concerns caused the firm to terminate its GAAP auditing of Yukos' financials in 2003, (iii) PwC established an informal working group in early 2007, several months before the March 2007 purported "raid" on PwC's Moscow offices, to consider whether the firm should withdraw its audit opinions, (iv) the working group conducted a thorough and careful review of both the firm's dealings with Yukos and the relevant accounting standards before deciding to withdraw its audit opinions, and (v) the judicial proceedings brought against PwC by the Russian authorities continued for almost two years following the withdrawal of the firm's audit opinions.

1179 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

1180 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

1181 *See, e.g.*,¶¶ 751-756..

1. Yukos' Senior Management Deceived And Misled PwC's Audit Team

710. PwC's 2003 decision that it could no longer audit Yukos' financials followed several years of concern about the trustworthiness of representations made by Yukos' senior management. Those concerns were confirmed in early 2007, when Mr. Miller was confronted with direct evidence that he had been lied to by Yukos senior management, and led the firm to withdraw its outstanding audit opinions.

a) For Years Prior To The Withdrawal Of Its Audit Opinions, PwC Was Rightfully Concerned About The Trustworthiness Of Yukos' Senior Management

711. PwC's concern arose as early as 1998, when the firm attempted to identify the group of related companies whose results should be consolidated in Yukos' 1998 financials. At that time, PwC questioned whether Yukos controlled a number of Russian trading companies with which it had entered into large oil sale-repurchase agreements. As Mr. Miller explained in a signed statement made to the Russian Federation's Prosecutor General's Office in 2007, Yukos' management first claimed that the trading companies "*were not their [i.e.,Yukos'] companies,*" and then, after an "*adjournment*" to reconsider the issue, stated that the companies "*were controlled [by Yukos] and used for tax optimization.*"[1182]

712. Yukos' management did not, however, provide the auditors with adequate support for its position concerning the trading companies. As a result, PwC refused to sign an audit opinion on the company's 1998 financial

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1182 Miller Interrogation Record (May 4, 2007), 7 (Exhibit RME-137): "The issue related to the consolidation perimeter arose in connection with the 1998 financial statements. At that time Michael Soublin was CFO. We audited the financial statements that YUKOS provided, but we did not understand them. In particular, we did not understand certain transactions involving the sale and repurchase of oil and oil products. […] We went to Michael and said that we did not understand the substance of these transactions and, consequently, the problems that can be associated with them. We did not get any answer about the purpose of the transactions, they said that those were not their companies. This was the answer that we received from their accountant. […] Michael asked for an adjournment to clarify the issue and then he said that those were the companies that were controlled and used for tax optimization. Then we refused to sign the audit opinion on the financial statements in the form in which they were presented. Because we had a problem: they could not prove that they controlled the companies though we knew that they controlled them." [emphases added].

statements. The following year, believing that it had finally been presented with sufficient information to understand the control relationship, PwC agreed to sign the audit opinions for Yukos' 1998 and 1999 financial statements. In fact, as shown at ¶¶ 730 to 732 below, the "proof" of "control" then provided by Yukos turned out to be both wrong and intentionally misleading.

713. PwC also had questions during the 1998 audit about the very large volume of oil sold by Yukos to three of the Jurby Lake Structure offshore companies, Behles Petroleum S.A., Baltic Petroleum Trading Limited, and South Petroleum Limited (collectively, the "BBS companies"), which in turn resold the oil to their customers.[1183] As Mr. Miller explained:

> "We wanted to know about these companies, as at that time practically all the export oil was sold through them and we needed to have a confirmation that they were related parties of YUKOS. We asked this question many times and got confirmations from YUKOS management that these companies were not related parties. Maybe this was more than once, but I remember one written confirmation from the management where it was stated that these companies were not related parties."[1184]

714. In the years that followed, Yukos continued to deny to its auditors that it was related to any of the BBS companies.[1185]

715. The ownership of the BBS companies was raised again in 2002, this time in connection with Yukos' proposed public offering of its shares in the United States. As part of that process, a draft registration statement on Form F-1 (the form used by foreign companies to register securities for public sale in the United States) was prepared by a working group that included Yukos, its counsel

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1183 *See* Miller Interrogation Record (May 4, 2007), 13-14 (Exhibit RME-137). *See* ¶¶ 81-95 *supra*.

1184 Miller Interrogation Record (May 4, 2007), 14 (Exhibit RME-137) [emphases added].

1185 In a jointly signed letter dated May 24, 2002, Mr. Khodorkovsky and Bruce Misamore, then Yukos' Chief Financial Officer, represented to PwC that "at December 31, 2001 and during the three-year period then ended, Behles Petroleum S.A., South Petroleum Limited, [and] Baltic Petroleum Trading Limited […] were not related to [Yukos] under the provisions of [U.S.] Statement of Financial Accounting Standards No. 57 ["FAS 57"], Related Party Disclosures." Letter from M.B. Khodorkovsky and B.K. Misamore to PwC, dated May 24, 2002, ¶ 17 (Exhibit RME-139). As shown above, that representation was false. *See* ¶¶ 89-92 *supra*.

Akin Gump, and PwC. According to Mr. Miller, Yukos denied that the BBS companies were "related" to Yukos.[1186]

716. Mr. Miller and the PwC audit team were not convinced.

> "[T]he replies by the management of Group Menatep Limited and Yukos Oil OJSC and their majority shareholders that there was no relation did not convince us; we continued to regard that information as not fully reliable."[1187]

717. During the same period, PwC also became suspicious of an agreement entered into by Claimant YUL with Messrs. Muravlenko, Golubev, Ivanenko, and Kazakov (the "Yukos Universal Beneficiaries"), all of whom had been involved in Yukos' privatization in the mid-1990s.[1188] As noted under the agreement, the Yukos Universal Beneficiaries received 15% of Group Menatep's beneficial interest in Yukos.[1189] As a result, the Yukos Universal Beneficiaries were entitled, in the event Group Menatep sold any of its Yukos stock, to receive their proportionate share of the proceeds. Based on Yukos' market capitalization at the time, the Yukos Universal Beneficiaries' interest in Yukos was worth on the order of US$ 4 billion.[1190] In light of the enormous sums involved, far in excess of the amounts typically paid to a company's employees, Mr. Miller and his team questioned the true purpose of the agreement.

718. Mr. Lebedev insisted that the payments were for services rendered to Yukos. According to Mr. Miller:

> "Lebedev presented the agreement and indicated that the individuals were receiving these benefits for services provided to

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1186 Miller Interrogation Record (May 8, 2007, 13:19), 5 (Exhibit RME-17): "Early on in the listing process, the ownership of BBS was questioned by the working group – specifically Akin Gump and PwC. Our requests to Lebedev resulted in a response dated 27 August, 2002 from [Anton] Drel [counsel for Group Menatep] […] effectively claiming that they did not know who owned BBS and that BBS were not related to Yukos or Group MENATEP. The latest draft Form F-1 (dated March 2003) that I have available to me included no disclosure regarding BBS." [emphasis added].

1187 Miller Interrogation Record (June 4, 2007), 4 (Exhibit RME-871).

1188 *See* Miller Interrogation Record (May 8, 2007, 13:19), 5-6 (Exhibit RME-17).

1189 *See* Miller Interrogation Record (May 10, 2007), 3 (Exhibit RME-18).

1190 *See* Miller Interrogation Record (May 10, 2007), 3 (Exhibit RME-18).

> Yukos during their terms of employment. […]. [Despite Lebedev's insistence,] my colleagues and I had serious reservations as to whether the consideration was being provided for services rendered to Yukos. Accordingly, I initiated a series of meetings with Lebedev and Drel [counsel for Group Menatep] to discuss the reasons behind the compensation. […] During these meetings, Lebedev insisted that the [Yukos Universal] Beneficiaries were receiving these benefits as a result of services provided to Yukos. I strongly questioned this, as most of these individuals did not work for Yukos for very long following the privatization and because the value of the compensation did not appear to be in any way commensurate to any work they could have performed for Yukos."[1191]

719. Not satisfied with the answer he received, Mr. Miller asked whether the agreement related to services that had been provided to Yukos' majority shareholders to assist them in acquiring Yukos or in obtaining control over the company following its privatization:

> "At various points, I asked whether perhaps they were being compensated for other services to the shareholders, such as assistance in acquiring Yukos or in bringing the company under control after privatization."[1192]

720. Mr. Khodorkovsky's answer -- that the real reason for the agreement, if disclosed, might lead to his going to prison -- was, to the say the least, troubling. According to Mr. Miller:

> "At that meeting, Khodorkovsky said (and I do not remember his exact words, but they implied) that if he confirmed that my assumptions were right and that if he told me the true reasons why the beneficiaries were receiving this money, he could be imprisoned."[1193]

721. Within a year of that 2003 meeting, both Messrs. Khodorkovsky and Lebedev were arrested and charged with various criminal acts arising out of the mid-1990s privatizations and with fraud in connection with Yukos' (and their own) tax filings. These developments only heightened PwC's concerns. PwC's

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1191 Miller Interrogation Record (May 8, 2007, 13:19), 5-6 (Exhibit RME-17) [emphasis added]. In a subsequent statement, Mr. Miller reiterated, "I could not understand what work could have been done by them for YUKOS for this huge amount of money; it wasn't logical to me." Miller Interrogation Record (May 10, 2007), 8 (Exhibit RME-18).

1192 Miller Interrogation Record (May 8, 2007, 13:19), 6 (Exhibit RME-17).

1193 Miller Interrogation Record (May 10, 2007), 8 (Exhibit RME-18) [emphasis added].

initial response was to request that the company conduct an investigation as to whether any crimes had been committed and, if so, what were the financial consequences of those crimes for the company -- often referred to as a "10A investigation" because of the section of the U.S. securities laws requiring accounting firms to investigate possible wrongdoing by clients having securities registered with the SEC.[1194]

722. Even though the purpose of the investigation was to determine whether a crime was likely to have been committed, and even though Yukos was then publicly proclaiming the innocence of Messrs. Khodorkovsky and Lebedev, the company never confirmed to PwC that no crime had been committed.[1195] In light of Yukos' failure to confirm to its auditors what it was telling the public on this important issue, PwC determined, not surprisingly, that it could no longer audit Yukos' financials. As Mr. Miller put it:

> "The results of the [10A] investigation were not final for us, they did not help us, i.e. we did not obtain the confirmation or comfort that would satisfy us as auditors. This was one of the factors which led to our refusal to audit the company in the future."[1196]

b) In 2007, PwC Received Confirmation That Yukos' Senior Management Had Lied To PwC's Audit Team And Concealed Material Information

723. In early 2007, Messrs. Khodorkovsky and Lebedev were indicted. In the months that followed, the Russian Federation's Prosecutor General's Office

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1194 Registration statements filed in connection with a public sale of securities in the United States must generally include an audit report of the issuer's financial statements, prepared by a registered public accounting firm (such as PwC). If the accounting firm becomes aware that an illegal act has or may have occurred, then, under Section 10A of the U.S. Securities Exchange Act of 1934, the accounting firm must determine whether it is likely that an illegal act has occurred and, if so, determine and consider its possible effects on the issuer's financial statements, and also inform the company's management and audit committee. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78J-1 (2011) (Exhibit RME-872).

1195 In a press release published soon after Mr. Khodorkovsky's arrest, Yukos' Board of Directors expressed "its full support for and confidence in the Company's management," and stated, "if open and public court hearings take place, all allegations against Mikhail Khodorkovsky and his arrest will be declared invalid." Press Release, Yukos Oil Company, Statement of the Board of Directors of YUKOS Oil Company (Oct. 30, 2003) (Exhibit RME-873). *But see* Miller Interrogation Record (May 4, 2007), 17-18 (Exhibit RME-137).

1196 Miller Interrogation Record (May 4, 2007), 17 (Exhibit RME-866).

interviewed Mr. Miller (and several other PwC employees) about the auditing work PwC had done for Yukos. During the course of his interviews, Mr. Miller was for the first time presented with direct evidence that senior Yukos management had lied to PwC about the auditing issues that had previously caused PwC to be concerned.

724. Contrary to senior management's prior repeated representations, Mr. Miller now learned that the BBS companies were in fact controlled by Group Menatep and Yukos, and were operated for their benefit. He also learned that the payments made to Messrs. Muravlenko, Golubev, Ivanenko, and Kazakov were not in fact for services rendered to Yukos, but rather for their assistance in facilitating Menatep's acquisition and assertion of control over Yukos.

725. Mr. Miller was also then able to determine, based on information provided by the Prosecutor General's Office and information previously known to PwC, that the Russia-based trading companies used by Yukos to "optimize" its taxes were in fact shell companies, fully controlled by Yukos' management.[1197] Finally, Mr. Miller learned during this period that Yukos' senior managers had as far back as 1999 intentionally withheld material information regarding Yukos' purchase of claims on Bank Menatep, made to benefit Group Menatep's principals at the expense of Yukos' minority shareholders. These transactions had not previously been identified as problematic, but, once disclosed, also contributed to PwC's decision to withdraw its prior audit opinions.

(1) Misrepresentations Concerning BBS

726. Based on the evidence presented by the Prosecutor General's Office, Mr. Miller no longer had any unresolved doubts about the relationship between Yukos and the BBS companies, or about the nature of Yukos' prior misrepresentations on this issue. The evidence showed that the BBS companies worked only in Yukos' interest, and that senior management's repeated denials

1197 *See* Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

of any link constituted a "direct deceit" of PwC. According to Mr. Miller, the question of whether Yukos and the BBS companies were related had been:

> "directly posed to Yukos management on numerous occasions, and each time the answer was that there was no affiliation. Based on the evidence presented to me […] that the BBS companies were operating only in the interests of YUKOS, specifically Khodorkovsky, Lebedev and the other key shareholders at Group Menatep Limited […], I think that denying that Yukos Oil OJSC was affiliated with these companies is a direct deceit of the auditors."[1198]

727. Yukos' "direct deceit" not only undermined the reliability of Yukos' financial statements, but it also gave PwC reason to suspect that senior management had lied to the firm about other matters as well. As Mr. Miller explained:

> "[T]he fact that the management conceals certain information would give us, the auditors, reasons to doubt the rest of the information made available to us."[1199]

(2) Misrepresentations Concerning The Payments To Messrs. Muravlenko, Golubev, Ivanenko, And Kazakov

728. Mr. Miller was also "indignant" about what he learned concerning the Yukos Universal Beneficiaries. The Prosecutor General's Office showed him statements signed by Messrs. Muravlenko, Ivanenko, and Kazakov (Mr. Golubev had by then passed away), confirming PwC's long-held suspicion that the payments made to the Yukos Universal Beneficiaries were not for services provided to Yukos, as the company had always insisted, but were instead connected to Group Menatep's acquisition of Yukos. As Miller stated:

1198 Miller Interrogation Record (June 4, 2007), 11 (Exhibit RME-871) [Emphases added]. Mr. Miller by now had also concluded that he and PwC had been intentionally "misled" on this issue. "Yukos management had consistently, both orally and in writing [...] confirmed to us that BBS were not related parties. We relied on their representation in forming our opinions on Yukos' financial statements. […] If BBS were effectively owned by Khodorkovsky and Lebedev, as is indicated in information from the Office of the General Prosecutor dated 16 February 2007, then PwC, as auditor, was misled as to the relationship between BBS and Yukos, and shareholders and other users of Yukos' financial statements were intentionally not given information necessary for a fair presentation of Yukos' financial results." Miller Interrogation Record (May 8, 2007, 13:19), 5 (Exhibit RME-17) [emphases added].

1199 Miller Interrogation Record (May 8, 2007, 15:56), 17 (Exhibit RME-140).

> "After hearing this testimony and in view of everything said, I can only express my indignation. […] I assumed that these people received compensation for their services not to Yukos, but to Group Menatep -- i.e., to Khodorkovsky and his team, and this is how it turned out to be."[1200]

729. Yukos' misrepresentations regarding the payments made to the Yukos Universal Beneficiaries not only resulted in the misclassification of these transactions on Yukos' financial statements, but, like senior management's deception concerning the BBS companies, also called into question all the other information on which PwC had relied in issuing its audit opinions.[1201] As Mr. Miller explained:

> "[T]he very fact that Lebedev, Drel and Khodorkovsky were deceiving me, a representative of YUKOS Oil OJSC's auditor, as to the real reasons for payments to Muravlenko and his company, yet again shows that the information provided to the auditors was unreliable. This accordingly further confirms my confidence that all information provided by YUKOS Oil OJSC's management was unreliable, including its financial statements."[1202]

(3) Misrepresentations Concerning Yukos' Control Over The Russian Trading Companies

730. As discussed at ¶ 711 above, Yukos initially denied that it exerted any control over its Russian trading counterparties. Yukos' senior managers later changed their tune, explaining that Yukos exerted sufficient control over these entities to support the consolidation of their results in Yukos' financial statements. They maintained, however, that the trading companies were supervised and controlled by their own management, and not by Yukos.

731. The managerial independence of Yukos' trading counterparties was essential to the company's "tax-optimization" scheme, as explained above at ¶ 243. Yukos in effect wanted to have things both ways -- just enough control to allow the trading companies' favorable results to be consolidated in Yukos' financial statements, but not so much control as to jeopardize Yukos' tax scheme.

1200 Miller Interrogation Record (June 4, 2007), 11 (Exhibit RME-871) [emphasis added].

1201 *See* Miller Interrogation Record (June 4, 2007), 11 (Exhibit RME-871).

1202 Miller Interrogation Record (June 4, 2007), 11 (Exhibit RME-871) [emphasis added].

Had Yukos been legally able to take advantage of both the tax and accounting rules, the company would have avoided paying taxes on the profits realized by its trading counterparties, but nonetheless recorded those profits as its own in Yukos' consolidated financial statements. It was thus critical to the company's reported financial results that the trading companies were sufficiently controlled by Yukos to permit consolidation, and at the same time critical to Yukos' tax-optimization scheme that its trading counterparties were not supervised and controlled by Yukos, but by their own management. With hindsight, it is not surprising that Yukos alternately represented to PwC that it controlled -- and did not control -- the trading companies.

732. In its withdrawal letter, PwC stated that while senior management had represented that the "*activities of these affiliated legal entities were under supervision and control of their own management*," the firm now had "*information demonstrating that the management of* [these entities] *did not control the activities of these entities, rather* [they] *were fully controlled directly by* [Yukos] *management*."[1203]

(4) Misrepresentations Concerning Yukos' Transactions With Bank Menatep

733. Many Russian banks failed following the 1998 financial crisis, among them Bank Menatep, controlled by the same group of Oligarchs who also, through Group Menatep, controlled Yukos. Supposedly hoping to profit from its familiarity with Bank Menatep's operations, Yukos purchased a number of third-party claims on the now bankrupt bank.[1204] Yukos in fact lost money on the transactions, which were reviewed by PwC in connection with Yukos' 1999 audit because the buyer and seller were related parties.[1205] No significant accounting issues were identified at the time.

734. In 2007, the Prosecutor General's Office showed Mr. Miller the minutes of a May 31, 2000 meeting attended by senior members of Yukos'

1203 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

1204 *See* Miller Interrogation Record (May 14, 2007), 15 (Exhibit RME-353).

1205 *See* Miller Interrogation Record (May 14, 2007), 15-16 (Exhibit RME-353).

management. Mr. Miller concluded that the minutes showed the senior managers discussing which information relating to the company's purchase of claims should -- and should not -- be disclosed to PwC, with a view to manipulating the information available to the company's auditors.[1206] According to Mr. Miller:

> "The minutes themselves—the content—looks very unpleasant, bad. According to the minutes I read, that meeting addressed what would be shown to us as auditors and how, and what wouldn't be shown to us. Non-disclosure of information to auditors is totally unacceptable. In fact, this amounts to unacceptable manipulation of information to be provided to auditors."[1207]

735. After reading the minutes, it was clear to Mr. Miller that Yukos understood at the time that the claims it had purchased would never be repaid. This raised a separate issue. Russian companies, like companies everywhere, may only enter into transactions that benefit the company itself, as opposed to a related company or some (but not all) of the company's shareholders.[1208] Mr. Miller concluded, on the basis of the newly-disclosed minutes, that Yukos' purchase of the claims on Bank Menatep had not been undertaken for Yukos' benefit, but rather for the benefit of the shareholders controlling Group Menatep, to the detriment of Yukos' minority shareholders. As he stated:

> "Yukos Oil OJSC as a separate independent company had no obligation to purchase the debts of Bank Menatep, especially since bankruptcy proceedings had been initiated against Bank Menatep and since Yukos was facing a real risk of failure to recoup such an investment. YUKOS, I warrant, realized that these debts would not be paid by the bankrupt bank. […] [M]anagement at the Group Menatep Limited level […] used Yukos Oil OJSC in the interests of the other Menatep group companies or in their own interests. […] Yukos Oil OJSC was simply used in the interests of some shareholders, that is, its key shareholders."[1209]

1206 *See* Miller Interrogation Record (June 4, 2007), 5-6 (Exhibit RME-871).

1207 Miller Interrogation Record (June 4, 2007), 6 (Exhibit RME-871) [emphasis added].

1208 *See* Federal Law No. 208-FZ Of December 26, 1995 On Joint-Stock Companies, Arts. 81-84 (Exhibit RME-876).

1209 Miller Interrogation Record (June 4, 2007), 6-7 (Exhibit RME-871) [emphases added].

736. In the end, Mr. Miller concluded that the Bank Menatep-related documents shown to him by the Prosecutor General's Office demonstrated "*a 'program' for deceiving auditors.*"[1210] As he explained, if an auditor is deceived, the "*audit opinions are simply not issued. If auditors become aware of deception later, this may cause the auditors' opinions to be withdrawn.*"[1211]

737. The confirmation in 2007 that Yukos' senior management had deceived PwC on four important accounting issues, and that on three of those issues -- Yukos' control of the BBS companies, the nature of the services provided by Messrs. Muravlenko, Golubev, Ivanenko, and Kazakov, and Yukos' control of the Russian trading shells -- the company had directly lied to its auditors, led PwC to question the truthfulness of all of the management representations upon which PwC had relied in rendering its audit opinions.[1212] Having determined that its audit opinions were based on specific management misrepresentations, and having lost confidence in management's audit representations more generally, PwC appropriately concluded that it had to withdraw all of its audit opinions on Yukos' financial statements. On June 15, 2007, PwC wrote to Mr. Rebgun, explaining that PwC could "*no longer rely upon the Statements of the Management, which we had relied upon throughout our audits*," and was accordingly withdrawing its prior opinions, which could "*no longer be relied upon as trustworthy.*"[1213]

738. PwC's withdrawal letter describes both some of the new information recently learned by the firm and some of the management misrepresentations on which it had previously relied, as follows:

1210 Miller Interrogation Record (June 4, 2007), 10 (Exhibit RME-871).

1211 Miller Interrogation Record (June 4, 2007), 10 (Exhibit RME-871).

1212 U.S. generally accepted auditing standards ("GAAS") require an independent auditor to obtain written representations from management as a part of its audit. Management's representations are so important that the auditor cannot complete the audit and render an unqualified opinion without them. *See* American Institute of Certified Public Accountants, AU § 333: Management Representations (June 1998), § 333.13 (Exhibit RME-877).

1213 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

"Whilst we were auditing the Company, its management many times declared to us that the Company and companies to which substantial volumes of crude oil and oil products were exported, namely Behles Petroleum S.A., Baltic Petroleum Trading Limited and South Petroleum Limited (hereinafter together referred to as "BBS"), were not affiliated parties. In the course of the Investigation [by the General Prosecutor's Office], we were provided with information showing that BBS had been controlled by the shareholders of Group Menatep Limited (hereinafter "Group Menatep") and had been used to their advantage. At the material time, Group Menatep held a controlling block of shares in the Company.

Now we have information demonstrating that the management of certain Russian legal entities affiliated with the Company did not control the activities of these entities [the Russian trading shells], rather these legal entities were fully controlled directly by the Company's management. Since the management of these affiliated entities [was] not in control of these entities' activities, the court found that these activities were fictitious. Consecutively, the courts found that the profit earned by these legal entities affiliated with the Company was a profit of the Company, and therefore the Company should have accrued and paid taxes on this profit. Nevertheless, in the course of the audits, the Company's management told us that key issues of the activities of these affiliated legal entities were under [the] supervision and control of their own management.

In the course of the Investigation, we were shown documents demonstrating that the Company had made significant payments to meet liabilities of the companies effectively owned and controlled by Group Menatep before AKB Menatep Bank. Complete information about the nature of these transactions and relations[hips] was not disclosed to us in the course of the audits.

The Company failed to timely disclose to us information about certain payments made by the shareholders of Group Menatep in favor of certain individuals, who were leading executives of the Company at the time of its privatization. In the course of the Investigation, some information disclosed to us ran counter to the explanations given to us by the management and shareholders of the Company in the course of our audits with regard to the exact nature of those payments."[1214]

2. PwC's Decision To Withdraw Its Audit Opinions Was Based On A Principled Application Of The Governing Auditing Standards,

1214 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

Following A Lengthy Deliberative Process Involving Senior Professionals Throughout PricewaterhouseCoopers' Global Organization

739. As a result of the new information PwC learned, the firm had no option but to withdraw its prior audit opinions in accordance with generally accepted auditing standards. That decision was taken only after PwC had conducted a careful and deliberative review, involving senior professionals throughout the firm's global organization, of those standards and the information recently learned by Mr. Miller. PwC's decision to withdraw its audit opinions was not the result of Russian Government harassment.

a) PwC's Withdrawal Of Its Audit Opinions Was Based On The Governing Auditing Standards

740. In auditing a company's financial statements, auditors are governed by generally accepted auditing standards. Section 561 of U.S. generally accepted auditing standards ("GAAS 561") prescribes the course of action to be followed by an auditor who subsequently discovers facts that (i) existed at the date of a prior audit report, and (ii) might have affected that report had the auditor been aware of them.[1215]

1215 *See* American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972) (Exhibit RME-878). GAAS imposes two different types of requirements on auditors: "unconditional requirements" and "presumptively mandatory requirements." American Institute of Certified Public Accountants, AU § 120: Defining Professional Requirements in Statements on Auditing Standards (Dec. 2005), § 120.04 (Exhibit RME-879). Unconditional requirements must be complied with "in all cases in which the circumstances exist to which the unconditional requirement applies." Presumptively mandatory requirements must be complied with "in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the auditor may depart from a presumptively mandatory requirement provided the auditor documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement." GAAS uses the word "should" "to indicate a presumptively mandatory requirement." Because GAAS 561 contains the operative term "should," it is a presumptively mandatory requirement. Given Yukos management's misrepresentations and intentional deception of its auditors, this was clearly not one of those "rare circumstances" warranting departure from PwC's presumptively mandatory requirement to withdraw its audit opinions.

741. As an initial matter, the auditor is required to undertake to determine whether the new information is reliable and whether the underlying facts existed as of the date of the auditor's report:

> "When the auditor becomes aware of information which relates to financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his audit, he should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of his report. In this connection, the auditor should discuss the matter with his client at whatever management levels he deems appropriate, including the board of directors, and request cooperation in whatever investigation may be necessary."[1216]

742. If the subsequently discovered information is determined to be reliable and to have existed at the date of the auditor's report, the auditor is then obligated to take the specific actions prescribed by GAAS 561, if the auditor believes that (i) its report would have been affected if the information had been known as of the date of the report, and (ii) there are persons currently relying on (or likely to rely on) the audited company's financial statements who would attach importance to the missing information:

> "When the subsequently discovered information is found both to be reliable and to have existed at the date of the auditor's report, the auditor should take action in accordance with the procedures set out in subsequent paragraphs if the nature and effect of the matter are such that (a) his report would have been affected if the information had been known to him at the date of his report and had not been reflected in the financial statements and (b) he believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the information. With respect to (b), consideration should be given, among other things, to the time elapsed since the financial statements were issued."[1217]

1216 American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.04 (Exhibit RME-878) [emphasis added].

1217 American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.05 (Exhibit RME-878) [Emphases added].

743. Under those circumstances, GAAS 561 first directs the auditor to advise its client to "make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently relying or who are likely to rely on the financial statements and the related auditor's report."[1218] If the client refuses to do so, GAAS 561 requires the auditor to inform the client's board of directors that, absent client disclosure, the auditor will itself act to prevent future reliance on its audit report. In order to prevent further reliance, the auditor is required, among other things, to notify each person known to the auditor to be relying on the company's financial statements that the auditor's report should no longer be relied upon:

> "If the client refuses to make the disclosures [described above], the auditor should notify each member of the board of directors of such refusal and of the fact that, in the absence of disclosure by the client, the auditor will take steps as outlined [below] to prevent future reliance upon his report. The steps that can appropriately be taken will depend upon the degree of certainty of the auditor's knowledge that there are persons who are currently relying or who will rely on the financial statements and the auditor's report, and who would attach importance to the information, and the auditor's ability as a practical matter to communicate with them. Unless the auditor's attorney recommends a different course of action, the auditor should take the following steps to the extent applicable:
>
> a. Notification to the client that the auditor's report must no longer be associated with the financial statements.
>
> b. Notification to regulatory agencies having jurisdiction over the client that the auditor's report should no longer be relied upon.
>
> c. Notification to each person known to the auditor to be relying on the financial statements that his report should no longer be relied upon."[1219]

1218 American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.06 (Exhibit RME-878).

1219 American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.08 (Exhibit RME-878) [Emphases added]. The Russian auditing standard addressing the subsequent discovery of facts that existed at the time of the preparation of an audit report is similar to GAAS 561. *See* Federal Rules on Auditing, Rule No. 10: Events After the Balance Sheet Date (Sept. 2002) (Exhibit RME-880). Under the Russian standard, if an auditor subsequently discovers a fact "that existed on the date of the signing of the auditor's report, as a result of which the auditor should have modified the auditor's report if said fact had been known at the time, the auditor

744. PwC's withdrawal letter of June 15, 2007 was clearly prepared with GAAS 561 in mind. As described above at ¶¶ 737-740, the letter describes the new information PwC learned after the issuance of its audit opinions. The letter then goes on to state that the new information has caused PwC to conclude that "*we can no longer rely upon the Statements of the Management, which we had relied upon throughout our audits*."[1220]

745. Under these circumstances, GAAS 561 provides that an auditor should notify "each person known to the auditor to be relying on the financial statements that his report should no longer be relied upon" -- that is, withdraw its outstanding audit opinions -- and that is precisely what PwC did in its withdrawal letter.[1221] After noting that both Yukos' financial statements and PwC's audit opinions "should no longer be relied upon," the letter states:

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should consider whether it is necessary to revise the financial statements, discuss this with management of the audited entity and take the actions required in these circumstances." Federal Rules on Auditing, Rule No. 10: Events After the Balance Sheet Date (Sept. 2002) (Exhibit RME-880). If it is necessary to revise the financial statements, but the "management of the audited entity does not take measures to notify everyone who had previously received the submitted financial statements together with the auditor's report on the statements on developments and does not revise the financial statements, whereas the auditor believes that a restatement is essential, the auditor should notify the persons to whom management of the entity reports that the auditor will independently take measures so that third parties do not rely on the auditor's report." Federal Rules on Auditing, Rule No. 10: Events After the Balance Sheet Date (Sept. 2002) (Exhibit RME-880) [emphasis added].

1220 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611). American Institute of Certified Public Accountants, AU § 333: Management Representations (June 1998), § 333.13 (Exhibit RME-877). Yukos had previously provided written representations to PwC with the express understanding that these representations would be relied on by PwC in preparing its audits opinions. The repeated lies of Yukos' senior management on specific issues raised by PwC understandably undermined PwC's confidence in the trustworthiness of management's representations more generally, including those contained in Yukos management's formal representation letters. With PwC's trust in those letters destroyed, PwC appropriately concluded that its audit opinions -- which depended on the reliability of management's representations -- could no longer stand. *See* American Institute of Certified Public Accountants, AU § 333: Management Representations (June 1998), § 333.04f (Exhibit RME-877) (if any of management's representations is called into question by other evidence, "the auditor should investigate the circumstances and consider the reliability of the representation made. Based on the circumstances, the auditor should consider whether his or her reliance on management's representations relating to other aspects of the financial statements is appropriate and justified.").

1221 American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.08 (Exhibit RME-878).

"This should be immediately communicated to the persons or regulatory authorities, which, to the best of your knowledge, rely or may rely upon these Audit Reports."[1222]

b) PwC Engaged In A Lengthy Deliberative Process, Involving Senior Professionals Throughout PricewaterhouseCoopers' Global Organization, Before Deciding To Withdraw Its Audit Opinions

746. In January 2007, shortly after embezzlement charges were filed against Messrs. Khodorkovsky and Lebedev, PwC established an informal working group to investigate whether the allegations against Yukos' senior managers, if true, would require PwC to withdraw its audit opinions. GAAS 561 recommends that an auditor considering whether to withdraw an audit opinion should consult legal counsel because of the possible legal implications of the withdrawal.[1223] In January 2007, Mike Kubena, PwC's General Director, accordingly asked Laurie Endsley, an in-house lawyer then on secondment from PricewaterhouseCoopers LLP ("PwC U.S.") to the Office of General Counsel of PricewaterhouseCoopers International Ltd ("PwC International"), where she was responsible for advising PwC Russia on current and past Yukos-related litigation, "for [her] legal advice on the possibility that PwC Russia might have to withdraw its audit opinions."[1224] Ms. Endsley in turn consulted senior audit professionals within the firm and outside counsel regarding the interpretation of the applicable Russian and international auditing standards.[1225]

747. Among those consulted were auditors at PwC Russia familiar with the relevant Russian and international accounting standards, PwC's Global Public Policy Leader, PwC International's General Counsel, PwC International's

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1222 Letter from D. Miller and I. Turchina to E.K. Rebgun, dated June 15, 2007 (Annex (Merits) C-611).

1223 *See* American Institute of Certified Public Accountants, AU § 561: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report (Nov. 1972), § 561.02 (Exhibit RME-878).

1224 Decl. of Laurie Endsley, *In re Application of Mikhail B. Khodorkovsky and Platon L. Lebedev for an Order Seeking Discovery Under 28 U.S.C. § 1782*, No. M8-85 (S.D.N.Y. 2011) ("Endsley Declaration"), ¶ 11 (Exhibit RME-881). Ms. Endsley's sworn declaration was submitted by PwC U.S. in January 2011 in the context of a U.S. discovery action initiated by Messrs. Khodorkovsky and Lebedev in the U.S. District Court for the Southern District of New York.

1225 *See* Endsley Declaration, ¶¶ 9, 11 (Exhibit RME-881).

Global Chief Auditor, and an in-house counsel at PwC U.S. then on secondment to the Office of the General Counsel of PwC International.[1226] The two last-mentioned members of the working group had both worked in the past on the withdrawal of audit opinions on GAAP-prepared financial statements.[1227]

748. This senior group of PwC professionals and their outside legal counsel discussed various aspects of PwC's potential withdrawal of its audit opinions throughout January and February 2007.[1228] Based on these discussions, a draft withdrawal letter was prepared by Ms. Endsley and circulated on March 2 and 3, 2007, to PwC International's senior leaders and legal counsel. [1229]

749. In May and June 2007, it will be recalled, Mr. Miller met with the Prosecutor General's Office, and in the course of those meetings learned that he and his audit team had been misled and lied to by senior Yukos management in connection with the preparation of PwC's outstanding audit opinions. Insofar as Ms. Endsley and her team of senior professionals were concerned, the information learned by Mr. Miller called into question both the continuing reliability of PwC's audit opinions and the credibility and trustworthiness more generally of the representations made by Yukos' senior management. Not surprisingly, the team concluded that this newly discovered information, had it been known to the firm during its audits, may have affected its audits of Yukos' financial statements and PwC's own audit opinions.[1230]

750. On June 15, 2007, following six months of deliberations by the team of senior auditing professionals and inside and outside legal counsel, PwC sent Mr. Rebgun its letter notifying him that the firm was withdrawing its audit opinions on Yukos' financial statements for the years 1995 through 2004.[1231]

1226 *See* Endsley Declaration, ¶ 12 (Exhibit RME-881).

1227 *See ibid.*, ¶ 12 (Exhibit RME-881).

1228 *See ibid.*, ¶ 13 (Exhibit RME-881).

1229 *See ibid.*, ¶ 13 (Exhibit RME-881).

1230 *See ibid.*, ¶¶ 9, 14 (Exhibit RME-881).

1231 *See ibid.*, ¶ 14 (Exhibit RME-881).

c) PwC's Withdrawal Of Its Audit Opinions Was Not The Result Of Russian Harassment

751. Claimants' unsupported allegation that PwC's withdrawal of its audit opinions was precipitated by the purported "raid" on PwC's offices on March 9, 2007,[1232] is belied by the chronology of events summarized above. A draft of the withdrawal letter had by that time already been circulated to the senior members of the PricewaterhouseCoopers informal working group that had been considering this issue for more than two months, and there is no evidence that the supposed raid had any effect on the decision already reflected in the text of the draft letter.

752. Claimants' assertion that the withdrawal was the result of the letter of June 14, 2007 from the Prosecutor General's Office , inquiring about the continuing reliability of PwC's audit opinions in light of the evidence showing that Yukos' management had deliberately misled PwC, is likewise unavailing.[1233] The letter informed PwC that Yukos' former managers were relying on the firm's outstanding audit opinions as evidence in pending judicial proceedings, and asked whether PwC's opinions "*ought to be relied upon at the present time as reliable.*"[1234] *The letter also inquired whether PwC could, "after receipt by* [PwC] *of information that had earlier been inaccessible to the auditors, confirm the reliability of the financial reporting of OAO NK Yukos for the 1995-2004 fiscal years*."[1235] The letter did not request that PwC withdraw its audit opinions, nor did it threaten any consequences if PwC failed to do so. As PwC had already concluded that its audit opinions were no longer reliable, the letter could not have had any effect on PwC's withdrawal decision.[1236]

1232 *See* Claimants' Memorial on the Merits, ¶¶ 146-148.

1233 *See ibid.*, ¶ 148.

1234 Letter from S.K. Karimov to M.L. Kubena, dated June 14, 2007, (Annex (Merits) C-610).

1235 *Ibid.*

1236 In his June 4, 2007 interview with the Prosecutor General's Office, Mr. Miller concluded: "[I]n my personal opinion the audit opinions issued on YUKOS Oil OJSC's financial statements starting from at least 1999 should be withdrawn." Miller Interrogation Record (June 4, 2007), 10 (Exhibit RME-871). Mr. Miller explained that the four problems later identified in PwC's withdrawal letter "should result in the audit opinions being withdrawn. These issues show that Yukos Oil OJSC's financial statements, starting at least from 1999, are unreliable and that

753. Claimants' attempt to link PwC's withdrawal decision to other factors is also without support and belied by the relevant chronology. There is simply no evidence of a *quid pro quo* arrangement between PwC and the Russian Federation, as Claimants insinuate. Had there been one, the two lawsuits filed by the Russian Federal Tax Service against PwC -- one in December 2006, relating to PwC's auditing of Yukos' financial statements, and the other in March 2006, alleging PwC's non-compliance with the Tax Code -- would have been voluntarily terminated promptly following the withdrawal of the firm's audit opinions. To the contrary, the tax evasion suit continued for more than a year and a half after PwC's withdrawal letter, and during that period three separate tribunals ruled against PwC before the firm finally prevailed in January 2009.[1237] The audit lawsuit tells a similar story. That action also continued well after PwC's withdrawal decision, and PwC lost twice in lower court proceedings before the case was finally dismissed by the Federal Arbitrazh Court for the Moscow District in October 2008.[1238] The Tax Service did not stop there, however, and appealed the dismissal to the Supreme Arbitrazh Court of the Russian Federation. It was not until April 2009 that the Supreme Arbitrazh Court finally ruled conclusively in PwC's favor.[1239]

754. Nor is there any evidence that PwC withdrew its audit opinions because it believed the firm's audit license was in jeopardy. To the contrary, the Russian authorities renewed PwC's license on April 19, 2007, several months before the final withdrawal decision was made.[1240]

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the oral and written representations received by PricewaterhouseCoopers from YUKOS' management on these issues are deceptive." Miller Interrogation Record (June 4, 2007), 12 (Exhibit RME-871) [emphasis added].

1237 *See* Resolution of the Presidium of the Supreme Arbitrazh Court, Case No. A40-11992/06-143-75 (Jan. 20, 2009) (Exhibit RME-882).

1238 *See* Ruling of the Federal Arbitrazh Court of the Moscow District, Case No. A40-77631/06-88-185 (Oct. 31, 2008) (Exhibit RME-883).

1239 *See* Ruling of the Supreme Arbitrazh Court of the Russian Federation, Case No. A40-77631/06-88-185 (Apr. 15, 2009) (Exhibit RME-884).

1240 *See* Order of the Ministry of Finance of the Russian Federation No. 348 (April 19, 2007) (Exhibit RME-885).

755. Claimants' suggestion that PwC withdrew its opinions because it was losing Russian clients, including State-owned clients,[1241] is equally meritless. PwC was in fact reappointed as the auditor for perhaps the most prestigious and lucrative of all Russian clients, the State-controlled energy giant Gazprom, in April 2007, around the same time as the firm's accounting license was renewed by the Russian authorities.[1242]

756. Accordingly, the evidence does not support Claimants' contention that PwC acted in response to the Russian Federation's "harassment." Rather, the evidence demonstrates that PwC acted as it did because Yukos' senior management -- including some of the very same individuals now before the Tribunal in the guise of Claimants and witnesses appearing on their behalf -- repeatedly and consistently lied to PwC about crucial matters that were material to Yukos' business and PwC's analysis of Yukos' financial statements. Not coincidentally, several of these matters are the very same ones summarized above, concerning Yukos' fraudulent "tax optimization" scheme, its Jurby Lake Structure and, dating back to the Oligarchs' corrupt acquisition of control over Yukos, Bank Menatep's secret kickback payments to members of Yukos' prior management, the Yukos Universal Beneficiaries.

1241 *See* Claimants' Memorial on the Merits, ¶ 148.

1242 *See Gazprom Stands By PwC*, Kommersant (Apr. 10, 2007) (Exhibit RME-886).

III. THE IMPLAUSIBILITY AND FALSITY OF CLAIMANTS' CONSPIRACY THEORY

757. It is Claimants' case that all of the charges leveled against Yukos were fabricated, the result of a vast and complex conspiracy to reassert State control over Russia's petroleum assets and to punish Yukos' controlling shareholders for their political activities. According to Claimants, this conspiracy was directed from above and implemented by virtually every organ of the Russian State. Respondent's case is much simpler. Yukos engaged in massive tax evasion, and then improperly resisted the Russian authorities' assessment and collection of the evaded taxes, resulting in substantial additional fines and penalties and criminal sanctions for those found to have violated the law, dooming Yukos to a self-inflicted demise.

758. Ockham's famous razor suggests that Claimants should have the burden of proving the existence of a complicated conspiracy animated by improper political motivation and implemented by literally hundreds of officials, judges, bailiffs, companies, banks and other parties. Public international law is in accord. As shown at ¶¶ 1328-1333 below, given the choice between a *"concerted malicious politically inspired campaign"* and a plausible alternative, Claimants have the burden of proving each element necessary to establish the alleged conspiracy.[1243]

759. Claimants' conspiracy theory here fails because it is wrong in fact and because there is a more direct, less complex, and more plausible explanation of the events that transpired. Claimants' conspiracy theory, by contrast, relies at critical moments on actions taken by its purported victims (Yukos and its controlling shareholders, including Claimants themselves) and by third parties manifestly not under the control of the Russian Federation. The hypothesized conspiracy theory also fails to explain why, if the Russian Federation's goal was

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1243 *Tokios Tokelès v. Ukraine*, ICSID Case No. ARB/02/18, Award of July 26, 2007, ¶ 113 (Annex (Merits) C-985).

to "*renationalize*" Yukos,[1244] it did not instead pursue that goal through other more direct, and decidedly less uncertain means.

760. Claimants contend that the destruction of Yukos and the ruin of its controlling shareholders was one of the principal aims of the alleged conspiracy. It thus defies logic and common sense that the principal targets and eventual victims of the alleged conspiracy posited by Claimants played such a critical role in ensuring its success. Yet, it is indisputable that, but for the active participation of Yukos and its controlling shareholders, the alleged conspiracy could never have succeeded. In reality, the injury that Claimants contend they sustained was ultimately caused by the actions of the management they installed and the company's controlling shareholders, and not the actions of the Russian Federation.

761. For instance, Claimants allege that the foundation of the conspiracy was the "*fabrication of massive tax debts*"[1245] that were then used to justify the enforcement of the tax liabilities that ultimately led to Yukos' demise.[1246] A much simpler explanation of the tax assessments is, however, available: Yukos' controlling shareholders knowingly pursued unlawful tax evasion schemes that other Russian oil companies at the time chose not to implement, and then persisted in the use of those evasive schemes after the other oil companies that had used similar schemes agreed to abandon them and to pay their evaded back taxes.[1247]

762. For Claimants' conspiracy theory to be accepted, the management and controlling shareholders of Yukos must be understood to have behaved in a way that inexplicably facilitated that conspiracy after the initial tax audits had laid bare the company's unlawful schemes. By using ruses and subterfuges to conceal assets and records,[1248] Yukos rendered unavoidable the freezes that are

1244 *See, e.g.*, Claimants' Memorial on the Merits, ¶¶ 482, 494.

1245 *See, e.g.*, *ibid.*, ¶ 268.

1246 *See ibid.*¶¶ 240-333.

1247 *See* ¶¶ 297-302 *supra*.

1248 *See* ¶¶ 528-539 *supra*.

alleged to have been the crucial next step in ensuring the success of the conspiracy.[1249] The managers and key shareholders of Yukos also made the critical decision not to amend the company's tax returns for tax years that had not yet been audited, a step that would have avoided billions of U.S. dollars in fines,[1250] the same fines that, according to Claimants, were critical to the achievement of the alleged conspiracy's goal of bankrupting the company. Had Yukos been more interested in 2003 and 2004 in resolving its tax dispute, and less committed to challenging, seemingly as a test of wills, virtually every action taken by the Russian Government, Yukos' tax bill would have been manageable, and its bankruptcy would have been avoided.

763. The decision by Yukos and its controlling shareholders not to pay the company's tax bills[1251] or its debts to other creditors[1252] (despite the fact that the company itself had the means to do so, as did the company's controlling shareholders, thanks to very substantial off-shore assets not subject to any freeze order),[1253] likewise played an essential role in ensuring the success of the alleged conspiracy, by providing the necessary grounds to the tax authorities to proceed with the YNG auction, and to third-parties (the SocGen syndicate) to put Yukos into bankruptcy. So too, the controlling shareholders' decision to cause Yukos to declare a massive dividend, just as it was becoming apparent that the company was likely to face a substantial tax bill, contributed to Yukos' tax delinquency and helped set in motion the chain of enforcement actions that ultimately led to Yukos' liquidation.

1249 *See, e.g.*, Claimants' Memorial on the Merits, ¶ 338.

1250 *See*, ¶ 370. For instance, Yukos could have amended its tax returns for year 2003 prior to October 28, 2004 and avoided all fines related to that tax year. Yukos could also have amended its tax returns even after the audit was completed and, had it done so, could have saved up to 50% of the fines otherwise assessable.

1251 *See, e.g.*, ¶¶ 374-376 *supra*.

1252 *See* ¶ 551. In addition to not paying its creditors, Yukos' controlling shareholders (acting through Group Menatep) exacerbated the company's financial difficulties by declaring an "Event of Default" with respect to a US$ 1.6 billion loan. *See* ¶ 390 *supra*.

1253 *See* ¶¶ 388-392, 536, 553 *supra*.

764. Yukos' management and its controlling shareholders made further critical contributions to the successful outcome of the alleged conspiracy by sabotaging the YNG auction. By threatening a "lifetime of litigation" to any prospective bidders and by filing for voluntary bankruptcy in the United States, knowing this would result in an automatic stay, and then requesting and obtaining the TRO,[1254] they scared away potential domestic and foreign bidders and banks, reducing auction demand (and hence auction proceeds), and facilitating Yukos' ultimate bankruptcy. If Claimants' conspiracy theory were to be believed these actions not only helped the alleged conspirators to achieve their objective of destroying Yukos, but also, by ensuring that no foreign company would bid for YNG, furthered the conspiracy's other alleged objective, the "renationalization" of Yukos by Rosneft.[1255]

765. As the foregoing demonstrates, the conspiracy Claimants posit could never have succeeded without the critical help repeatedly provided by the conspiracy's supposed target -- Yukos, the management Claimants appointed, and the company's controlling shareholders, including Claimants themselves. This fact alone is sufficient to defeat Claimants' conspiracy theory.

766. Similarly implausible is Claimants' contention that Russia's judicial system played a prominent role in implementing the alleged conspiracy. According to Claimants, judges favorably disposed to Yukos were improperly dismissed, and Yukos was denied due process in the cases handled by the remaining judges. Even if both of these charges were correct -- and Respondent vigorously denies that they are -- Claimants' conspiracy theory would still make no sense on its own terms. Yukos-related lawsuits were heard by some 60 different Russian judges, in most cases at three, and in some cases four, different

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1254 *See* ¶¶ 492, 502-506.

1255 The management and controlling shareholders of Yukos provided additional support to the conspiracy when they threatened foreign bidders and bankers with litigation if they participated in the bankruptcy auctions. By once again frightening prospective foreign bidders and their sources of finance, they simplified advancement of the alleged conspiracy's goal of allowing Rosneft to acquire a majority of the liquidated assets at reasonable prices. At the same time, by limiting the price competition that additional bidders would have brought, Yukos reduced the total auction proceeds, thereby undermining Yukos' prospects for recovery after the sale of YNG. *See* ¶¶ 492-496.

judicial levels, including the Moscow Arbitrazh Court (and its Appellate Division), the Ninth Arbitrazh Appellate Court, the Federal Arbitrazh Court of the Moscow District (Court of Cassation) and the Supreme Arbitrazh Court. In order for the alleged conspiracy to have had any effect on the ultimate resolution of these cases, the judges hearing the cases at the highest appellate level would have had to be co-conspirators. Otherwise, the lower level decisions would have been reversed and the conspiracy frustrated. Adding to the implausibility of Claimants' theory, among the judges who heard the final appeals of Yukos-related cases were V.N. Isaychev, Deputy Chairman of the Supreme Arbitrazh Court, N.P. Ivannikova, a Supreme Arbitrazh Court judge, A.A. Ivanov, Chairman of the Supreme Arbitrazh Court and a noted legal scholar, O.A. Kozlova, a Supreme Arbitrazh Court judge, S.V. Sarbash, likewise a Supreme Arbitrazh Court judge and authoritative legal scholar, and V.V. Vitryanskiy, Deputy Chairman of the Supreme Arbirtazh Court and a distinguished legal scholar. All of these judges are well known Russian jurists with unblemished judicial careers.[1256] Claimants' conspiracy theory notwithstanding, Claimants do not allege any wrongdoing by any of these judges or by any of the many other judges who also heard Yukos-related cases at the appellate level.

767. Claimants' conspiracy theory is also implausible because it requires the knowing cooperation and commitment to secrecy of third parties that were manifestly never under the control of the Russian Federation. In addition to the long list of Russian Federation tax officials, bailiffs, and judges that Claimants, without any proof, assume to have been essential instruments of the conspiracy,[1257] the hypothesized plot could never have succeeded without the active assistance of the many other individuals and entities not remotely subject to Russian Government control, all of whom would have had to agree to serve as willing puppets to the conspiracy's mastermind, in many instances at

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1256 For example, Mr. Ivanov has published more than 40 legal works, Mr. Sarbash is the author of more than 50 works on civil law and Mr. Vitryanskiy is the author of more than 300 publications on civil law, including several fundamental treatises.

1257 *See, e.g.*, Claimants' Memorial on the Merits, ¶ 551.

considerable cost and risk to themselves. This group of third-party co-conspirators includes, among others, the following:

(i) Other private oil companies in Russia. Contrary to Claimants' contention that other Russian oil companies that evaded taxes merely received a slap on the wrist,[1258] the Russian Federation assessed and collected large amounts of back taxes from other delinquent oil companies.[1259] If no taxes were in fact ever properly due from any Russian oil company, as posited by Claimants' conspiracy theory, then the Russian Federation must be presumed to have assessed and collected taxes from the other Russian oil companies in order to camouflage its real intent to destroy Yukos alone. It is not credible that those other oil companies would have paid large sums of money to the Russian tax authorities, generally without major complaint -- and certainly without Yukos' scorched-earth resistance -- in order to serve as window-dressing to mask the conspiracy's true intent, the "renationalization" of Yukos.

(ii) The U.S. Bankruptcy Court. By improvidently accepting Yukos' voluntary bankruptcy petition (which resulted in an automatic stay), and by issuing the TRO, the U.S. Bankruptcy Court played a decisive role in deterring the announced bidders for YNG, including Gazprom's subsidiary Gazpromneft, and the financial institutions supporting the announced bidders, as well as potential foreign bidders (and any banks that might have financed their bids), from participating in the YNG auction.[1260] The Russian Federation obviously had nothing to do with the initiation of Yukos' bankruptcy proceedings in the United States. Yet if those proceedings had never been commenced (and the U.S. Bankruptcy Court had never chosen to intervene), a foreign bidder (or another

1258 *See, e.g.*, Claimants' Memorial on the Merits, ¶ 774.

1259 *See* ¶ 299

1260 *See* ¶¶ 497-506.

Russian bidder, such as Gazprom) might very well have won the YNG auction, frustrating the conspiracy's alleged objective of "renationalizing" Yukos via Rosneft. [1261]

(iii) The major Western financial institutions in the SocGen syndicate. According to Claimants, a syndicate of Western banks led by SocGen and also including Citibank N.A., BNP Paribas S.A., Calyon, Commerzbank AG, Deutsche Bank AG, and ING Bank N.V., worked in active concert with the Russian Government and Rosneft to destroy Yukos by invoking Yukos' default under a US$ 1 billion loan facility as a pretext to initiate the Russian bankruptcy proceedings.[1262] It is, to say the least, highly unlikely that major Western financial institutions, aware of the threats of a "*lifetime of litigation*" by Yukos and its controlling shareholders, would have agreed to join in such a conspiracy that would have exposed them to potentially enormous damages.

(iv) Sibneft. A leading role in the conspiracy is also ascribed to Sibneft. According to Claimants, the Sibneft shareholders called off the merger with Yukos following a private conversation with the President of the Russian Federation in which Roman Abramovich was presumably given appropriate instructions.[1263] Even assuming this conversation ever took place, there is, as with so many of the other features of Claimants' conspiracy theory, a much simpler explanation for the Sibneft demerger. Mr. Abramovich did not need the President of the Russian Federation to tell him that Sibneft's proposed merger partner was the subject of a contentious tax dispute whose ultimate magnitude could not yet be known and

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1261 Even if all of the foreign bidders that might otherwise have participated in the YNG auction would ultimately have been outbid, the auction proceeds would almost certainly have been higher. Yukos deliberately chose instead to threaten bidders and discourage competition, which can only have increased the likelihood that Yukos would be bankrupted, the other supposed objective of Claimants' purported conspiracy.

1262 *See* Claimants' Memorial on the Merits, ¶¶ 413-430.

1263 *See ibid.*, ¶ 211.

had certainly not previously been disclosed to Sibneft. In the circumstances, any reasonable company would have sought to extricate itself from the planned merger, or at least to ensure that the new company was not led by two executives recently indicted for tax evasion. Claimants' theory admittedly adds high (but unnecessary) dramatic color to a simple case of a company pursuing its own self-interest, but it has no basis in reality. Claimants' conspiracy theory also overlooks the important role played by Yukos in the ultimate failure of the merger. In Claimants' own account of Mr. Abramovich's supposed conversation, it was Mr. Abramovich who raised the possibility of changing the management team for the combined entity, and Mr. Putin is said to have welcomed that idea, strongly suggesting that he in fact supported the merger. In reality, the successful completion of the merger was frustrated by Yukos' own acknowledged refusal to accept the proposed change in the management team -- yet another self-inflicted wound.

(v) The participants in the bankruptcy auctions. According to Claimants, the bankruptcy auctions were rigged, with the under-bidders (and their financing banks) purportedly playing the roles assigned to them by the conspiracy's masterminds. According to Claimants' theory, some of Rosneft's main competitors, such as TNK-BP, agreed to submit bids for auction lots without any hope of winning, and then stopped bidding at pre-arranged moments in order to allow Rosneft to prevail as planned.[1264] As for the bidders (other than Rosneft) that actually won some of the allegedly rigged auctions (*e.g.*, ENI's winning bid to acquire Yukos' stake in OAO Gazpromneft (formerly, Sibneft) and various Siberian gas fields),[1265] Claimants would have the Tribunal believe that they

1264 *See* Claimants' Memorial on the Merits, ¶ 474.

1265 *See ibid.*, ¶ 483.

agreed to do so -- at enormous cost -- to disguise the sham nature of the auctions. Here too, prominent Western banks are assumed to have played a role. Rosneft purchased many of Yukos' former assets with considerable financial backing from a consortium of major Western financial institutions, including ABN AMRO, Barclays, BNP Paribas, Citibank, Goldman Sachs, JPMorgan Chase, and Morgan Stanley.[1266] It is highly implausible that these publicly-traded institutions would have been willing to engage in such chicanery. And even had they been willing to join the alleged conspiracy, it is not likely that they would have been able to keep their roles secret for so long.

(vi) PricewaterhouseCoopers. PwC must also be counted among Claimants' supposed co-conspirators. The firm's 2007 withdrawal of its audit opinions, then being relied on by Messrs. Khodorkovsky and Lebedev as proof that Yukos had never evaded any taxes, was, according to Claimants, solely the result of *"harassment"* by the Russian authorities.[1267] Claimants' self-serving conspiracy theory ignores (i) PwC's refusal, as early as in 2003, to audit Yukos' GAAP financials because of concerns about the trustworthiness of representations made by Yukos' senior management, and (ii) the information provided to PwC in 2007 by the Prosecutor General's Office showing, according to the senior PwC auditor responsible for auditing Yukos' financials, that the firm had been directly and intentionally deceived by the company's senior management, resulting in the loss of PwC's confidence in the reliability of Yukos' financial statements. Here too, the alleged victim -- Yukos -- was the author of its own

1266 *See* Rosneft, "Resolutions of the Rosneft Board of Directors," Press Release (Mar. 20, 2007) (Exhibit RME-896). In March 2007, Rosneft obtained US$ 22 billion in financing from an international consortium of financial institutions. If, as Claimants propose, Rosneft's acquisition of Yukos was the result of a vast conspiracy masterminded by the Russian Government to expropriate the assets of Yukos, it was a conspiracy richly funded by the world's leading financial institutions.

1267 *See* Claimants' Memorial on the Merits, ¶ 144.

downfall. Had Yukos' senior management not repeatedly lied to PwC, the world's second largest accounting firm would never have been required to withdraw its opinions.

(vii) Other individuals and entities. Claimants' conspiracy theory also necessarily implies the participation of a long list of other individuals and entities. For instance, the Roseko consortium that valued the assets sold in Yukos' bankruptcy must be presumed to have likewise participated in a series of sham transactions by providing sufficiently low valuations to make it easier for Rosneft to buy auctioned assets. Even DKW, a member of the Dresdner banking group, whose valuation of the YNG shares underpinned the rationale for the allegedly unfair starting bid price of the YNG auction,[1268] is implicitly assumed to have risked its reputation, and incurred potential liability to Yukos and its shareholders, to facilitate implementation of the alleged conspiracy.

768. This lengthy list of literally hundreds of putative co-conspirators is not exhaustive, but suffices to show that Claimants' conspiracy theory is, at a minimum, highly implausible, and unworthy of the Tribunal's endorsement.

769. Claimants' conspiracy theory also fails to explain why, if the Russian Federation's alleged plan to renationalize Russia's petroleum resources was of such strategic importance to the Russian Federation, the execution of the plan was not carried out in a much more direct manner.

770. For example, if the Russian Federation's goal were, as Claimants suggest, to bring about Yukos' liquidation, the Russian authorities could have elected to proceed under various provisions of Russian law that would have led to the company's liquidation far earlier and far more securely than the path in fact pursued, including the following:

1268 *See ibid.*, ¶ 369.

(i) The Russian authorities could have sought the "executive enforcement" of the taxes and default interest owed by Yukos for tax year 2000.[1269] Under this procedure, Yukos would not have been able to delay collection of the overdue taxes by judicially challenging their assessment, significantly accelerating the company's demise. The Tax Ministry instead opted to allow Yukos to contest its 2000 tax assessment in court, and only after that assessment had been judicially upheld (at the first instance and on appeal) did the Tax Ministry apply the frozen cash in Yukos' bank accounts to pay its overdue taxes, something it could have done months before if the real purpose of the tax assessments had been to bankrupt Yukos at the earliest possible date.

(ii) Under another provision of Russian law, the Russian authorities could have directly confiscated the proceeds of Yukos' fraudulent tax evasion scheme, as the proceeds of transactions contrary to public order,[1270] which would have ensured the company's immediate bankruptcy and liquidation.

(iii) The Tax Ministry even had the authority to file a claim -- which, on Claimants' conspiratorial view of things, would have been promptly rubberstamped by the Russian judiciary -- to wind up Yukos and its subsidiaries due to their repeated and serious violations of Russian tax law.[1271]

(iv) In addition to civil law actions, the Russian authorities also could have used procedures available under Russian criminal law to confiscate Yukos' cash and other assets to the extent they were

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1269 *See* ¶ 1416 *infra*.

1270 *See* Russian Civil Code, Art. 169 (Exhibit RME-909).

1271 *See* Russian Civil Code, Art. 61 (Exhibit RME-909).

used or intended to finance an organized criminal group of the kind run by Mr. Khodorkovsky.[1272]

771. Claimants' conspiracy theory cannot explain why the Tax Ministry failed to pursue any of these alternative paths, even though doing so would have ensured Yukos' earlier and more certain liquidation. More generally, Claimants offer no explanation as to why, if there truly were a conspiracy to renationalize Yukos' assets, the responsible officials of the Russian Federation: (i) allowed Yukos' 2000 tax assessments to be subjected to extensive judicial scrutiny; (ii) allowed nine months to elapse between those assessments and the first auction of Yukos' assets, during which time Yukos could have discharged its liabilities with its non-frozen or foreign assets; (iii) hired a world-class financial institution (DKW) to conduct an independent appraisal of YNG; (iv) did not sell the YNG shares to Rosneft (or another state-owned company) in a private sale; (v) set the rules for the YNG auction in a manner that invited foreign as well as privately-owned domestic bidders (even though those rules could, without difficulty, have been manipulated so as to discourage foreign and privately-owned bidders);[1273]

1272 *See* Art. 104.1 of the Criminal Code of the Russian Federation (Exhibit RME-898) (updating the existing criminal law permitting the seizure and confiscation of assets related to organized criminal activities). Several other countries also have similar laws in place that authorize their law enforcement agencies to seize and confiscate the proceeds or assets used in the commission of criminal activities. For instance, in England and Wales, Parts 2 and 5 of the Proceeds of Crime Act permit government authorities to confiscate or otherwise restrain property and other assets that have been obtained through unlawful conduct. *See* Proceeds of Crime Act 2002, c.29 (Exhibit RME-899). In the U.S., asset forfeiture is an explicit penalty for organized criminal activity and defendants are subject to forfeiture of all the proceeds from the entire criminal scheme. *See United States v. Gotti*, 459 F.3d 296, 346-347 (2d. Cir. 2006) (Exhibit RME-900); *see also Alexander v. United States*, 509 U.S. 544 (1993) (Exhibit RME-901); *see generally* 18 U.S.C. §§ 982, 1963 (Exhibit RME-902). The basic principle that proceeds from criminal activity can be seized and confiscated is also shared by, *inter alia*, Germany, Italy and Sweden. *See*, *e.g.*, L. 31-5-1965, n. 575, Measures Against Mafia and Foreign Criminal Organizations *and* D.L. 8-6-1992, n.306, Urgent Amendments to the New Criminal Procedure Code Against Mafia Crimes (Exhibit RME-903); German Criminal Code (*Strafgesetzbuch*), §§ 73 et seq. (Exhibit RME-904); *and* Chapter 36 of the Swedish Penal Code (Exhibit RME-905).

1273 In addition to manipulating the *ad hoc* rules for the YNG auction, the Russian Federation could have simply enacted a law similar to the one it eventually passed in April 2008, giving the Government the right to veto any sale of strategic assets to a foreign bidder. *See* Federal Law No.57-FZ "On the Procedure for Making Foreign Investments in Business Enterprises Having Strategic Significance for National Defense and State Security." dated Apr. 29, 2008 (Exhibit RME-906). Had the Russian authorities' real goal been to prevent the participation of foreign bidders in the YNG auction, the adoption of a strategic asset law would have made that aim far more certain of achievement. Laws granting the government a powerful say in

(vi) conducted the YNG auction and realized US$ 9.4 billion in proceeds that were applied to Yukos' overdue tax liabilities, thereby exposing the purchaser to the risk of U.S. bankruptcy litigation -- a risk that materialized when Yukos' management filed a US$ 20 billion claim against the auction participants; and (vii) organized an orderly bankruptcy process, that included 17 public auctions open to any bidder, was carried out on the basis of independently appraised pricing, and generated an additional US$ 34.8 billion in proceeds to defray Yukos' liabilities.[1274]

772. The actions taken by the Russian Government to ensure the success of the YNG auction warrant special mention. The Russian Government did not, as a matter of Russian law, need to hold a public auction of the YNG shares. As in many other countries, the shares could instead have been sold in a private sale.[1275] The Russian authorities likewise did not need to appoint an internationally respected firm (DKW) to value the YNG shares. While both the conduct of the YNG auction and the role played by DKW's valuation report have been sharply criticized by Claimants -- without justification -- the truly important point is that the Russian Government could have avoided any possible criticism on this score by instead selling the shares quickly and privately. It is a strange conspiracy theory indeed that posits a Russian Government supposedly hell-bent to nationalize its oil assets that appoints an international bank as its advisor and then provides for the YNG shares to be sold to the highest bidder in a public auction open to domestic and foreign bidders alike. The contrast with Yukos' determined efforts to sabotage that auction is striking.

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the sale of strategic assets to foreign entities are common in other countries. For instance, in the U.S., the Committee on Foreign Investment in the United States (CFIUS) has a broad mandate to review and block any transactions that would result in the acquisition of, or control over, strategic assets by foreign entities. *See* "Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons," 31 CFR Part 800 (Exhibit RME-907). In Germany, the Federal Ministry of Economics reserves the right to veto or restrict the acquisition by any non-German investor of 25% or more of the voting rights of companies in certain sensitive or strategic fields such as the defense and cryptology industries. *See* Section 53, German Foreign Trade and Payment Regulation (*Außenwirtschaftsverordnung*) (Exhibit RME-908).

1274 *See* ¶¶ 633-635.

1275 *See* ¶¶ 452.

773. The Russian Federation's actions thus repeatedly disprove Claimants' conspiracy theory. Objectively viewed, they show that the Russian Federation, far from planning and carrying out an illegal expropriation, enforced its tax laws against an aggressively delinquent company, and administered bankruptcy proceedings whose fairness even Claimants have found difficult to challenge. In contrast to Claimants' complicated and implausible conspiracy theory, Respondent's simple account of taxes evaded, assessed, and collected is a far more credible and logically consistent explanation for Yukos' demise.

774. Yukos and its controlling shareholders had a long and varied history of unlawful activity, especially with respect to tax evasion. In light of their unlawful behavior, it is not surprising that the Russian Federation's law enforcement efforts resulted in the tax assessments and criminal convictions that ensued.

775. Yukos' willful failure to pay its taxes led the Russian authorities first to assess and then to seek to collect the evaded tax. The resulting enforcement measures led to the YNG auction, which was carried out despite the best efforts of Yukos and its controlling shareholders to sabotage it, while Yukos' willful failure to pay its major creditors (the SocGen syndicate) led to those creditors filing a lawsuit before the English High Court, which in turn provided the catalyst for Yukos' bankruptcy proceedings.

776. Yukos' inability to meet its liabilities with the company's remaining Russian assets, and its refusal to employ its substantial foreign assets, ultimately resulted in a formal declaration of bankruptcy. Yukos' creditors voted to sell its assets in open and fair auctions, all of which were conducted in compliance with Russian law, with the highest bidder winning every auction (in marked contrast to the "loans for shares" auction conducted by Mr. Khodorkovsky and his cohorts).[1276] To the extent Rosneft prevailed in the auctions, that was not the result of a nefarious and far-reaching conspiracy. To the contrary, Rosneft was the most logical purchaser of the assets (after

1276 *See* ¶¶ 663-640, 20-29.

outbidding the other interested parties), once it had acquired the YNG shares by purchasing Baikal Finance, which had itself prevailed in an auction that Yukos and its controlling shareholders had attempted to sabotage.[1277]

777. Claimants' conspiracy theory, not surprisingly, relies on circumstantial evidence -- reports by political bodies and NGOs, a selective survey of rulings from foreign jurisdictions (none of which is persuasive or relevant to this case, let alone binding on this Tribunal),[1278] statements by former Russian Government officials now politically opposed to the current Government, and a miscellany of other circumstantial "proof."

778. Even when viewed in the light most favorable to Claimants, this "evidence" does not begin to support their conspiracy hypothesis. Respondent respectfully requests that the Tribunal adjudicate this case on the basis of the facts, and not on the basis of the anecdotes, hearsay, unsupported charges, Yukos-generated propaganda, and other circumstantial evidence proffered by Claimants.

779. Virtually all of the circumstantial evidence Claimants cite can be traced back to the massive public-relations campaign orchestrated and financed at considerable expense by Yukos' controlling shareholders and senior managers, which continues to this day. The basic story, originally told by Yukos' public relations team in 2003 and 2004, has since been picked up and repeated, without examination, by journalists, pundits, and politicians. That is how public opinion is formed today, and how Yukos' failure has come to be seen in certain circles as emblematic of the Russian Government's supposed efforts to punish Yukos' controlling shareholders and to renationalize Russia's petroleum resources. Not one of the reports or decisions cited by Claimants, however, adduces detailed information concerning Yukos' tax assessments, Yukos' efforts to resist the Russian authorities' attempts to collect the assessed taxes, the YNG auction, Yukos' subsequent bankruptcy or any of the other issues at the center of these

1277 *See* ¶¶ 490-506, *supra*.

1278 *See*, *e.g.*, ¶ 781.

proceedings. Likewise, not one of the reports or decisions cited by Claimants is based on an independent legal assessment of the tax issues in dispute here. Needless to say, the Tribunal is not charged with assessing public opinion, but rather with determining, on the basis of the law and facts presented by the parties, whether the Russian Federation's actions are in breach of the specific provisions of the ECT that Claimants purport to invoke.

780. It is a matter of public record that in 2003 and 2004 alone, Yukos and affiliated organizations spent at a minimum millions of dollars to propagate Claimants' version of events.[1279] Among the explicit aims of Yukos' lobbying efforts during this period was an attempt to convince the United States Congress to pass resolutions condemning the Russian Federation for its supposed political prosecution of Yukos' management and for its claimed failure to adhere to democratic norms.[1280] Similarly, Group Menatep -- the holding company for Yukos' controlling shareholders -- has since 2003 spent very large sums lobbying for such issues as addressing "*actions taken by Russian authorities against principals*

1279 According to U.S. filings, Yukos spent at least US$ 195,000 in 2003 and 2004 for lobbying activities in the United States alone. *See* APCO Worldwide Inc. 2003 Year End Lobbying Report for Yukos Oil Company (Exhibit RME-911) and BKSH & Associates 2004 Midyear and Year End Lobbying Reports for Yukos Oil Company (Exhibit RME-912). While the United States requires lobbyists to publicly register their affiliations, other countries and international organizations (such as the Council of Europe) do not. U.S. reporting requirements also only encompass efforts to influence U.S. government officials, and do not extend to public relations campaigns or other attempts to influence public opinion. The U.S.-only figures thus almost certainly represent merely the tip of the iceberg of Yukos' worldwide spending on lobbying and propaganda efforts.

1280 On behalf of Yukos, APCO Worldwide lobbied for passage of the identical House Concurrent Resolution 336 and Senate Concurrent Resolution 85. *See* APCO Worldwide Inc. 2003 Year End Lobbying Report for Yukos Oil Company (Exhibit RME-911). Without explicitly naming Yukos, these resolutions refer to "*the arrest and prosecution of prominent Russian business leaders [...] [as] examples of selective application of the rule of law for political purposes*" and claim (again, without naming names) that "*the courts of Great Britain, Spain, and Greece have consistently ruled against extradition warrants issued by the Russian Government after finding that the cases [...] have been inherently political in nature*." *See* Senate Concurrent Resolution 85 (Introduced), Nov. 21, 2003 (Exhibit RME-913). *See also* House Concurrent Resolution 336 (Introduced), Nov. 21, 2003 (Exhibit RME-914). Neither of these resolutions was adopted by either chamber of the U.S. Congress.

of GML and Yukos," in addition to spending untold further amounts internationally to influence public opinion and policy elites.[1281]

A. The Leutheusser-Schnarrenberger Report and the Council of Europe Resolution

781. Claimants repeatedly cite a non-binding political (not judicial) resolution of the Parliamentary Assembly of the Council of Europe entitled "The Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives" (the "PACE Resolution"). The PACE Resolution, in turn, was based *verbatim* on a fundamentally flawed report (the "PACE Report") prepared by Ms. Sabine Leutheusser-Schnarrenberger (the "Rapporteur").

782. As an initial matter, the Parliamentary Assembly of the Council of Europe is a political body, not a judicial one. Resolutions of the Parliamentary

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1281 *See* Greenberg Traurig Lobbying Reports for Group Menatep, Lobbying Disclosure Act Database (Exhibit RME-915) (detailing Group Menatep's U.S.-only expenditures of more than US$ 820,000 since 2005); APCO Worldwide Lobbying Reports for Group Menatep, Lobbying Disclosure Act Database (Exhibit RME-916) (detailing Group Menatep's U.S.-only expenditures of US$ 1.16 million since 2004); Covington & Burling Lobbying Reports for Group Menatep, Lobbying Disclosure Act Database (Exhibit RME-917) (detailing Group Menatep's U.S.-only expenditures of more than US$ 620,000 since 2003); Barnes & Thornburg Lobbying Reports for Group Menatep, Lobbying Disclosure Act Database (Exhibit RME-918) (detailing Group Menatep's U.S.-only expenditures of more than US$ 260,000 since 2006); and Alston & Bird Lobbying Reports for Group Menatep, Lobbying Disclosure Act Database (Exhibit RME-919) (detailing Group Menatep's U.S.-only expenditures of approximately US$ 300,000 in 2005).

Yukos' propaganda efforts were not limited to overt influence-seeking in the halls of government, but also extended to broad and creative campaigns designed to mold public opinion. APCO Worldwide, for example, ran "*an extended international campaign that began mid-2003*," targeting, according to APCO, "*so-called 'opinion elites' – policy makers and policy influencers primarily in the UK, Brussels, Berlin and the U.S.*" *See* Kate Kaye, *Yukos Shareholder Behind Ads Feeding Trial News to Policy Makers*, Personal Democracy Forum (Mar. 31, 2005) (Exhibit RME-920). As part of that campaign, APCO published a series of ads on the New York Times website in 2005 "*intended to raise awareness of Khodorkovsky's 'political prisoner' status.*" *Ibid.* The ads were designed to look like a newsletter named 'Russia in Focus,' with no indication of sponsor or ownership.

On the advice of his lobbyists, Mr. Khodorkovsky also began engaging in philanthropy to bolster his and Yukos' image. *See* Timothy O'Brien, *How Russian Oil Tycoon Courted Friends in U.S.*, N.Y. Times (Nov. 5, 2003) (Exhibit RME-921) (reporting on Mr. Khodorkovsky's "*efforts to carve out contacts and make his name*" by "*donat[ing] substantially to philanthropies in Russia and to American think tanks*"). Not everyone was convinced, however. *See ibid.* (quoting Fiona Hill, a Brookings Institution Russia analyst, as saying "*[t]he think tanks were all joking about who wanted to take money to fund the Mikhail Khodorkovsky chair of good corporate governance. [...] There were still questions about his business dealings and whether he really made the transition from being a robber baron and now wore a white hat.*").

Assembly are not legal determinations and carry no weight as legal precedent. The European Court of Human Rights, for example, has repeatedly called the resolutions and recommendations of Council of Europe bodies "*intrinsically non-binding*."[1282]

783. The PACE Report contains only a cursory discussion of Yukos' tax audits and related enforcement proceedings (the report focuses almost exclusively on the criminal proceedings against Mr. Khodorkovsky and Mr. Lebedev).[1283] Even that brief discussion, however, was based almost entirely on

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1282 *See Menchinskaya v. Russia*, European Court of Human Rights, Application No. 42454/02, Judgment of Jan. 15, 2009 ¶ 34 (Exhibit RME-922); *Demir and Baykara v. Turkey*, European Court of Human Rights, Application No. 34503/97, Grand Chamber Judgment of Nov. 12, 2008, ¶ 74 (Exhibit RME-923); *see also Sławomir Musiał v. Poland*, European Court of Human Rights, Application No. 28300/06, Judgment of June 5, 2009, ¶ 96 (Exhibit RME-924). In the words of the Parliamentary Assembly's own website, "*The texts adopted by PACE - recommendations, resolutions and opinions - serve as guidelines for the Committee of Ministers, national governments, parliaments and political parties. See* Council of Europe, "PACE: The Parliamentary Assembly of the Council of Europe" (Exhibit RME-925) [emphasis added].

1283 The Rapporteur relied almost exclusively on a "*detailed study published on 21 October 2004 by the London-based think tank 'Russian Axis'*" (*see* PACE Report, note 12 (Annex (Merits) C-490)) for her allegation of the "*notorious openness to corruption*" of the Russian courts. *Ibid.*, Section III, ¶ 59 (Annex (Merits) C-490) Far from being an independent think tank, however, Russian Axis is yet another cog in Yukos' propaganda machine. Lord Paddy Gillford, the director of Russian Axis in 2003 and 2004, is also the founder and owner of The Policy Partnership (since renamed, Gardant Communications), which was retained by Yukos to provide consulting and media services. *See* Julian Evans, *Why Russians Are Keen to Get a Lord on Board*, London Times (Aug. 15, 2006) (Exhibit RME-926). *See also UPS Role at Policy Partnership for ex-PPS Lobbyist*, PR Week (Sep. 15, 2000) (Exhibit RME-927).

In addition to disseminating propaganda on behalf of Yukos and its controlling oligarchs, The Policy Partnership also appears to have had a direct financial or control interest in Yukos International UK BV. U.S. lobbying disclosure laws require disclosure of non-U.S. entities directly or indirectly seeking to influence U.S. policy, including non-U.S. entities that directly or indirectly own, control or have an interest in a U.S. client. BKSH's lobbying disclosure forms list two non-U.S. entities with an interest in its client Yukos International UK BV. The first is Stichting Administratiekantoor Yukos International, a Dutch Stichting that owns 100% of the shares of Yukos International. The second is The Policy Partnership, which, according to the disclosure requirements, either (1) supervises, directs, controls, finances or subsidizes the activities of Yukos International UK BV, or (2) is an affiliate of Yukos International UK BV that also has a direct interest in the outcome of the lobbying activities. *See* BKSH & Associates Lobbying Reports for Yukos International UK BV (Exhibit RME-928). The director of Russian Axis at the time, Vadim Malkin, was also previously the Russia Practice Co-Head of Burson-Marsteller (*see* Curriculum Vitae of Vadim Malkin (Exhibit RME-929)), a global public relations firm that boasts on its website of helping to direct "*communications activities for Yukos in its battle with the Russian Federation*." *See* Burson-Marsteller, "Regional Leadership – Michael B. Lake" (Exhibit RME-930). The Rapporteur's reliance on Russian Axis as her principal authority on the Russian court system is, to say the least, another reason why the PACE Report lacks credibility.

press reports that, according to the Rapporteur herself, often reflected one party's attempt to mold public opinion and should therefore "*be treated with utmost caution*":

> "I am aware that the information pointing at Yukos (and thereby its former leading executives and main shareholders) being deprived of their main asset, its oil-producing subsidiary Yuganskneftegaz, must be treated with utmost caution: apart from some factual elements obtained from Yukos' current CEO, Steven Theede, and CFO, Bruce Misamore, and Yukos' international lobbyists on the one side, as well as the head of the Federal Tax Service, Mr Serdyukov, on the other, I am basing myself entirely on reports in the press, which are in turn a reflection of sometimes incomplete or contradictory public declarations by different actors, or of leaks that may be intended to test national and international public opinion, and market reaction."[1284]

The Rapporteur also made clear that "an examination of the substance of the tax claim exceeds my possibilities and my mandate."[1285]

784. On the basis of this inadequate record the Rapporteur nonetheless charged the Russian tax authorities with having (i) engaged in "*retrospective prosecution*" (on the grounds that Yukos' pre-2004 tax schemes were lawful until a supposed "*loophole*" was subsequently closed), and (ii) discriminated against Yukos because similar tax minimization schemes, used by other oil companies, were not subjected to a similar tax assessment.[1286] The charge of retroactive prosecution is simply wrong, and is not made even by Claimants, and the discrimination allegation is also wrong as a matter of fact and without merit as a matter of law, as shown in ¶¶ 1182-1228 below.

785. Various other statements made by the Rapporteur also demonstrate her lack of impartiality with respect to the Yukos case.[1287] A

1284 PACE Report, Section III, ¶ 62 (Annex (Merits) C-490) [emphases added].

1285 *Ibid.*, Section III, ¶ 65.

1286 *See ibid.*, Section I, ¶ 10.

1287 The Rapporteur based her report on two short fact-finding trips to Russia in 2004, during the second of which she attended only one court session. Even before her second trip, after having spent only four days in Russia and not yet attended a single session of the criminal trial of Mr. Khodorkovsky, the Rapporteur gave an interview to the German television station ZDF that showed she had already made up her mind. *See The Yukos Case and its Consequences*

political figure in her home country of Germany, the Rapporteur has made a number of political speeches sharply criticizing the prior German administration for its failure to support Mr. Khodorkovsky. For instance, the Rapporteur spoke forcefully about how Mr. Khodorkovsky's arrest was a signal of the "*Sovietization of Russia*,"[1288] how political leaders should oppose "*Putin's authoritarian policies*,"[1289] and why "*a relapse of the Cold War will only be prevented*" if Germany declares that "*it is worried about the fate of Mr. Khodorkovsky*."[1290]

786. In August 2009, the Rapporteur produced another report that, like the PACE Report, focused almost entirely on the criminal proceedings, and was not based on an independent review of the law or facts of the type conducted by a judge or arbitral tribunal. The Rapporteur herself acknowledges the limitations of her second report, stressing that she is "*not trying to play the role of a judge*" and that "*it is of course up to the courts to establish the underlying facts and to apply the law to these facts.*"[1291]

787. In sum, the Tribunal should give neither the PACE Report nor its progeny -- the PACE Resolution and the Rapporteur's August 2009 report -- any weight. They are the fruits of Yukos' propaganda machine, and do not reflect a

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– *Interview with Sabine Leutheusser-Schnarrenberger*, ZDF (Aug. 7, 2004) (Exhibit RME-931). In the interview, the Rapporteur stated "*primarily the objective of the Russian government is to gain state control over the oil production again*."

1288 *See* Sabine Leutheusser-Schnarrenberger, "Verhaftung Chodorkowskis Fanal der Sowjetisierung Russlands," Press Release (Oct. 25, 2007) (Exhibit RME-932); *see also* Sabine Leutheusser-Schnarrenberger, "Der Fall Chodorkowski," Speech to the European Parliament (Feb. 15, 2005) (Exhibit RME-933).

1289 *See* Sabine Leutheusser-Schnarrenberger, "Merkel muss autoritären Kurs Putins thematisieren," Press Release (Oct. 14, 2007) (Exhibit RME-934) (criticizing Chancellor Angela Merkel's handling of Russia, stating that "*Chancellor Merkel has a duty to express more clearly than she has so far the serious worries with respect to developments in Russia. European voices against Putin's authoritarian politics are increasing*").

1290 *See* Sabine Leutheusser-Schnarrenberger, "Verhaftung Chodorkowskis Fanal der Sowjetisierung Russlands," Press Release (Oct. 25, 2007) (Exhibit RME-932). The Rapporteur's support for Yukos appears to be intertwined with her domestic policy positions regarding energy independence. *See* Sabine Leutheusser-Schnarrenberger, "Merkel muss autoritären Kurs Putins thematisieren," Press Release (Oct. 14, 2007) (Exhibit RME-934) (arguing that "*Since Merkel's last meeting with Putin the Sovietization of Russia has increased. [...] The German Federal Government must immediately regain room to maneuver for a critical dialogue by reducing the dependence on Russia in energy matters.*").

1291 Parliamentary Assembly of the Council of Europe, Doc. 11993 of August 7, 2009, Report of the Committee on Legal Affairs and Human Rights, 29 (Annex (Merits) C-494).

genuine examination of the relevant facts or law, let alone a balanced assessment of any of the issues relevant to these proceedings.

B. Non-Russian Court Decisions

788. In light of their heavy reliance on the PACE Report, it is not surprising that Claimants also rely on several court decisions in non-Russian jurisdictions, based wholly or predominantly on that report. However, far from assisting the Tribunal, the court decisions cited by Claimants do not discuss Yukos' tax assessments or any other issue relevant to this proceeding, or they do so only in a perfunctory manner, relying predominantly on the PACE Report and newspaper accounts for support.

789. Most of the court decisions cited by Claimants concern requests for extradition or mutual legal assistance, and are manifestly concerned with issues that are very different from those present here. These cases were also generally heard by courts of lower jurisdiction, on records often acknowledged to be incomplete, applying a low standard of proof. In the absence of an adequate record, several of the courts cited published reports in lieu of witness testimony or documentary evidence as the basis for their decisions. In the Czech case relied on by Claimants, for example, the court acknowledged that that it had taken into account "*the way this case has been portrayed, especially by the mass media.*"[1292]

790. Claimants cite three extradition cases decided by the Bow Street Magistrates' Court as if three independent finders of fact all came to the same conclusion. In reality, the three cases were decided by the same judge, who acknowledged in the first case that he had attached "*great weight*" to the PACE Report.[1293] Neither this decision nor either of the two follow-on decisions

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1292 *Decision to Deny Extradition of Elena Vybornova to the Russian Federation*, High Court of Olomouc, Czech Republic, July 31, 2007 (Annex (Merits) C-461).

1293 *Government of the Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Bow Street Magistrates Court, Mar. 18, 2005 (Annex (Merits) C-462), *Government of the Russian Federation v. Ramil Raisovich Bourganov and Alexander Gorbachev,* Bow Street Magistrates Court, Aug. 17, 2005 (Annex (Merits) C-463), *Government of the Russian Federation v. Alexander Viktorovich Temerko*, Bow Street Magistrates Court, Dec. 23, 2005 (Annex (Merits) C-464).

referred to the tax and enforcement proceedings at issue here.[1294] The second case was decided on the basis that the defendants had already been granted asylum, and in the third case the court heard evidence from Yuri Schmidt, Mr. Khodorkovsky's defense lawyer, and the Rapporteur herself. The Russian Federation did not reply to the evidence submitted in any of the cases, and the standard of proof applied by the judge in determining whether to grant extradition was low ("*more likely than not*").[1295] Further, Magistrates' Court ranks below a court of general jurisdiction in England and its findings have no precedential value.

791. The extradition hearing before the Westminster Magistrates' Court, a court of the same rank, followed a similar pattern. The judge observed that the defendant, Mr. Azarov, was *"by all accounts a very rich man […] in a position to throw a great deal of money at experts and lawyers in his attempt to defeat this extradition request."* The Russian Federation, by contrast, tendered no evidence or material in rebuttal, *"save a wholly inadequate 4-page response received just four days before the commencement of the hearing."*[1296]

792. The Liechtenstein decision Claimants cite concerned a request for legal assistance in the context of Russian criminal proceedings made on behalf of Russia's Office of the Prosecutor General.[1297] The request was denied on the ground that the Russian Prosecutor had not supplied sufficient information in support of his request.[1298] The court mentioned the PACE Resolution as a reason for requiring more information, and gave the Prosecutor General full latitude to

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1294 *See* Claimants' Memorial on the Merits, ¶ 191.

1295 *Government of the Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Bow Street Magistrates Court, Mar. 18, 2005, 4 (Annex (Merits) C-462).

1296 *The Government of the Russian Federation v. Andrei Borisovich Azarov*, In the City of Westminster Magistrates' Court, Dec. 19, 2007, 4 (Annex (Merits) C-465).

1297 *See* Decision 12 RS.2003.255 of the Princely Court of Justice, Principality of Liechtenstein, Feb. 6, 2006 (Annex (Merits) C-467).

1298 *See ibid.*, 5.

re-file the request with additional information if he so desired.[1299] Like the other English extradition cases, this decision has no precedential value.

793. The Swiss decisions Claimants cite likewise concerned requests for mutual assistance in the context of foreign criminal proceedings,[1300] and the judgments cited by Claimants have no relevance to these proceedings. The materials seized by the Swiss authorities following the Prosecutor's initial request were initially ordered to be handed over to the Russian Federation.[1301] In remitting the request for further scrutiny, the Federal Tribunal cited the PACE Report and stated that it was unable, on the basis of the materials provided by the Russian Federation, to determine "*which crimes the specific acts of mutual judicial assistance correspond to,*"[1302] but did not rule out the possibility that judicial assistance might ultimately be granted.[1303] Like the Liechtenstein decision, the request was ultimately denied on the basis that the Prosecutor had not supplied sufficient information.[1304] The decision relied on reports of non-governmental organizations and domestic decisions denying extradition, and did not address any tax-related issues. Once again, the standard of proof applied by the Swiss

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1299 *Ibid.*

1300 Entry and Interlocutory Order issued by the Swiss Federal Prosecutor's Office on Mar. 25, 2004 (Annex (Merits) C-473); Judgment of the Swiss Federal Tribunal, June 10, 2004, *WJB Chiltern Trust Co Ltd & Veteran Petroleum Ltd v. Public Prosecutor's office of the Swiss Confederation* (Annex (Merits) C-474); Judgment of the Swiss Federal Tribunal, Jan. 4, 2006, *F, P, W & M v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-476); *Mikhail Khodorkovsky v. Swiss Federal Prosecutor's Office*, Swiss Federal Supreme Court, Aug. 13, 2007 (Annex (Merits) C-477); Judgment of the Swiss Federal Tribunal, Aug. 13, 2007, *Leonid Nevzlin v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-478); Judgment of the Swiss Federal Tribunal, Aug. 13, 2007, *Platon Lebedev v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-479); Judgment of the Swiss Federal Tribunal, Aug. 13, 2007, *B, E, F & G v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-480); Judgment of the Swiss Federal Tribunal, Aug. 13, 2007, *A, E & G v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-481); Judgment of the Swiss Federal Tribunal, Aug. 13, 2007, *C, L, E, F & G v. Swiss Federal Prosecutor's Office* (Annex (Merits) C-482).

1301 *See* Judgment of the Swiss Federal Tribunal, Jan. 4, 2006, *F, P, W & M v. Swiss Federal Prosecutor's Office*, ¶ F (Annex (Merits) C-476).

1302 Judgment of the Swiss Federal Tribunal, Jan. 4, 2006, *F, P, W & M v. Swiss Federal Prosecutor's Office*, ¶ 3.8 (Annex (Merits) C-476).

1303 *Ibid.*, ¶ 5.

1304 *See, e.g., Khodorkovsky v. Office of Attorney General*, Swiss Federal Supreme Court, Aug. 13, 2007, 17 (Annex (Merits) C-477).

court was significantly lower than the standard applicable in this arbitration: "[C]*ooperation must be refused if it appears that the criminal proceedings for which it is requested are politically motivated*."[1305]

794. The parties to the first Lithuanian decision Claimants cite were the Prosecutor General's Office of Lithuania, the Migration Department of the Ministry of the Interior of Lithuania, and Igor Babenko, an applicant for refugee status, as an interested third party and the appellant in the case.[1306] The decision contains no information of any relevance to the present proceedings. In addition to employing the "well-founded fear" standard generally applicable in requests for refugee status, the court relied heavily on circumstantial evidence, including the PACE Report and PACE Resolution, NGO press releases, and "*information presented in the Russian media*" from sources including the "*Press-centr Mikhaila Khodorkovskogo.*"[1307] Even in Lithuania, this decision has no precedential value.

795. The decision of the Prosecutor General's Office of the Republic of Lithuania, an extradition case, is likewise irrelevant.[1308] The decision involves criminal proceedings and does not refer to the tax or enforcement proceedings that are the subject of the arbitrations. The Prosecutor General's decision is not, in any event, a court decision and has no precedential value. The standard of proof employed by the Prosecutor General -- "*very likely*" and "*reasonable doubts*" -- is again much lower than that applicable here. The Prosecutor General relied principally on extradition and asylum cases in the United Kingdom, including

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1305 *Ibid.*, ¶ 2.5. *See also ibid.*, ¶ 4 ("*All these elements corroborate the suspicion that these criminal proceedings were orchestrated by the regime in power with a view to subordinating the class of rich 'oligarchs' and eliminating potential or sworn political opponents*") [emphasis added].

1306 Decision to Grant Refugee Status to Igor Babenko, Supreme Administrative Court of Lithuania, Oct. 16, 2006 (Annex (Merits) C-468).

1307 *Ibid.*, 21.

1308 *See* Prosecutor General's Office of the Republic of Lithuania, Decision to Deny Extradition of Mikhail Brudno to the Russian Federation, Aug. 24, 2007 (Annex (Merits) C-469). Under Lithuanian law, decisions of the Prosecutor General are not publicly available and it is unclear how Claimants obtained a copy of it.

the Bow Street Magistrate Court's decisions, on the Lithuanian case discussed above[1309] and on the PACE Resolution and PACE Report.

796. The Cyprus district court decision Claimants cite concerned a request by the Russian Federation for the extradition of Mr. Vladislav Kartashov, a former Yukos manager in charge of three trading shells involved in the company's tax evasion scheme.[1310] The decision relied heavily on the PACE Resolution and PACE Report. The judge, in denying the request, procedurally similar to a preliminary inquiry, emphasized that he did "*not make an assessment of the civil rights or obligations of the fugitive or of any charge brought against him.*"[1311]

797. The Amsterdam Court of Appeal decision involved a dispute between Yukos Capital -- which is still controlled by Yukos' former managers -- and Rosneft, as to whether, under Dutch law, a Dutch court could enforce an arbitral award that had been annulled by a Russian court. The Amsterdam Court of Appeals relied on the PACE Report and on reports by non-governmental organizations in enforcing the annulled award. Under the Dutch Code of Civil Procedure, any fact put forward by a plaintiff that is not specifically denied by the defendant may be deemed to have been established.[1312] The Russian Federation was not a party to the proceedings; and was thus not able to challenge the plaintiff's claims. The standard of proof applied to disputed facts was also very low -- mere "*plausib[ility]*"[1313] was sufficient. In any event, for the reason explained below, this decision today has no precedential effect.

1309 Although the ruling of the Supreme Administrative Court discussed here did not create a binding precedent in Lithuania, as the Prosecutor General's Office was a party to those proceedings, it cited that ruling in its subsequent decision.

1310 *See In the matter of the Application of the Russian Federation for the extradition of Kartashov Vlatislav Nicolay*, District Court of Nicosia, Apr. 10, 2008 (Annex (Merits) C-460).

1311 *Ibid.*, 35.

1312 Code of Civil Procedure of the Netherlands, Art. 149 (Exhibit RME-936).

1313 *See Yukos Capital SARL v. OAO Rosneft*, Amsterdam Court of Appeal, Decision of Apr. 28, 2009, ¶ 3.10 (Annex (Merits) C-484).

798. The decision of the District Court of Amsterdam concerns the enforceability in the Netherlands of an order issued in Yukos' bankruptcy proceedings.[1314] The plaintiffs were former directors of Yukos' Dutch subsidiary, Yukos Finance B.V. The Russian Federation was not a party to the proceeding and, consistent with Dutch law, any fact put forward by the plaintiffs that was not specifically denied by the defendant was deemed to have been established.[1315] The District Court's decision was appealed to the Amsterdam Court of Appeals. That proceeding has since been stayed pending the decision of the ECHR in the action brought by Yukos. In staying the appeal, the Amsterdam Court of Appeals did not consider itself bound by either the lower court's findings or its own prior decision, discussed in ¶ 797 above.[1316]

799. Given their very different circumstances, inadequate evidentiary records, perfunctory treatment, if any, of tax and enforcement issues, reliance on the PACE Report and other published accounts, as well as their lack of precedential or other authority, the non-Russian court proceedings cited by Claimants should not be given any weight by the Tribunal.

C. Other Statements

800. Of all the unreliable circumstantial evidence cited by Claimants, the least reliable are the statements made by certain non-governmental organizations and legislative bodies.

801. Many NGOs are committed to a specific view of the world. Some are ideological interest groups whose pronouncements are unremittingly predictable. None of the NGOs cited by Claimants sought or obtained the views of the Russian authorities, or conducted an independent analysis of the legal

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1314 *See Godfrey, Misamore, Yukos Finance B.V. v. Rebgun, Yukos Oil Co., Hogerbrugge, Shmelkov*, Case No. 355622, District Court of Amsterdam, Oct. 31, 2007 (Annex (Merits) C-483).

1315 Code of Civil Procedure of the Netherlands, Art. 149 (Exhibit RME-936).

1316 *Eduard Konstantinovic Rebgun v. OOO Promneftstroy*, Amsterdam Court of Appeal, Case No. 200.002.097/01, at ¶¶ 3.6.1-3.6.2, 4, (Oct. 19, 2010) (Exhibit RME-937).

issues underlying either Yukos' tax assessments or the Russian Government's related collection and enforcement measures.

802. The pronouncements of national legislative bodies cited by Claimants are likewise unreliable. These pronouncements are rarely based on independent investigation, and even less frequently are both sides to a disputed issue afforded the opportunity to make their views known. That is certainly true of the legislative declarations cited by Claimants. Legislative declarations instead almost invariably answer to domestic political concerns, and provide their sponsors with the opportunity to make political points without engaging the full moral and political force of the State. Because they are understood to have little or no effect, their authors understandably feel free to express their views in strong -- but not necessarily warranted -- terms.

803. Claimants also cite statements made by the OECD and World Bank. The view expressed in the OECD's 2004 survey is, to say the least, peculiar. According to the author of the survey, "*[w]hether the charges against the company [Yukos] […] are true or not, it is clearly a case of highly selective law enforcement.*"[1317] In light of the OECD's professed agnosticism as to whether Yukos had in fact engaged in massive tax evasion, there was absolutely no basis for the survey's claim -- without any cited support -- that Yukos had been singled out for invidious treatment. Whether Yukos actually received different treatment would, of course, depend on (among other things) the nature and extent of the taxes actually evaded by Yukos and by other Russian companies. Not surprisingly, the OECD survey is silent on that issue. The OECD's 2006 survey suffers from a more fundamental problem. Its claims are not supported by any cited authority, and so there is no basis on which to assess the author's *ipse dixit*. It would also appear that some of the statements made in the survey are the result of the same publicity campaign that informs so much of Claimants' circumstantial evidence. There is certainly no indication that the author of the

1317 OECD, *Economic Survey of the Russian Federation* (2004), 71 (Annex (Merits) C-501) [emphasis added].

survey sought out the Russian authorities' views or carried out an independent assessment of the facts or the legal basis for the Russian Federation's actions.

804. The World Bank's 2005 report is much more balanced. In a section dealing with the Russian Government's economic strategy, there is a passing reference to Yukos, but no view is expressed on the merits of Yukos' tax assessments or the Russian authorities' related collection and enforcement efforts.

D. Statements by Former Russian Officials

805. In a further attempt to substantiate their contention that Respondent's prosecution of Yukos for tax evasion was animated by an improper, *mala fide* motive to expropriate the company's assets,[1318] Claimants rely on statements submitted by two former Russian officials now opposed to the Russian Government -- Mikhail Kasyanov and Andrei Illarionov -- and on a statement submitted by Vladimir Dubov, a former member of Russia's Duma.[1319]

1318 *See, e.g.*, Claimants' Memorial on the Merits, ¶ 65.

1319 Claimants' conspiracy theory also relies on a statement attributed to First Deputy Prime Minister Igor Shuvalov, to the effect that Mr. Khodorkovsky was supposedly targeted for "*political reasons*." Claimants' Memorial on the Merits, ¶ 543. There is good reason to believe that Mr. Shuvalov never said anything like that. At a press conference in 2005, Mr. Shuvalov actively supported the Russian Government's actions in forcing Yukos to pay the taxes it owed. "'*The situation surrounding Yukos has negatively affected the Russian investment climate, but it was impossible to avoid – the decision was right,' presidential aide Igor Shuvalov told correspondents. According to Shuvalov, a liberal economic model must dictate all tax-collection issues. 'We have to teach everyone to pay taxes [...] the government's position must be tough. Our legislation must be liberal, but the state machinery must force people to abide by such legislation*.'" *Shuvalov: Yukos Case Hurts Foreign Investment*, RIA Novosti (Mar. 17, 2005) (Exhibit RME-940) [emphases added].

Claimants additionally refer to statements submitted by Leonid Nevzlin, the former Deputy Chairman of Yukos' Board of Directors and a beneficial owner of Yukos shares, and by Yuri Schmidt, one of the two most senior members of Mr. Khodorkovsky's criminal defense team. Both of these individuals are manifestly interested (in different ways) in the outcome of this proceeding, and their views should be discounted accordingly. Mr. Nevzlin also fundamentally contradicts himself in explaining the Russian authorities' supposed motivation. According to Mr. Nevzlin, he was warned in mid-Spring 2003 that a decision had already been taken to renationalize Yukos. *See* Witness Statement of Leonid Nevzlin ("Nevzlin Witness Statement"), ¶ 30. Yet Mr. Nevzlin acknowledges that in April 2003 President Putin approved both the Yukos-Sibneft merger and the surviving company's own merger with a major U.S. oil corporation, though, according to Mr. Nevzlin, it was understood that the latter should not result in the acquisition of more than 25% of YukosSibneft. *See ibid*., ¶ 26. What Mr. Nevzlin does not – and can not – explain is how the Russian Federation intended both to renationalize Yukos and to allow a U.S. oil major to

806. Mr. Kasyanov is a disgruntled former Chairman (Prime Minister) of the Russian Government. He was fired by the President of the Russian Federation on February 24, 2004, shortly before the Presidential elections scheduled for March 14 of that year.[1320] At the time, it was reported that his firing "*is believed to help Putin's re-election bid further by cutting his ties with the prime minister who has often been associated with shady relations with the business community.*"[1321]

807. During his time as Prime Minister, Mr. Kasyanov dealt principally with economic and social issues, and was not involved "*in the activity of law enforcement agencies.*"[1322] His views on the arrest of Messrs. Khodorkovsky and Lebedev should be discounted accordingly.

808. In support of his view that Yukos' tax assessments were politically motivated, Mr. Kasyanov asserts that they were "*created artificially*" by retroactively applying a law adopted in December 2003 to close the ZATO "*tax loopholes.*"[1323] According to Mr. Kasyanov, the use of ZATO tax minimization schemes had previously "*contradicted the financial and economic policy of our Government but did not run counter to the law in force at the time.*"[1324] For Mr. Kasyanov, Yukos' tax assessments were thus the result of the illegal retroactive application of the December 2003 law.[1325] The principal -- and fatal -- defect in Mr. Kasyanov's explanation is that not even Claimants allege that their tax assessments were based on the retroactive (or any other) application of that law, and for good reason. While the 2003 law did amend the ZATO tax system, Yukos

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acquire at least 25% of YukosSibneft. Mr. Schmidt's statement suffers from a more fundamental defect. As one of Mr. Khodorkovsky's two most senior criminal lawyers, the views he offers on the adequacy of the Russian legal system in this case constitute special pleading, and not a proper witness statement.

1320 Witness Statement of Mikhail Kasyanov ("Kasyanov Witness Statement"), ¶ 38.

1321 *Putin Fires Prime Minister Kasyanov, Entire Cabinet*, Kyodo News (Mar. 1, 2004) (Exhibit RME-941). [emphasis added]

1322 Kasyanov Witness Statement, ¶ 13.

1323 *See ibid.*, ¶¶ 34-37.

1324 *See ibid.*, ¶ 34.

1325 *See ibid.*, ¶¶ 34-37.

was charged with having evaded taxes due under the prior law, and the changes introduced in 2003 did not affect Yukos' tax liability.[1326]

809. Mr. Kasyanov's statements in this proceeding have all the hallmarks of a vengeful failed politician. He was dismissed first by the President of the Russian Federation and then rejected by the Russian electorate when he mounted an unsuccessful campaign for president in 2008. Mr. Kasyanov's apparent sympathy for Mr. Khodorkovsky may also have another explanation.

810. Mr. Illarionov is a well known ideologue and critic of the Russian Government, with a gift for inflammatory and fanciful rhetoric. He is often quoted for his view that the YNG auction was the *"scam of the year"* -- a charge repeated in his statement submitted by Claimants, in which he also alleges, based on unnamed but supposedly *"reliable"* sources, that a *"special unit was set up at the General Prosecutor's office, comprised of approximately 50 people and working exclusively on fabricating evidence against Mr. Khodorkovsky and Yukos."*[1327]

811. His attack on the YNG auction is based on a series of demonstrably untrue propositions[1328] and his claim that a 50-person "special unit" was set up before any charges were filed "exclusively" to fabricate evidence is both completely unsupported and absurd on its face. While Claimants do assert that the charges brought against Yukos were not grounded in Russian law, not even Claimants themselves allege that the evidence against Mr. Khordokovsky and Yukos was "fabricated." The existence of a 50-person strong "special unit," had it in fact existed, would also eventually have come to light. Mr. Illarionov's hypothesized pile of fabricated evidence nonetheless played no role in Yukos'

1326 *See* ¶ 368.

1327 *See* Illarionov Witness Statement, ¶¶ 35 and 50.

1328 *See ibid*., ¶¶ 42-48. Mr. Illarionov, for example, is wrong in claiming that DKW's valuation was dismissed by the Russian authorities (*see* ¶ 467), and that the price realized in the YNG auction was inconsistent with DKW's valuation report (*see* ¶¶ 471-478). He likewise overlooks the fact that the TRO obtained by Yukos from the U.S. bankruptcy court legally prohibited all of the expected bidders from participating in the YNG auction (*see* ¶¶ 503-504) and refuses to acknowledge that a real strategic bidder might have used Baikal Finance as an acquisition vehicle precisely because it was an unknown shell company not subject to the TRO.

defense, and no enterprising journalist or investigator retained by Yukos has ever claimed to have any knowledge of Mr. Illarionov's "special unit."

812. Even prior to the Yukos affair, Mr. Illarionov was "known throughout Russia for his sharp tongue and outspoken views"[1329] and his "abrasive style,"[1330] not to mention his desire to be seen as "the rebel within the Kremlin walls"[1331] and a "maverick figure in Mr. Putin's entourage,"[1332] all features of his personality that figure prominently in his submitted statement.

813. Philosophically, Mr. Illarionov is a libertarian extremist with a strong aversion to taxes and government efforts to collect them, once remarking that "*[e]very tariff and every limit on foreign exchange transactions is a blow to our consciousness. Every tax acts against our freedom*."[1333] After leaving his position as economic advisor to Mr. Putin in late 2005,[1334] Mr. Illarionov continued his anti-tax crusade as a senior policy fellow at the Cato Institute, the U.S. libertarian think tank.[1335]

814. Mr. Illarionov's radical anti-tax philosophy and his penchant for intemperate bombast make his comments regarding the YNG auction and the

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1329 *See* John Rossant, *Andrei Illarionov, Presidential Aide and Economic Adviser,* Business Week (June 17, 2002) (Exhibit RME-947).

1330 *Ibid.*

1331 *Ibid.*

1332 *See* Neil Buckley, *Yukos Affair Has Damaged Russia, Says Putin Adviser*, Financial Times (June 2, 2005) (Exhibit RME-948).

1333 *See* John Rossant, *Andrei Illarionov, Presidential Aide and Economic Adviser,* Business Week (June 17, 2002) (Exhibit RME-947).

1334 According to Mr. Illarionov, he was so opposed to the Government's dealings with Yukos that he resigned as Russia's G-8 *sherpa* in the Fall of 2004. Illarionov Witness Statement. ¶ 52. Despite his professed "*strong disapproval*" of the Government's actions, Mr. Illarionov nonetheless continued to serve as the economic advisor to the same President whose actions he so sharply criticizes, until he chose to resign more than a year later, in December 2005. *See* C. J. Chivers, *Putin's Senior Economic Adviser Abruptly Resigns*, N.Y. Times (Dec. 27, 2005) (Exhibit RME-949).

1335 *See* Andrei Illarionov, Senior Fellow, Center for Global Liberty and Prosperity, Cato Institute (Exhibit RME-950).

Russian Government's tax collection efforts entirely predictable. These comments do not, however, constitute credible evidence of an improper motive on the part of the Russian Federation in this case.

815. Mr. Illarionov is also well known for his view of the world as beset by authoritarian conspiracies. For example, Mr. Illarionov characterized the Kyoto Protocol to limit greenhouse gases and protect the environment as a "*death treaty*" that would have an impact on the Russian economy akin to "*an international gulag or Auschwitz*."[1336] When Russia was contemplating ratification of the Kyoto Protocol, he claimed that the British government had used "*bribes, blackmail and murder threats*"[1337] to obtain Russia's support. According to Mr. Illarionov, the treaty's supporters suffer from "*a severe case of mental depression*" and the scientists working at the Hadley Centre for Climate Prediction and Research, a part of the United Kingdom's renowned official weather service (the Met Office) and one of the world's leading climate change research centers, are a "*totalitarian sect*" whose support of the Kyoto Protocol he likened to that of "*two previous totalitarian ideologies*" -- "*communism and [...] Nazism*."[1338]

816. Mr. Dubov was a member of Yukos' Board of Directors from 1998 through the end of 1999. Before that he occupied senior positions at Bank Menatep and affiliated companies. Through his shareholdings in Group Menatep Ltd., he was also an indirect beneficial owner of Yukos shares. Mr. Dubov was elected to the Duma in December 1999 and took office in January of

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1336 *See* Nick Paton Walsh, *Putin Adviser Calls Kyoto Protocol a 'Death Treaty': Russia Fears Greenhouse Gas Limits Would Hold Back Economy*, Guardian (Apr. 15, 2004) (Exhibit RME-951). Mr. Illarionov also sarcastically noted that efforts to curb greenhouse gases with quotas would cause the Russian people to have to "*turn into dwarves or babies, or to stop [breathing].*" *Ibid*.

1337 *See* Simon Ostrovsky, *Illarionov Attacks Britain, Vows to Bury Kyoto*, The Moscow Times (July 12, 2004) (Exhibit RME-952).

1338 *See Q&A with Presidential Economic Adviser Andrei Illarionov*, Federal News Service (Feb. 8, 2005) (Exhibit RME-953). Mr. Illarionov's list of "*approximately 15*" theories supposedly "*tested*" by the Russian authorities as a "*smoke screen*" for their real motives is of a piece with his penchant for perceiving totalitarian intrigue everywhere, and should be given no weight by the Tribunal (*See* Illarionov Witness Statement, ¶ 36).

the following year, where he served as Chairman of the Tax Sub-Committee, a part of the Duma's Tax and Budget Committee, until October 27, 2003.[1339]

817. Mr. Dubov reviews the many meetings he supposedly had with Russian Government and Mordovian officials, in an attempt to show that the Russian authorities were aware of Yukos' "tax optimization scheme."[1340] What is notably missing from his account is any indication that the Russian and Mordovian officials were put on notice of the facts constituting Yukos' abuse of the ZATO tax-reduction program. *See* ¶¶ 230-277 *supra*.

818. Mr. Dubov also passes over the role he played on the Duma's Tax Sub-Committee as Yukos' front man. Gennady Seleznev, the former Speaker of the Duma, has observed that *"[w]hen bills affecting YUKOS's interests were discussed in the Duma, I had the impression that there were 250 Dubovs in the Chamber."*[1341] His influence on budgetary matters was, if anything, more decisive. During the period of his membership, the Tax and Budget Committee *"practically turned into a structural sub-unit of Yukos,"* according to the journalist Natalya Arkhangelskaya.[1342]

819. Mr. Dubov was an interested party when he served in the Duma furthering Yukos' interests, and he remains an interested party today through his indirect holdings in Claimants Hulley and YUL.[1343] His statement should accordingly be afforded no weight by the Tribunal.

820. The foregoing survey of Claimants' circumstantial evidence demonstrates that Claimants' conspiracy theory is based on anecdote, hearsay, innuendo and, above all, the continuing effect of the massive ongoing public relations campaign carried out by Yukos and its core shareholders. The survey also shows that Claimants' conspiracy theory fails to take account of the

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1339 Witness Statement of Vladimir Dubov ("Dubov Witness Statement"), ¶ 6, 8.

1340 *Ibid.*, ¶¶ 11-54.

1341 Vladimir Perekrest, *Why Khodorkovsky Is in Jail (Part 3)*, Izvestiya (Exhibit RME-74).

1342 RICHARD SAKWA, THE QUALITY OF FREEDOM: KHODORKOVSKY, PUTIN AND THE YUKOS AFFAIR (2009), 114 (quoting Natalya Archangelskaya) (Exhibit RME-73).

1343 Dubov Witness Statement, ¶ 8.

company's own very significant contribution to its demise, and cannot explain why, if the Russian Federation's real goal was to liquidate Yukos as quickly as possible, the Russian authorities took the actions they did -- affording the company an opportunity to challenge every one of the Russian Government's actions in court up to the highest appellate level -- rather than pursuing alternative remedies that would have resulted much earlier in the company's liquidation.

821. The Tribunal is thus faced with two very different views of this case: Claimants' complicated and inadequate conspiracy theory, and Respondent's much simpler story of a company that, from its very inception, has illegally pursued its own aggressive agenda at the expense of the Russian Federation's Treasury, Yukos' minority shareholders, and those who have sought to call the company to account.

822. By aggressively challenging virtually every action taken by the Russian authorities, Yukos has nonetheless managed to create the impression in some circles, reinforced by its relentless public relations machine, that it has been treated differently from other Russian companies. As discussed at ¶¶ 1233-1251, this is not in fact the case. To the extent there is any truth to this image, it is that Yukos evaded more taxes more aggressively than any other Russian company, and then resisted more aggressively than any other taxpayer the Russian authorities' efforts, in accordance with Russian law, to enforce and collect the evaded taxes. The Yukos story thus is different from that of many other Russian taxpayers, but only because Yukos consistently conducted its affairs outside the law and then aggressively refused to comply with the Russian authorities' predictable response, and not because Yukos was the innocent victim of some vast and complicated conspiracy supposedly implemented by virtually every organ of the Russian State and numerous third parties not remotely under the control of the Russian Government.

823. A final irony should be noted. As discussed above at ¶¶ 452, 770 the Russian authorities took numerous actions not required by Russian law in order to afford Yukos an opportunity to judicially challenge their actions, and

then took additional steps, likewise not required by Russian law, to ensure that the YNG shares were sold at the highest possible price. Yukos' response was to seek to take advantage of the protections provided for by the Russian Government, while complaining that the Government's actions were nonetheless inadequate. For example, in the extra time required to carry out a public auction of the YNG shares, Yukos filed a contrived bankruptcy petition in the United States, and then sought and obtained a TRO that effectively sabotaged the auction, all the while objecting to virtually every aspect of the Government's plan. So too, in the time afforded to Yukos to legally challenge its tax assessments and the Government's related enforcement actions, Yukos' controlling shareholders caused the company to transfer enormous sums abroad and then refused to use the transferred amounts to pay its delinquent taxes. At the same time, Yukos attacked both the decisions handed down by the Russian courts and the judges who decided them, while opposing the Government's collection efforts on the grounds that the company had not been afforded enough time to pay its tax bill.

IV. PRELIMINARY OBJECTIONS

A. The Tribunal Lacks Jurisdiction Pursuant To Art. 26(3)(b)(i) ECT Over The Present Dispute

1. Yukos Shareholders, Including Claimants, Are Pursuing The Same Claims For Recovery Of Losses Arising From Yukos' Demise Before The ECHR

824. Yukos shareholders are seeking damages in the amount of US$ 104.497 billion before the European Court Of Human Rights ("ECHR") based on the same allegations of discrimination and expropriation that are asserted before this Tribunal, with a similarly astounding amount of damages claimed.[1344] In their final submission to the ECHR, they summarize the conduct complained of as follows:

> "[The violations] essentially arise from the series of unlawful Tax Assessments raised against [Yukos], the unfairness of the proceedings relating to them, the fact that the law was interpreted in an unforeseeable, unique and selective way and that the enforcement of the liabilities was conducted in an arbitrary and capricious way, with absurd time limits for payment, successive freezes of all assets and contradictory orders to pay, which also imposed further freezes. The enforcement also concentrated exclusively on the forced sale at undervalue of the principal production subsidiary YNG in a disguised expropriation in favour of the State entity, Rosneft. Thereafter, the authorities maintained all the freezes for a further fifteen months, so that the Applicant Company remained paralysed, without any further disposals being undertaken to meet the liabilities, with the result that [Yukos] was eventually forced into a spurious bankruptcy. In the bankruptcy the Creditors' Committee, comprised as to more than 90% and so controlled by Rosneft and the tax authorities, decided to reject the proposal for the rehabilitation of [Yukos] and rather to liquidate its

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1344 *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Application of Yukos Oil Company under Art. 34 of the European Court of Human Rights (Apr. 23, 2004) (Exhibit RME-976); *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Urgent Additional Facts and Complaints concerning the Enforcement of Additional Tax Liabilities on the Company by the decision to sell Yuganskneftegaz by auction on 19 December 2004 (Dec. 3, 2004) (Exhibit RME-977); *Yukos Oil Co. v. Russian Federation*, ECHR, Application Nos. 14902/04; 977/06 & 8446/06, Notification of Factual Developments Affecting the Applicant's Complaints & Status as a Victim and Requiring Urgency (May 18, 2006) (Exhibit RME-978); *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Urgent Submission of New Facts (May 23, 2007) (Exhibit RME-979).

assets. This process led to the dissolution of [Yukos] under Russian law."[1345]

825. On November 12, 2007, Yukos ceased to exist.

826. On January 29, 2009, the ECHR dismissed Respondent's request to discontinue the examination of the case and accepted Mr. Gardner, Yukos' former representative, as a valid representative in the continuing proceedings.[1346]

827. On May 4, 2009, Mr. Gardner for the first time disclosed that he seeks compensation on behalf of Claimants through a Stichting created under Dutch law to ensure payment of compensation to "the ultimate stakeholders" in Yukos:

> "The Stichting has been created with the object of, in summary, the payment of creditors of Yukos Oil Company, the representation and protection of the interest of Yukos Oil Company including as a 'benevolent intervener' (*zaakwaarnemer*) pursuant to Section 6:198 of the Dutch Civil Code, the maintenance of proceedings, including before the Court, with a view to striving '*for distribution of any funds received by it and to be received through a scheme to shareholders of Yukos Oil Company in accordance with the applicable law and principles of reasonableness and fairness*'.
>
> The Stichting has therefore been created to ensure that, notwithstanding the dissolution of Yukos Oil Company as a matter of Russian law, there are two proper vehicles, both created in a jurisdiction in which the spurious bankruptcy has not been recognized, because of short comings which are in part the object of this Application, which is able to receive an award of just satisfaction and distribute it, under the appropriate judicial supervision, to the ultimate stakeholders in the Applicant Company in the way in which a lawful and fair distribution on liquidation should occur.
>
> In this way the Stichting represents a legitimate mechanism whereby an award can be made under Article 41 of the Convention

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1345 *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Applicant's Representative's Application for Just Satisfaction (May 4, 2009), ¶ 1 (Exhibit RME-980).

1346 *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Decision as to the Admissibility of Application No. 14902/04 by OAO Neftyanaya Kompaniya Yukos against Russia (Jan. 29, 2009), 80 (Exhibit RME-981).

notwithstanding the eradication of the Applicant Company under domestic Russian law."[1347]

828. These circumstances deprive the Tribunal of jurisdiction under Article 26(3)(b)(i) and 26(2)(b), Annex ID ECT.

2. The ECHR Claims And The ECT Claims Share the "Same Fundamental Basis"

829. As set forth in Respondent's First Memorial on Jurisdiction and Admissibility,[1348] the Russian Federation has expressly conditioned its consent to submission of a dispute to international arbitration on the investor not having previously submitted the dispute to a "*previously agreed dispute resolution procedure*."[1349]

830. The Interim Awards on Jurisdiction and Admissibility, which summarily dismissed Respondent's objection that the Tribunal lacked jurisdiction pursuant to Article 26(3)(b)(i) ECT, were based on the incorrect assumption that the parties in the ECHR proceedings and the present proceedings are different.[1350] The fact that Yukos interests represented in the continuing ECHR proceeding are seeking damages on behalf of Claimants themselves based on the same purported entitlement to compensation for the alleged expropriation of Yukos that Claimants assert before this Tribunal triggers the "fork-in-the-road provision" under the "triple identity test" that the Interim Awards seem to have adopted. The Interim Awards contented themselves with the categorical statement that "*there is no question*" that the ECHR applications fail to trigger the "fork-in-the-road-provisions," but failed to mention the

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1347 *Yukos Oil Co. v. Russian Federation*, ECHR, Application. No. 14902/04, Applicant's Representative's Application for Just Satisfaction (May 4, 2009), ¶¶ 63-65 (Exhibit RME-980). [italics in original; other emphases added]

1348 Respondent's First Memorial on Jurisdiction and Admissibility (Hulley), ¶¶ 88 *et seq.*; Respondent's First Memorial on Jurisdiction and Admissibility (YUL), ¶¶ 88 *et seq.*; Respondent's First Memorial on Jurisdiction and Admissibility (VPL), ¶¶ 90 *et seq.*

1349 Article 26(3)(b)(i) ECT in conjunction with Article 26(2)(a) ECT, Annex ID.

1350 Interim Award on Jurisdiction and Admissibility (Hulley), ¶¶ 597-599; Interim Award on Jurisdiction and Admissibility (YUL), ¶¶ 598-600; Interim Award on Jurisdiction and Admissibility (VPL), ¶¶ 609-611.

requirements of the "triple identity test" and state which requirement was not fulfilled.

831. First, following Yukos' liquidation, Yukos' "ultimate stakeholders," including Claimants, are the only Yukos interests that are represented in the ECHR proceedings and seek compensation there.

832. Second, the relief requested in the ECHR and ECT proceedings is identical. The remedies sought in these parallel proceedings are substantially the same, *i.e.*, compensation for Yukos' alleged expropriation in the amount of US$ 103.622 billion plus interest and US$ 104.497 billion, respectively.[1351]

833. Third, the ECHR and ECT claims are based on the same set of facts and share the same fundamental basis. The ECHR and ECT claims have the identical aim of obtaining compensation for Yukos' alleged expropriation and the claimed entitlements have the same normative source. The expropriation guarantees in Article 13 ECT and Article 1 of Protocol No. 1 of the European Convention on Human Rights do not lay down independent standards by which the conduct of the Respondent is to be judged.

834. As confirmed by the recent award in *Pantechniki v. Albania*, these circumstances deprive the Tribunal of jurisdiction under Article 26(3)(b)(i) ECT:

> "It is common ground that the relevant test is the one expressed by the America-Venezuela Mixed Commission in the *Woodruff* Case (1903): whether or not 'the fundamental basis of a claim' sought to be brought before the international forum is autonomous of claims to be heard elsewhere. This test was revitalised by the ICSID *Vivendi* annulment decision in 2002. It has been confirmed and applied in many subsequent cases. The key is to assess whether the same dispute has been submitted to both national and international fora. […] What I believe to be necessary is to determine whether claimed entitlements have the same normative source."[1352]

1351 Claimants' Memorial on the Merits, ¶ 1056; *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Applicant's Representative's Application for Just Satisfaction (May 4, 2009), ¶ 45 (Exhibit RME-980).

1352 *Pantechniki S.A. Contractors & Engineers v. Republic of Albania*, ICSID ARB/07/21, Award (July 30, 2009), ¶¶ 61-62 (Exhibit RME-982). [emphases added]

The *Pantechniki* tribunal concluded:

> "Its final submission (in the since abandoned petition to the Supreme Court) was that it was entitled to payment of US$ 1,821,796 'because the Defendant had recognised and admitted that this amount is due.' The logic is inescapable. To the extent that this prayer was accepted it would grant the Claimant exactly what it is seeking before ICSID -- and on the same 'fundamental basis'. The Claimant's grievance thus arises out of the same purported entitlement that it invoked in the contractual debate it began with the General Roads Directorate. The Claimant chose to take this matter to the Albanian courts. It cannot now adopt the same fundamental basis as the foundation of a Treaty claim. Having made the election to seise the national jurisdiction the Claimant is not longer permitted to raise the same contention before ICSID."[1353]

835. Commentaries are in accord and emphasize that an interpretation of fork-in-the-road provisions that focuses strictly on the legal bases of the claims gives fork-in-the-road provisions no effective scope, contrary to a basic rule of treaty interpretation codified in Article 31 of the Vienna Convention on the Law of Treaties[1354] ("VCLT").[1355] McLachlan, Shore and Weiniger state:

> "The problem with [treaty/breach of contract distinction] in the present context is that it would give no effective scope of operation to the fork in the road clause in the context of the rights which are the principal subject of investment treaties. It is a basic principle of treaty interpretation that treaties should be interpreted, so far as possible, to give an effective meaning to their provisions. The

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1353 *Ibid.*, ¶ 67.

1354 Vienna Convention on the Law of Treaties (May 23, 1969), 1155 U.N.T.S. 331 (Exhibit RME-983).

1355 *See, e.g.*, OPPENHEIM'S INTERNATIONAL LAW, VOL. 1 (Robert Jennings and Arthur Watts, eds. 9th ed. 1996) 1280 (Exhibit RME-984): "The parties are assumed to intend the provisions of a treaty to have a certain effect, and not to be meaningless: the maxim is *ut res magis valeat quam pereat*. Therefore, an interpretation is not admissible which would make a provision meaningless, or ineffective."; Gerald G. Fitzmaurice, *The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points*, 28 BYIL 1 (1951), 8 (Exhibit RME-985): "[O]ther things being equal, so to speak, texts are to be presumed to have been intended to have a definite force and effect, and should be interpreted so as to have such force and effect rather than so as not to have it, and so as to have the *fullest* value and effect consistent with their wording (so long as the meaning be not strained) and with the other parts of the text […][the I.C.J.] has in fact adopted the principle of effectiveness, subject to limitations which ensure that the language of the instrument is not strained and the interpretative function not exceeded." [italics in original]

choice which such clauses offer to the investor must be construed as being between real alternatives.

[…] Thus, for example, there are close parallels between the protection afforded by international law against regulatory taking as expropriation, and the protection against regulatory taking under the US Constitution or the First Protocol of the European Convention on Human Rights. In the absence as yet of direct authority, it is submitted that the fork in the road clause ought to operate should the investor choose to pursue a *claim equivalent in substance* to that created by the BIT against the host State."[1356]

836. Or as stated by Douglas:

"[The] approach of focusing on the object of the claim is preferable to a test based upon the legal nature of the obligation forming the basis of the claim. If the preclusive effects of the 'fork in the road' provision can be avoided simply by pleading different types of causes of action, then it will be interpreted out of practical existence. For instance, if a claimant were to sue the host state for damages in the tort of conversion in a municipal Court and then attempt to sue for the same damages in a claim for expropriation before an international tribunal, this earlier claim would constitute an earlier election of a judicial forum for the purposes of a 'fork in the road' provision."[1357]

837. In summary, the Tribunal should not lend assistance to Claimants' "*lifetime of litigation*"[1358] strategy which undermines the legitimacy of the international dispute settlement system and exposes Respondent to double recovery:

"The concerns about duplication are similar both municipally and internationally. Duplicative filings can lead to inefficiency of process as disputes arising from the same underlying facts are re-litigated or rearbitrated at great time and expense. The legitimacy

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1356 CAMPBELL MCLACHLAN, LAURENCE SHORE, MATTHEW WEINIGER INTERNATIONAL INVESTMENT ARBITRATION (2007), ¶¶ 4.82-4.83 (Exhibit RME-986). [italics in original]

1357 ZACHARY DOUGLAS, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS (2009), 156 ¶ 325 (Exhibit RME-987).

1358 *See* Timothy Osborne's widely-quoted public announcement: "'*We have warned the Russian government about their continuing attacks against Yukos, its personnel and its shareholders and we have warned any buyer of Yuganskneftegaz that they would face a lifetime of litigation*,' *said Tim Osborne, a director of Group Menatep. 'The time for warning is over and actions to recover the value of our losses begin in earnest today*.'" BBC NEWS, *Yukos Owner Sues Russia for $28bn* (Feb. 9, 2005), http://news.bbc.co.uk/1/hi/business/4249323.stm (Exhibit RME-988). [emphasis added]

> of the dispute settlement system or systems may also be undermined because of the perception that claimants have too many places in which they can seek relief. There is a risk that tribunals will come to inconsistent decisions about liability and/or the payment of damages. Two problems arise from inconsistent decisions: one is the practical problem of reconciling the two disparate decisions in other tribunals later called upon to enforce the awards; the second is the philosophical problem that the legitimacy of the dispute settlement bodies at issue is compromised because of the inconsistent outcomes. To make matters worse, there is the possibility that a claimant will get duplicative recovery, an outcome suggesting substantive unfairness in the process itself."[1359]

B. The Tribunal Lacks Jurisdiction Over Claimants' Claims Or They Are Inadmissible Or They Must Be Dismissed On The Merits Pursuant To Article 21(1) ECT

838. Article 21(1) ECT provides:

> "Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency."

839. Pursuant to the ordinary meaning of Article 21(1) ECT, Articles 10, 13 and 26 ECT do not create any rights for Claimants and do not impose any obligations on Respondent "*with respect to Taxation Measures*," except as otherwise provided in Article 21. Claimants thus are not entitled and Respondent is not obliged to arbitrate any claims "*with respect to Taxation Measures*" and Claimants are not entitled and Respondent is not obliged to grant Claimants the protections under Articles 10 and 13 ECT, except as otherwise provided in Article 21. The carve-out in Article 21(1) ECT therefore deprives the Tribunal of jurisdiction over any claims "*with respect to Taxation Measures*"[1360] and modulates Claimants' rights

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1359 Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working*, 59 Hastings L.J. 241 (2007-2008), 259 (Exhibit RME-989) [emphases added]. *See also In re Yukos Oil Company*, U.S. Bankruptcy Court for the Southern District of Texas, No. 04-47742, Opinion (Feb. 24, 2005), 321 B.R. (Bankr. S.D. Tex. 2005) 396, 411 (Exhibit RME-990).

1360 *See* Respondent's Second Memorial on Jurisdiction and Admissibility, ¶¶ 3-8. *See also El Paso v. The Argentine Republic*, ICSID ARB/03/15, Decision on Jurisdiction (Apr. 27, 2006), 21 ICSID Rev. 488 (2006), 534 ¶ 116 (Exhibit RME-991): "In other words, the only claims that the Tribunal can consider at the merits stage are the tax claims based on the existence of an

and Respondent's obligations under the substantive protections of Part III of the ECT "*with respect to Taxation Measures*," rendering claims "*with respect to Taxation Measures*" inadmissible[1361] and requiring dismissal of such claims on the merits,[1362] unless covered by the claw-backs in Article 21(2), (3), (4) and (5) ECT. Thus, the same result pertains whether the Taxation Measures carve-out is viewed as a question of jurisdiction, admissibility or the merits. Claims "*with respect to Taxation Measures*" must therefore be dismissed.

840. The term "*Taxation Measures*" in Article 21(1) ECT covers any measure, which on its face enacts, implements, or enforces tax legislation, whether of general or individual application and whether taken by the legislature, the executive or the judiciary, (1) - (2). All allegations on which Claimants seek to base their Article 10(1) and 13 ECT claims, except the reference to the court decisions concerning the Sibneft de-merger, are clearly linked to Taxation Measures and thus excluded from the scope of the ECT unless provided otherwise in Article 21 ECT, (3).

841. Despite Claimants' extraneous references to the claw-backs in Article 21(3) ECT relating to national and most-favored nation treatment obligations in Article 10(2) and (7),[1363] Claimants do not purport to make claims under Article 10(2) and (7) ECT. Claimants' claims are based exclusively on Articles 10(1) and 13(1) ECT. Article 21 ECT contains no claw-back for

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expropriation and on the violation of an investment agreement or authorisation. Everything else is beyond the competence of the Tribunal." [emphasis added]; *Burlington v. Ecuador*, ICSID ARB/08/5, Decision on Jurisdiction (June 2, 2010), ¶ 208 (Exhibit RME-992): "The Tribunal further finds that Burlington's remaining fair and equitable treatment claims raise 'matters of taxation' under Art. X. Therefore, it will probe whether these latter claims relate to the observance and enforcement of the terms of an 'investment agreement' in order to finally determine whether it can assert jurisdiction over them." [emphasis added]

1361 *See* Respondent's Second Memorial on Jurisdiction and Admissibility (Hulley), ¶¶ 9-11; Second Memorial on Jurisdiction and Admissibility (YUL), ¶¶ 9-11; Second Memorial on Jurisdiction and Admissibility (VPL), ¶¶ 9-11

1362 Claimants' Counter-Memorial on Jurisdiction and Admissibility (Hulley), ¶ 377; Claimants' Counter-Memorial on Jurisdiction and Admissibility (YUL), ¶ 376; Claimants' Counter-Memorial on Jurisdiction and Admissibility (VPL), ¶ 378; Claimants' Rejoinder on Jurisdiction and Admissibility (Hulley), ¶¶ 400-404; Claimants' Rejoinder on Jurisdiction and Admissibility (YUL), ¶¶ 395-399; Claimants' Rejoinder on Jurisdiction and Admissibility (VPL), ¶¶ 398-402.

1363 Claimants' Memorial on the Merits, 417 and ¶ 1005.

Article 10(1) ECT claims, however, and the expropriation claw-back in Article 21(5) ECT is restricted to "*taxes*," a limited subcategory, which excludes other Taxation Measures, such as measures to enforce and ensure the effective collection of taxes. Claimants have not made and cannot make a viable claim under the Article 21(5) claw-back concerning "*taxes*," but rather depend on other Taxation Measures to argue that an expropriation occurred, an approach that Article 21(1) does not allow, (4).

1. Article 21 ECT Must Be Interpreted In Accordance With Articles 31 And 32 VCLT

842. As stated in the Interim Awards on Jurisdiction and Admissibility,[1364] the ECT must be interpreted in accordance with the rules of treaty interpretation codified in Articles 31 and 32 VCLT. Claimants' Counter-Memorials and Rejoinders on Jurisdiction and Admissibility are in accord.[1365]

843. Claimants' attempt now to rely on the "principle of restrictive interpretation of exceptions"[1366] to deprive Article 21 ECT of any effective application is unavailing. This alleged principle of interpretation is not included in the Vienna Convention on the Law of Treaties. Accordingly, the Interim Awards on Jurisdiction and Admissibility, subscribing to the Decision on Jurisdiction in *Kardassopoulos v. Georgia*,[1367] interpreted Article 45 ECT pursuant to the general rule of treaty interpretation in Article 31(1) VCLT and rejected a

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1364 Interim Award on Jurisdiction and Admissibility (Hulley), ¶¶ 76, 260; Interim Award on Jurisdiction and Admissibility (YUL), ¶¶ 76, 260; Interim Award on Jurisdiction and Admissibility (VPL), ¶¶ 76, 260. *See also* Declaration of Norway supported by Armenia, Belarus, Estonia, European Communities and their Member States, Finland, Iceland, Lithuania, Liechtenstein, Kazakhstan, Moldova, the Russian Federation, Sweden, Switzerland and Ukraine, Chairman's Statement at Adoption Session on December 17, 1994 (Exhibit RME-993): "[T]he Treaty shall be applied and interpreted in accordance with generally recognized rules and principles of observance, application and interpretation of treaties as reflected in Part III of the Vienna Convention on the Law of Treaties of 25 May 1969."

1365 Claimants' Counter-Memorial on Jurisdiction and Admissibility (Hulley), ¶ 209; Claimants' Counter-Memorial on Jurisdiction and Admissibility (YUL), ¶ 209; Claimants' Counter-Memorial on Jurisdiction and Admissibility (VPL), ¶ 211; Claimants' Rejoinder on Jurisdiction and Admissibility (Hulley), ¶ 108; Claimants' Rejoinder on Jurisdiction and Admissibility (YUL), ¶ 108; Claimants' Rejoinder on Jurisdiction and Admissibility (VPL), ¶ 108.

1366 Claimants' Memorial on the Merits, ¶ 1017.

1367 *Ioannis Kardassopoulos v. Georgia*, ICSID ARB/05/18, Decision on Jurisdiction (July 6, 2007), ¶¶ 205 and 206 (Exhibit RME-994).

restrictive interpretation of Article 45 ECT, setting forth an exception to the rule that no State is required to perform a treaty whose entry into force is subject to ratification without such ratification.

844. As confirmed by the WTO Appellate Body in the *EC-Hormones* case, the alleged principle of restrictive interpretation of exceptions cannot be employed to override the meaning of a treaty provision resulting from the application of Article 31:

> "[M]erely characterizing a treaty provision as an 'exception' does not by itself justify a 'stricter' or 'narrower' interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in context and in the light of the treaty's object and purpose, or in other words, by applying the normal rules of treaty interpretation."[1368]

845. Literature is in accord:

> "It should, in this context, be pointed out that Arts. 31-2 of the Vienna Convention do not call for a restrictive interpretation of derogating norms or exceptions. Whereas under GATT 1947 panels stated that exceptions (in particular GATT Art. XX) are to be interpreted narrowly, the Appellate Body has rightly pointed out that 'merely characterizing a treaty provision as an 'exception' does not by itself justify a 'stricter' or 'narrower' interpretation of that provision than would be warranted … by applying the normal rules of treaty interpretation'."[1369]

846. Tellingly, Claimants have not cited a single investment treaty tribunal that has applied the "principle of restrictive interpretation of exceptions" to a taxation carve-out.[1370] Arbitral tribunals and courts in annulment

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1368 European Communities, EC Measures Concerning Meat and Meat Products (Hormones), AB-1997-4, Report of the Appellate Body (Jan. 16, 1998), ¶ 104 (Exhibit RME-995). *See also* European Communities, Conditions for the Granting of Tariff Preferences to Developing Countries, AB-2004-1, Report of the Appellate Body (Apr. 7, 2004), ¶ 98 (Exhibit RME-996): "Whatever its characterization, a provision of the covered agreements must be interpreted in accordance with 'the customary rules of interpretation of public international law', as required by Article 3.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the 'DSU')."

1369 JOOST PAUWELYN, CONFLICT OF NORMS IN PUBLIC INTERNATIONAL LAW (2009), 250 (Exhibit RME-997).

1370 Instead, Claimants relied on the interpretation of the national security exception in the US-Argentina BIT by the tribunal in *Enron v. Argentina* (Claimants' Memorial on the Merits, ¶ 1018). The award quoted by Claimants was annulled on July 30, 2010. The *Ad Hoc*

proceedings have rejected Claimants' approach and applied the ordinary meaning of the terms of taxation carve-outs. Interpreting the taxation carve-out in Article X of the U.S.-Ecuador BIT, the tribunal in *Duke Energy v. Ecuador* stated:

> "Further, the Tribunal notes the open wording of Article X(2), which excludes all taxation matters except for those expressly included within the scope of (a) to (c). The scope of Article X(2) was specifically discussed in *OEPC v. Ecuador*, in the award rendered by the LCIA tribunal under the US-Ecuador BIT, and in the subsequent decision by Justice Aikens of the Queen's Bench Division dismissing Ecuador's application against the award. This later decision stated that the wording of Article X(2) '*makes it clear that, apart from matters of taxation that come within the three identified exceptions, all matters of taxation are outside the ambit of the BIT*'."[1371]

The decision of the Queen's Bench Division in *OEPC v. Ecuador* referenced by the *Duke* tribunal made it clear that taxation carve-outs cannot be ignored, as Claimants would ask this Tribunal to do, and awards that ignore a taxation carve-out may be subject to annulment. After noting the applicability of Articles 31 and 32 of the VCLT to the taxation carve-out in Article X of the U.S.-Ecuador BIT, Mr. Justice Aikens held:

> "In my view the Parties to the BIT intended that, generally, all matters of taxation should be outside the scope of the BIT. I think that this is clear from the way Article X.1 is phrased and the opening words of Article X.2. […] Article X.2 expressly states that '*nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to the following…*'. To my mind that wording makes it clear that, apart from matters of taxation that come within three identified

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Committee held that the "Tribunal's decision that Argentina is precluded from relying on Article XI of the BIT [the national security exception] and on the principle of necessity under customary international law must be annulled." *Enron v. Argentina*, ICSID ARB/01/3, Decision on Annulment (July 30, 2010), ¶ 406 (Exhibit RME-998). Claimants' reliance on the WTO Appellate Body Reports in *US Gasoline* and *US-Shrimp* (Claimants' Memorial on the Merits, ¶¶ 1116-1117) is equally unavailing. First, the WTO Appellate Body expressly stated in *EC Measures Concerning Meat and Meat Products (Hormones)* and *Conditions for the Granting of Tariff Preferences to Developing Countries* that characterizing a treaty provision as an exception in itself justifies no stricter interpretation than that resulting from Article 31 of the Vienna Convention on the Law of Treaties (*see* ¶ 844 *supra*). Second, the Appellate Body reports quoted by Claimants interpreted the express limiting terms in the chapeau in Article XX GATT. While such express limiting terms are included in Article 21(2)(b) and (3)(b) ECT, Article 21(1) ECT, unlike Article XX GATT, contains no such qualification.

1371 *Duke Energy Electroquil and Electroquil SA v. Ecuador*, ICSID ARB/04/19, Award (Aug. 12, 2008), ¶ 178 (Annex (Merits) C-993). [italics in original]

> exceptions, all matters of taxation are outside the ambit of the BIT. The Submittal Letter of the Secretary of State to President Clinton explains that this general exclusion is based on the assumption that tax matters are properly covered in bilateral tax treaties between States. That explanation seems plausible. Therefore, in my view, unless a particular '*matter of taxation*' comes within the ambit of Article X.2 (a), (b) or (c), then the dispute resolution provisions of the BIT in Article VI cannot apply to any dispute that arises between a State and investor in relation to that '*matter of taxation*'.
>
> To the extent that the Tribunal appeared to conclude that matters of taxation were within the scope of the BIT on some broader basis, I must respectfully disagree."[1372]

847. Thus, Claimants' reliance on the alleged "principle of restrictive interpretation of exceptions" or allegations of abuse of Respondent's tax power to set aside the clear language of Article 21(1) ECT agreed upon by the Contracting Parties is without merit. The tribunal in *Rompetrol v. Romania* correctly rejected such an approach to "treaty interpretation":

> "The Tribunal would in any case have great difficulty in an approach that was tantamount to setting aside the clear language agreed upon by the treaty Parties in favour of a wide-ranging policy discussion [abuse of the ICSID mechanism]. Such an approach could not be reconciled with Article 31 of the Vienna Convention on the Law of Treaties (which lays down the basic rules universally applied for the interpretation of treaties), according to which the primary element of interpretation is 'the ordinary meaning to be given to the terms of the treaty'."[1373]

848. Claimants' attempt to invoke the object and purpose of the ECT to set aside the terms of the taxation carve-out in Article 21(1) ECT[1374] is equally unavailing. It is firmly established that the object and purpose of a treaty cannot justify revision or nullification of the terms of a treaty. As stated by Lord McNair:

1372 *The Republic of Ecuador v. Occidental Exploration & Production Co.*, Queen's Bench Division, Commercial Court Case No. 04/656, Judgment (Mar. 2, 2006), [2006] EWHC 345 (Comm.), ¶¶ 92-94 (Exhibit RME-999). [italics in original]

1373 *Rompetrol Group NV v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility (Apr. 18, 2008), ¶ 85 (Annex C-1545) (Exhibit RME-1000).

1374 Claimants' Memorial on the Merits, ¶ 1036.

"[I]t is the duty of a tribunal to ascertain and give effect to the *intention of the parties as expressed in the words used by them in the light of the surrounding circumstances.* Many treaties fail – and rightly fail – in their object by reason of the words used, and tribunals are properly reluctant to step in and modify or supplement the language of the treaty."[1375]

849. Or as held by the International Court of Justice:

"It may be urged that the Court is entitled to engage in a process of 'filling in the gaps', in the application of a teleological principle of interpretation, according to which instruments must be given their maximum effect in order to ensure the achievement of their underlying purposes. The Court need not here enquire into the scope of a principle the exact bearing of which is highly controversial, for it is clear that it can have no application in circumstances in which the Court would have to go beyond what can reasonably be regarded as being a process of interpretation,

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1375 A. MCNAIR, THE LAW OF TREATIES (1961), 383 (Exhibit RME-1001) [italics in original]. *See also* Mustafa K. Yasseen, *L'interprétation des traités d'après la Convention de Vienne sur le droit des traités*, 151 Rec. des cours 1 (1976), 58 (Exhibit RME-1002): "L'interprétation à la lumière du but et de l'objet comme le prévoit la Convention de Vienne ne diminue pas la valeur du texte. L'objet et le but ne peuvent pas être la source directe et unique d'une disposition. Ils ne sont qu'un élément entre autres, en fonction duquel le sens susceptible d'être attribué aux termes doit être examiné. Cet examen peut d'ailleurs ne pas aboutir nécessairement à écarter une solution qui ne semble pas être en harmonie avec l'objet et le but du traité s'il paraît évident que cette solution est celle que les parties veulent. L'objet et le but du traité peuvent en effet ne pas être l'objet et le but de toutes les dispositions du traité. Certains traités peuvent même avoir plus d'un seul objet et d'un seul but étant donné les questions très variées sur lesquelles ces traités portent et les solutions nuancées qu'ils consacrent." "The interpretation in light of the purpose and object as provided for by the Vienna Convention does not diminish the value of the text. The object and purpose cannot be the direct and unique source of a provision. They are but an element among others, in accordance with which the sense that might be given to terms has to be examined. This analysis might by the way not lead to necessarily excluding a solution which seems not to be in harmony with the object and purpose of the treaty if it appears evident that this solution is the one that the parties want. The object and purpose of the treaty may indeed not be the object and purpose of all the provisions of the treaty. Some treaties may even have more than one single object and one single purpose given the variety of questions to which these treaties apply and the nuanced solution that they establish." [unofficial translation] [emphasis added]; Gerald G. Fitzmaurice, *The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points*, 28 BYIL 1 (1951), 8 (Exhibit RME-985): "But the Court rejects the use of this method for purposes going beyond interpretation; for example, altering the apparent sense of a phrase, supplementing texts by reading into them something that is not there, &c."; IAN SINCLAIR, THE VIENNA CONVENTION ON THE LAW OF TREATIES (2nd ed. 1984), 131 (Exhibit RME-1003): "There is also the risk that the placing of undue emphasis on the 'object and purpose' of a treaty will encourage teleological methods of interpretation. The teleological approach, in some of its more extreme forms, will even deny the relevance of the intentions of the parties; it in effect is based on the concept that, whatever the intentions of the parties may have been, the convention as framed has a certain object and purpose, and the task of the interpreter is to ascertain that object and purpose and then interpret the treaty so as to give effect to it."

> and would have to engage in a process of rectification or revision. Rights cannot be presumed to exist merely because it might seem desirable that they should."[1376]

850. Investment treaty tribunals are in accord. For example, the tribunal in *Fraport v. Philippines* held:

> "It is also clear that the parties were anxious to encourage investment, which was the *raison d'être* of the treaty. But while a treaty should be interpreted in the light of its objects and purposes, it would be a violation of all the canons of interpretation to pretend to use its objects and purposes, which are, by their nature, a deduction on the part of the interpreter, to nullify four explicit provisions."[1377]

851. The terms of Article 21 ECT, just as those of Article 45 ECT, must thus be interpreted in their ordinary meaning in their context and in the light of the ECT's as well as Article 21's object and purpose rather than pursuant to an alleged principle of restrictive interpretation of exceptions or a teleological

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1376 *South West Africa Cases (Ethiopia v. South Africa; Liberia v. South Africa) (Second Phase)*, Judgment (July 18, 1966), 1966 I.C.J. Rep. 6, 48 ¶ 91 (Exhibit RME-1004) [emphasis added]. *See also Interpretation of Peace Treaties with Bulgaria, Hungary and Romania (second phase)*, Advisory Opinion (July 18, 1950), 1950 I.C.J. Rep. 221, 229 (Exhibit RME-1005): "The principle of interpretation expressed in the maxim : *Ut res magis valeat quam pereat*, often referred to as the rule of effectiveness, cannot justify the Court in attributing to the provisions for the settlement of disputes in the Peace Treaties a meaning which […] would be contrary to their letter and spirit." [emphasis added]

1377 *Fraport AG Frankfurt Airport Services Worldwide v. The Republic of Philippines*, ICSID ARB/03/25, Award (Aug. 16, 2007), ¶ 340 (Exhibit RME-1006) [emphases added]. *See also Plama Consortium Limited v. Bulgaria*, ICSID ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005), 20 ICSID Rev. 262 (2005), 323 ¶ 193 (Annex C-248) (Exhibit RME-1007): "Here, the Tribunal is mindful of Sir Ian Sinclair's warning of the '*risk that the placing of undue emphasis on the 'object and purpose' of a treaty will encourage teleological methods of interpretation [which], in some of its more extreme forms, will even deny the relevance of the intentions of the parties*.'" [italics in original]. *See also U.S.A. and The Federal Reserve Bank of New York v. Iran and Bank Markazi*, Iran-U.S. Claims Tribunal, Case A28, Decision (Dec. 19, 2000), ¶ 58 (Exhibit RME-1008): "Even when one is dealing with the object and purpose of a treaty, which is the most important part of the treaty's context, the object and purpose does not constitute an element independent of that context. The object and purpose is not to be considered in isolation from the terms of the treaty; it is intrinsic to its text. It follows that, under Article 31 of the Vienna Convention, a treaty's object and purpose is to be used only to clarify the text, not to provide independent sources of meaning that contradict the real text."; World Trade Organization, United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products From Germany, Report of the Panel (July 3, 2002), ¶ 8.46 (Exhibit RME-1009): "The context of a particular provision and the object and purpose of a treaty – or of the provision at issue – do not override the plain meaning of the text of the provision; rather, the text is to be read in its context and in light of the object and purpose of the treaty." [emphases in original]

interpretation that would override or render meaningless the terms of Article 21 ECT.

2. Article 21(1) ECT Applies To Any Executive Or Judicial Act Apparently Implementing Tax Legislation

852. The ECT does not contain an exhaustive definition of the term "*Taxation Measures*." Article 21(7) ECT provides:

> "For the purposes of this Article:
>
> (a) The term 'Taxation Measure' includes:
>
> (i) any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein; and
>
> (ii) any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound."[1378]

853. This illustrative list of Taxation Measures clarifies that Taxation Measures of a Contracting Party cover both domestic and international measures and all aspects of the tax regime relating to the payment of taxes, including measures providing relief from taxation, such as tax credits under double taxation treaties.[1379] Interpreted in accordance with Article 31 VCLT, as it must be, Article 21(7) ECT does not, however, as Claimants assert, confine "*Taxation Measures*" to tax legislation, to the exclusion of enforcement and collection measures.

854. First, the ordinary meaning of the term "*includes*" is non-exclusive. The NEW OXFORD DICTIONARY OF ENGLISH defines "*include*" as "*comprise or contain as part of a whole*," or "*make part of a whole or set*,"[1380] WEBSTER'S NEW WORLD

1378 [emphasis added]

1379 *See* Canada Department of Finance, Tax Policy Branch: Fax from A. Castonguay to F. Mullen *et al*. (Mar. 19, 1993), 4 (Exhibit RME-1010): "Regarding the definition of 'taxation measure', we have intentionally agreed on such an approach [of using an illustrative list]; given the wide variety of taxation measures that the parties want included in the definition, it would be counterproductive to attempt to come up with anything more precise."; Telefax from O. Kirkvaag, Advisor, Norway, to EEC Secretariat (Mar. 19, 1993), 3 (Annex (Merits) C-1044): "There does not seem to be a need for a closed definition of tax measures. The idea is that both domestic and international instruments are covered." [emphases in original]

1380 (Annex C-1449) (Exhibit RME-1011). [emphases added]

DICTIONARY as "*have as part of a whole; contain; comprise*,"[1381] the OXFORD AMERICAN DICTIONARY AND LANGUAGE GUIDE as "*comprise or reckon in as part of a whole*,"[1382] and the CENTURY NEW DICTIONARY as "*comprise as a part*."[1383]

855. Second, the use of the terms "*means*" and "*includes*" in the definitional sections of the ECT confirm that the term "*includes*" in Article 21(7)(a) ECT is intended to be non-exhaustive. Article 1 ECT consistently uses the term "*means*" for exhaustive definitions (Article 1(1)-(5), (7)-(11), (13) and (14)), but uses the term "*includes*" for the non-exhaustive definitions of "*investment*" in Article 1(6)[1384] and "*Intellectual Property*" in Article 1(12).[1385]

856. Third, exclusion of tax enforcement and collection measures would defeat the object and purpose of Article 21 ECT. Taxation carve-outs are designed to retain the freedom of each Contracting Party to enact, administer, and enforce its tax laws and ensure that investment treaty arbitration yields to the dispute settlement procedures in applicable double taxation treaties.[1386]

1381 (Annex C-1448) (Exhibit RME-1012). [emphasis added]

1382 (Annex C-1447) (Exhibit RME-1013). [emphasis added]

1383 (Annex C-1446) (Exhibit RME-1014) [emphasis added]. *See also* Canada's Statement in Implementation of the North American Free Trade Agreement, Can. Gaz. Part I, 22 (Jan. 1, 1994), 80 (Exhibit RME-1015): "The term 'measure' is a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions." [emphasis added]. The "non-exhaustive definition" of "measure" in Article 201 NAFTA reads: "measure includes any law, regulation, procedure, requirement or practice." [emphasis added]

1384 "'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes: […]" [emphasis added]. It is well-established that the term "includes" in Article 1(6) ECT is non-exhaustive. *See, e.g.*, *Plama Consortium Limited v. Bulgaria*, ICSID ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005), 20 ICSID Rev. 262 (2005), ¶ 125 (Annex C-248) (Exhibit RME-1007): "As defined by Article 1(6) ECT, *''Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor'*; and there follows a broad, non-exhaustive list of different kinds of assets […]." [italics in original]; *Mytilineos Holdings SA v. The State Union of Serbia & Montenegro and Republic of Serbia*, UNCITRAL, Partial Award on Jurisdiction (Sept. 8, 2006), ¶ 103 (Exhibit RME-1016): "Such a definition, usually referred to as a 'broad asset-based definition of investment,' follows a well-established pattern pursued by many other BITs. It combines a broad definition (*'every kind of asset'*) with an illustrative list of assets categories that fall within the definition of investment." [italics in original]

1385 "'Intellectual Property' includes copyrights and related rights, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits and the protection of undisclosed information." [emphasis added] *See also* Articles 7(10), 19(3) and 25(2) ECT.

1386 *See* Daniel M. Berman, Opinion on the Scope of the Term 'Taxation Measures' in the Energy Charter Treaty (Jan. 22, 2007) ("Berman Opinion"), ¶ 10; Witness Statement of Stephen Knipler (July 21, 2007) ("Knipler Opinion"), ¶ 5.

Exclusion of tax enforcement and collection measures would permit a Contracting Party to impose a statutory duty to pay a tax, but at the same time preclude it from enforcing or collecting that tax. Such an interpretation would deprive the carve-out of any meaningful scope of application and lead to a manifestly absurd and unreasonable result.

857. Exclusion of tax enforcement measures would also subject taxation measures covered by dispute settlement procedures in double taxation treaties to investor-State arbitration. The dispute settlement procedures in double taxation treaties, in general, and those in force between Russia and Cyprus and Russia and the United Kingdom and the OECD Model Tax Convention on Income and Capital, in particular, apply to legislative and enforcement measures, namely "*actions of one or both of the Contracting States* [that] *result or will result for* [a person] *in taxation not in accordance with the provisions of this Convention.*"[1387] Needless to say, the dispute settlement procedures in double taxation treaties are inter-State proceedings.

858. Fourth, the travaux préparatoires confirm the non-exhaustive nature of Article 21(7) ECT. In March 1993, the chairman of the Legal Sub-group drew attention to the fact that Article 21(7) ECT, then Article 20(6), is "*an*

1387 Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains (Feb. 15, 1994), Art. 25(1) (Mutual Agreement Procedure) (Annex (Merits) C-915). *See also* Agreement between the Government of the Republic of Cyprus and the Government of the Russian Federation for the Avoidance of Double Taxation with respect to Taxes on Income and on Capital (Dec. 5, 1998), Art. 25(1) (Mutual Agreement Procedure) (Annex (Merits) C-916); 2010 OECD Model Tax Convention on Income and Capital, Art. 25(1) (Mutual Agreement Procedure) (Exhibit RME-1017). *See also* OECD, Model Tax Convention on Income and Capital, Condensed version (2010), Commentary on Article 25, 357, ¶ 14 (Exhibit RME-1018): "Such actions mean all acts or decisions, whether of a legislative or regulatory nature, and whether of general or individual application, having as their direct and necessary consequence the charging of tax against the complainant contrary to the provisions of the Convention."; KLAUS VOGEL, ON DOUBLE TAXATION CONVENTIONS (3rd ed. 1997), 1354 (Exhibit RME-1019): "Taxation contrary to the [OECD Model Tax] Convention must be based on **actions of one or both of the contracting States**. 'Actions' can either be acts or omissions; the decisive point is whether such acts or omissions are or may be the **cause** of taxation contrary to the Convention." [bold in original]

illustrative list, not a definition."[1388] As Claimants emphasize, France advocated replacing "*includes*" with "*means*" in response to the Legal Sub-group's note:

> "Il conviendrait donc de remplacer le mot 'includes' par le mot 'means'."[1389]

However, no delegation other than Norway was amenable to this suggested word change, and even Norway opposed the idea that there was "*a need for a closed definition of tax measures*." [1390] For example, Canada responded, agreeing with the chairman of the Legal Sub-group:

> "Regarding the definition of 'taxation measure', we have intentionally agreed on such an approach; given the wide variety of taxation measures that the parties want included in the definition, it would be counterproductive to attempt to come up with anything more precise."[1391]

Article 21(7) ECT accordingly retained the word "*includes*," thus confirming the non-exclusive nature of the list of Taxation Measures.

859. The ordinary meaning of the term "*Taxation Measures of the Contracting Parties*" includes tax legislation, tax treaties, and tax enforcement and collection measures. First, Article 21(1) ECT does not refer to taxation measures adopted by the legislature. Rather, Article 21(1) ECT refers to "*Taxation Measures of the Contracting Parties*," *i.e.*, the States as a whole, of which the executive and judiciary are constituent parts. Taxation measures of the executive and judiciary are therefore covered.[1392]

1388 (Exhibit RME-1020).

1389 Memorandum from the Ministère du Budget of France to the ECT Secretariat (Mar. 19, 1993), 3 (Annex (Merits) C-1045).

1390 Telefax from O. Kirkvagg, Advisor, Norway, to EEC Secretariat (Mar. 19, 1993), 3 (Annex (Merits) C-1044). [original emphasis omitted; other emphasis added]

1391 Canada Department of Finance, Tax Policy Branch: Fax from A. Castonguay to F. Mullen *et al*. (Mar. 19, 1993), 4 (Exhibit RME-1010).

1392 *See also The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID ARB(AF)/98/3, Decision on hearing of Respondent's objection to competence and jurisdiction (Jan. 5, 2001), ¶ 47 (Exhibit RME-1021): "Such an interpretation of the word 'measures' accords with the general principle of State responsibility. The principle applies to the acts of judicial as well as legislative and administrative organs."

860. Second, the ordinary meaning of the terms "*taxation*" and "*measures*" encompasses tax legislation and tax enforcement and collection measures. BLACK'S LAW DICTIONARY defines "*taxation*" as "[t]*he imposition or assessment of a tax; the means by which the state obtains the revenue required for its activities*,"[1393] the OXFORD ENGLISH DICTIONARY as "[t]*he imposition or levying of taxes (formerly including local rates); the action of taxing or the fact of being taxed; also* transf. *the revenue raised by taxes*,"[1394] and WEBSTER'S NEW WORLD DICTIONARY OF AMERICAN ENGLISH as "***1** a taxing or being taxed **2** a tax or tax levy **3** revenue from taxes*."[1395]

861. The ordinary meaning of the term "*measure*" clearly includes enforcement measures. The term "*measure*" is defined by WEBSTER'S NEW WORLD DICTIONARY OF AMERICAN ENGLISH as including both "*a procedure; course of action; step*" and "*a legislative bill, resolution, etc.* […]."[1396] Likewise, the OXFORD ENGLISH DICTIONARY defines "*measure*" as a "*plan, a course of action*" and specifically a "*plan or course of action intended to attain some object; a suitable action*" and a "*legislative enactment proposed or adopted*."[1397] Finally, the LONGMAN DICTIONARY OF CONTEMPORARY ENGLISH defines "*measure*" as "*an action, especially an official one, that is intended to deal with a particular problem*."[1398] As stated by the International Court of Justice in the *Fisheries Jurisdiction Case*:

> "[I]n its ordinary sense the word [measure] is wide enough to cover any act, step or proceeding, and imposes no particular limit on their material content or on the aim pursued thereby."[1399]

1393 "taxation," BLACK'S LAW DICTIONARY (9th ed. 2009) (Exhibit RME-1022). [emphasis added]

1394 "taxation, n." OXFORD ENGLISH DICTIONARY (ONLINE VERSION), http://www.oed.com (Exhibit RME-1023).

1395 "taxation, n." WEBSTER'S NEW WORLD DICTIONARY OF AMERICAN ENGLISH (3rd College Ed. 1988) (Exhibit RME-1024).

1396 "measure, n." WEBSTER'S NEW WORLD DICTIONARY OF AMERICAN ENGLISH (3rd College Ed. 1988) (Exhibit RME-1025).

1397 "measure, n." OXFORD ENGLISH DICTIONARY (ONLINE VERSION), http://www.oed.com (Exhibit RME-1026).

1398 LONGMAN DICTIONARY OF CONTEMPORARY ENGLISH (5th ed. 2009) (Exhibit RME-1027).

1399 *Fisheries Jurisdiction (Spain v. Canada)*, Jurisdiction of the Court, Judgment (Dec. 4, 1998), 1998 I.C.J. Rep. 432, 460 ¶ 66 (Exhibit RME-1028).

862. Moreover, pursuant to Article 31(1) VCLT, the term "*Taxation Measures*" in Article 21(1) ECT has to be interpreted in context, which is the entire ECT. Interpreted in context, the term "*Taxation Measures*" in Article 21(1) ECT includes legislative, judicial, and executive taxation measures. The ECT generally uses the term "*measure*" interchangeably to refer to legislative and executive measures. Claimants will readily agree, and indeed assert, that the terms "*measure or measures having effect equivalent to nationalization or expropriation*" in Article 13(1) ECT and "*unreasonable and discriminatory measures*" in Article 10(1) ECT, respectively, encompass executive and judicial action. Numerous other provisions of the ECT also make clear that the term "*measure*" necessarily includes acts of the judiciary and executive. For example, the preceding Article 20 states that "[l]*aws, regulations, judicial decisions and administrative rulings of general application*" are "*among the measures subject to the transparency disciplines of the GATT and relevant Related Instruments*." Article 10(9) ECT refers to "*laws, regulations or other measures*" and Article 26(8) ECT refers to "[a]*n award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party*."

863. Respondent's interpretation of the term "*Taxation Measures*" in Article 21(1) ECT as covering legislative, executive and judicial measures is in line with investment treaty decisions. Most recently, the tribunal in *Burlington v. Ecuador* interpreting the taxation carve-out in Article X of the U.S.-Ecuador BIT ruled that "*a dispute raises 'matters of taxation' whenever an investor challenges the validity or enforcement of a tax*."[1400]

864. The decision in *EnCana v. Ecuador* also fully supports Respondent's position. The tribunal interpreting the term "*taxation measures*" in Article XII(1) of the Canada-Ecuador BIT stated:

1400 *Burlington v. Ecuador*, ICSID ARB/08/5, Decision on Jurisdiction (June 2, 2010), ¶ 168 (Exhibit RME-992). [emphasis added]

> "And if a law is a taxation measure, then any executive act apparently (and not merely colourably) implementing that law is equally a taxation measure."[1401]

The Canada-Ecuador BIT, like the ECT, contains no definition of the term "*taxation measures*," although it defines the term "*measure*" to include "*any law, regulation, procedure, requirement, or practice*."[1402] The non-exhaustive definition of the term "*measure*" in the Canada-Ecuador BIT comports with the ordinary meaning of the term "*measure*" set forth at ¶¶ 860 and 861 above. Claimants' assertion that "the definition of 'measures' in the bilateral investment treaty applicable in *EnCana* was markedly different from that of 'Taxation Measures' in the ECT"[1403] is therefore inapposite.

865. As also confirmed by the *EnCana* tribunal, an executive act apparently implementing tax legislation does not cease to qualify as a Taxation Measure because it may misapply the tax law or do so idiosyncratically. The *EnCana* tribunal distinguished taxation measures within the scope of the taxation carve-out, *i.e.*, acts of tax authorities in purported compliance with tax laws, from "*arbitrary demands unsupported by any provision of the law of the host State*" outside the scope of the taxation carve out, and applied the "*apparent implementation*" standard as follows:

> "Tax authorities are not robber barons writ large, and an arbitrary demand unsupported by any provision of the law of the host State would not qualify for exemption under Article XII. […] [T]he Tribunal is not a court of appeal in Ecuadorian tax matters, and provided a matter is sufficiently clearly connected to a taxation law or regulation (or to a procedure, requirement or practice of the taxation authorities in apparent reliance in such a law or regulation), then its legality is a matter for the courts of the host State."[1404]

1401 *EnCana Corp. v. Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 143 (Annex (Merits) C-976).

1402 Agreement between the Government of Canada and the Government of the Republic of Ecuador for the Promotion and Protection of Investments (Apr. 29, 1996), Art. I(i) (Exhibit-RME-1029).

1403 Claimants' Memorial on the Merits, ¶ 1009.

1404 *EnCana Corp. v. Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 142 (Annex (Merits) C-976). [emphases added]

> "But even if (as the Tribunal is inclined to conclude) SRI has not been consistent in its interpretation of Article 69A the essential point is that the obligations not to discriminate and to act in an equitable manner as between different classes of investors – obligations that may be derived from Articles II and IV of the BIT – do not apply to taxation measures. Even if SRI has applied the VAT rules in an 'idiosyncratic' manner, this does not lead to the conclusion that its conduct falls outside the scope of the exclusion for taxation measures. The demands were made by authorized tax officials in purported compliance with the relevant law; they were subject to review by the tax courts and eventually by the Taxation Chamber of the Supreme Court. They bear all the marks of a taxation measure – whether a lawful one under Ecuadorian law it is not for the Tribunal to decide."[1405]

866. Claimants' assertion that Article 21(1) ECT applies "exclusively [to] a genuine and legitimate use of [the Russian Federation's] taxation powers,"[1406] not where "it is established that the use of taxation was a disguise for what is an outright expropriation and a violation of the fair and equitable standard [*sic*]"[1407] confuses two issues, the legality of a State's exercise of its tax power and the definition of Taxation Measures. Whether a "*tax*," which is a subset of "*Taxation Measures*," is abusive and thus a "*measure*[] *having effect equivalent to nationalization or expropriation*" for purposes of Article 13 ECT, is an issue covered by the expropriation claw-back in Article 21(5) ECT. An abusive tax thus cannot be excluded from the taxation carve-out in Article 21(1) ECT in the first place. Indeed, as Canada pointed out at an early stage of the ECT negotiations, the referral process in Article 21(5) ECT is specifically designed to determine "*whether the contentious tax measure is indeed tantamount to expropriation, or else a bona-fide tax measure*."[1408]

867. Moreover, Article 21(1) ECT refers to "*Taxation Measures of the Contracting Parties*." As confirmed by the International Law Commission's Commentary on Article 4 of the International Law Commission's 2001 Articles on Responsibility of States for Internationally Wrongful Acts ("ILC Articles on State

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1405 *EnCana Corp. v. Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 146 (Annex (Merits) C-976). [emphasis added]

1406 Claimants' Memorial on the Merits, ¶ 1004.

1407 *Ibid.*, ¶ 1003.

1408 37/92 Annex, BA-15 foot, Brussels (Aug. 12, 1992), 63 (Exhibit RME-1030).

Responsibility"),[1409] measures of the Contracting Parties include any measure taken by a State organ that acts "*in an apparently official capacity*" regardless of whether the State organ "*may have had ulterior or improper motives or may be abusing public power*."[1410]

868. Unsurprisingly, the tribunal in *Burlington v. Ecuador* held that Burlington's fair and equitable treatment claim that Ecuador abused its tax power falls within the taxation carve-out in Article X of the U.S.-Ecuador BIT:

> "Claimant's second fair and equitable treatment claim is that Respondent used its tax power in bad faith in order to force Claimant to surrender its rights under the PSCs. In the view of the Tribunal, this claim ostensibly challenges Law 42, as well as Respondent's tax power, and therefore raises 'matters of taxation'."[1411]

869. Claimants' position that the scope of Article 21(1) ECT is limited to a "legitimate and genuine exercise" of a State's tax power must therefore be rejected. Claimants' position is incompatible with Articles 31 and 32 VCLT and would render meaningless the limited claw-back in Article 21(5) ECT, which reinstates the protections of Article 13 ECT in the event of abusive taxes. Most recently, the tribunal in *Nations Energy v. Panama* correctly rejected such a position:

> "The Plaintiffs' argument also leads to a result contrary to the object of the BIT.
>
> There is no doubt, indeed, that the purpose of Article XI.2 is to exclude matters of taxation from the BIT. The reason is easy to understand, given the importance of fiscal policy for the sovereignty of the State. Article XI distinguishes and separates issues which, with respect to tax matters, are left to the discretion of the parties and those which are subject to the BIT. Article XI.1 leaves the issue of fair and equitable treatment with respect to fiscal matters as a prerogative of the contracting State as part of the

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1409 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 26-30 (Exhibit RME-1031).

1410 *Ibid.*, 42.

1411 *Burlington v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Jurisdiction (June 2, 2010), ¶ 207 (Exhibit-RME-992). [emphases added]

> implementation of its fiscal policy. However, Article XI.2 is explicit with respect to the aspects which, despite being related to tax issues, the contracting States agreed to include within the scope of the BIT.
>
> The exclusion of fiscal matters is therefore defined and does not apply in the limited cases enumerated in Article XI.2. On the other hand, interpreting Article XI.1 as the Plaintiffs do would render meaningless the limited inclusion of matters of taxation provided for in Article XI.2 giving the Arbitral Tribunal broad powers to assess the tax policy of the State."[1412]

3. Claimants' Claims Are Almost Entirely Claims "*With Respect To Taxation Measures*"

870. Article 21(1) ECT provides that "nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties."[1413]

871. As established at ¶¶ 859 to 862 above, the term "*Taxation Measures of the Contracting Parties*" encompasses any measure apparently implementing tax legislation, including tax enforcement and collection measures. Article 21(1) ECT thus excludes from the scope of Part III of the ECT any claim "*with respect to*" measures apparently implementing tax legislation, including tax enforcement and collection measures.

872. The term "*with respect to*" in its ordinary meaning includes any direct or indirect link of a matter with a measure apparently implementing tax

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1412 [unofficial translation] "La tesis de los Demandantes además conduce a un resultado contrario al objeto del TBI. No cabe duda, en efecto, de que el objeto del artículo XI.2 es excluir asuntos de tributación del marco del TBI. La razón para ello es fácil de entender, dada la importancia de la política fiscal para la soberanía del Estado. El artículo XI distingue y divide los temas que, en materia tributaria, quedan al arbitrio de las partes y los que son materia del TBI. El artículo XI.1 deja el tema de trato justo y equitativo en materia fiscal como una prerrogativa del Estado contratante en la aplicación de su política fiscal. Sin embargo, el artículo XI.2 es expreso en cuanto a los aspectos, que a pesar de estar relacionados con el tema fiscal, los Estados contratantes acordaron que fueran incluidos dentro del ámbito de aplicación del TBI. La exclusión de la materia fiscal es por lo tanto delimitada y no se aplica en los casos limitadamente enumerados por el artículo XI.2. Ahora bien, interpretar el artículo XI.1 como hacen los Demandantes llegaría a vaciar de todo sentido la admisión limitada de los asuntos tributarios, prevista en el artículo XI.2 confiriendo al Tribunal Arbitral una amplia competencia para apreciar la política tributaria del Estado." *Nations Energy Inc and others v. Panama*, ICSID ARB/06/19, Award (Nov. 24, 2010), ¶¶ 480-482 (Exhibit RME-1032).

1413 [emphasis added]

legislation. As stated by Mr. Justice Aikens in interpreting the phrase "[n]*evertheless, the provisions of the Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only* with respect to […] *(c) the observance and enforcement of terms of an investment agreement*" in Article X(2) of the U.S.-Ecuador BIT:

> "[T]he effect of the words '*only with respect to*' demonstrate [*sic*] that there has to be a link between a matter (or affair) of taxation and '*the observance and enforcement of the terms of an investment agreement*.' To my mind, '*with respect to*' indicates that the link can be both direct and indirect. The words '*with respect to*' in their ordinary meaning connote 'as concerns,' or 'with reference to,' or 'in connection with' and so are broad in effect.
>
> […] A test of whether something comes within paragraph (c) could be: does a matter of taxation touch upon or affect the performance of terms of the investment agreement; or does a matter of taxation touch upon or affect enforcement of terms of the investment agreement?"[1414]

873. As will be shown below, all allegations on which Claimants seek to base their Article 10(1) ECT claim, except the reference to the Sibneft de-merger in ¶ 718 of Claimants' Memorial on the Merits, are Taxation Measures or clearly "*touch upon*" or "*affect*" Taxation Measures.

874. Claimants seem to concede that the core of their complaints, the tax assessments, including fines and interest, and the court decisions upholding the tax assessments, as well as measures taken to secure the effective collection of taxes, such as asset freezes, are "*Taxation Measures*" if the term "*Taxation Measures*" includes tax enforcement and collection measures, which it does. Indeed, each of these measures was taken by Russian tax officials in apparent implementation of Russian tax laws. In fact, as set forth at ¶¶ 987 to 1002 below, although not essential to Respondent's defense, each of these measures was consistent with Russian law. Claimants allege, however, that "many" of the actions complained of, including "the arrests, harassment and intimidation of

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1414 *The Republic of Ecuador v. Occidental Exploration & Production Co.*, Queen's Bench Division, Commercial Court Case No. 04/656, Judgment (Mar. 2, 2006), [2006] EWHC 345 (Comm.), ¶¶ 98 and 99 (Exhibit RME-999) [italics in original]. *See also Canfor Corporation v. United States*, UNCITRAL, Decision on Preliminary Question (June 6, 2006), ¶ 201 (Exhibit RME-1033): "[T]he Tribunal is of the view that the words 'with respect to' are to be interpreted broadly."

Yukos' management, employees and counsel, the sham auction of Yuganskneftegaz […] as well as the sham bankruptcy proceedings,"[1415] "do not relate to taxation at all."[1416] This bald assertion is simply wrong and not credible. Indeed, as early as 2002, Yukos acknowledged in internal documentation that if it were to disclose to public authorities the details of its "tax optimization" scheme, "[s]*uch information may be used by the Russian tax authorities to challenge our approach to certain transactions and, consequently, would result in substantial tax claims being brought against the Company* […] [and] *may result in attempts to impose administrative and tax liability on the Company's officers*."[1417]

875. Claimants complain of the following measures, each of which is a tax enforcement or collection measure or a measure linked, directly or indirectly, to a tax enforcement or collection measure:

(i) "Improper and illegal raids, searches and seizures"[1418]: the impugned raids, searches, and seizures form part of the criminal investigations against Messrs. Khodorkovsky and Lebedev relating to, *inter alia*, tax evasion, and the tax proceedings against Yukos and Yukos subsidiaries. These measures were in support of tax enforcement efforts of the Russian Federation and thus measures aimed at the effective collection of taxes or measures clearly linked to tax enforcement measures, as Claimants must concede.

(ii) "Due process violations in the administrative, court and enforcement proceedings brought against Yukos in relation to the so-called tax re-assessments"[1419]: there is no doubt that the impugned proceedings constitute tax enforcement measures, and Claimants do not allege otherwise.

1415 Claimants' Memorial on the Merits, ¶ 1006.

1416 *Ibid.*

1417 Memorandum from Maliy to Sheyko (Apr. 22, 2002), ¶ A.2 (Exhibit RME-184)

1418 Claimants' Memorial on the Merits, Section III(A)(1)(a)(i).

1419 *Ibid.*, Section III(A)(1(a)(ii).

(iii) "The forced sale of Yuganskneftegaz at a sham auction in breach of any regard for due process and procedural propriety"[1420]: the YNG auction was a forced sale expressly to satisfy Yukos' tax liabilities and thus constitutes a tax collection measure.

(iv) "Due process violations in the bankruptcy proceedings against Yukos"[1421]: according to Claimants' own allegations, the initiation of the bankruptcy proceedings was predicated on the tax assessments and previous freezes of Yukos assets,[1422] and the forced sales at bankruptcy were necessary to satisfy Yukos' tax liabilities. Thus, the bankruptcy proceedings constitute tax enforcement and collection measures or are at least indirectly linked to such measures.

(v) "The Russian Federation's orchestrated campaign of coercion, harassment and intimidation against Yukos and related entities and persons"[1423]: according to Claimants, the "key acts" of the alleged campaign of coercion and intimidation were the launching of criminal investigations and the arrests of Messrs. Khodorkovsky and Lebedev,[1424] which were, *inter alia*, on criminal charges for tax evasion and thus constitute tax enforcement measures. The impugned interrogations and detention of Yukos' employees and advisors and searches of their offices equally formed part of and occurred during the course of investigations of Yukos and its principals concerning violations of tax laws and thus are directly linked to tax enforcement measures.

(vi) "Arbitrarily and disproportionately large payment demands imposed under the guise of tax reassessments, enforced within

1420 *Ibid.*, Section III(A)(1(a)(iii).

1421 *Ibid.*, Section III(A)(1(a)(iv).

1422 *Ibid.*, ¶¶ 421, 604, 684, 825, 834.

1423 *Ibid.*, Section III(A)(1(b)(i).

1424 *Ibid.*, ¶ 657.

short periods of time, and coupled with arbitrary freezing orders"[1425]: there is no doubt that these allegations concern tax enforcement measures, and Claimants do not allege otherwise.

(vii) "Unreasonable and arbitrary rejections of Yukos' proposals to settle or resolve the alleged tax claims"[1426]: again, there is no doubt that these allegations concern tax enforcement measures, and Claimants do not allege otherwise.

(viii) Differential treatment of Yukos and other Russian oil companies by the Russian tax authorities[1427]: again, there is no doubt that these allegations concern tax enforcement measures, and Claimants do not allege otherwise.

(ix) Differential treatment of Yukos-related creditors and Yukos' shareholders and State or State-related creditors in the bankruptcy proceedings[1428]: as set forth at iv. above, the conduct of the bankruptcy auctions and proceedings constitute tax enforcement and collection measures or are at least indirectly linked to such measures.

(x) The "threat" of revocation of YNG's oil licenses[1429]: The investigation of YNG's oil licenses was for failure to pay taxes and thus was also linked to Taxation Measures.

876. Out of the myriad of allegations spanning pages 231 through 332 of Claimants' Memorial on the Merits, only one paragraph, concerning the "unwinding" of the Sibneft merger,[1430] does not constitute and is not linked to a Taxation Measure. But Claimants have failed to specify any injury cognizable

1425 *Ibid.*, Section III(A)(1(b)(ii).

1426 *Ibid.*, Section III(A)(1(b)(iii).

1427 *Ibid.*, Section III(A)(2)(a) and (b).

1428 *Ibid.*, Section III(A)(2)(c).

1429 *Ibid.*, ¶ 719.

1430 *Ibid.*, ¶ 718.

under Article 10 ECT based on this allegation as opposed to measures "*with respect to Taxation Measures*," and Claimants' Article 10(1) claim must therefore be dismissed pursuant to Article 21(1) ECT.

877. Claimants' Article 13 ECT claim is equally based exclusively on measures "*with respect to Taxation Measures*," subject to the exception of the Sibneft de-merger allegations.[1431] With respect to the Sibneft de-merger, Claimants have again failed to specify any injury cognizable under Article 13 ECT.

878. The allegations on which Claimants seek to base their Article 13 ECT claim are virtually identical to those that form the basis of their Article 10(1) ECT claim. As with their Article 10(1) ECT claim, Claimants base their purported expropriation claim on the imposition of tax assessments;[1432] bankruptcy proceedings[1433] that Claimants themselves insist were the fruit of the asset freezes instituted during previous tax enforcement efforts;[1434] the auction of YNG to meet Yukos' tax liabilities;[1435] the "threat" of revocation of YNG's oil licenses for failure to pay taxes;[1436] the alleged "campaign" against Yukos and its affiliates, including the arrests of Messrs. Khodorkovsky and Lebedev on charges including tax fraud;[1437] searches and seizures during the course of investigation and enforcement relating to violations of tax laws;[1438] and the alleged seizure of shares of Hulley and YUL as collateral for damages from criminal conduct, including tax evasion.[1439] As explained at ¶ 875 above, all of these measures are tax enforcement and collection measures or are linked, directly or indirectly, to such measures.

1431 *Ibid.*, ¶¶ 805-807.

1432 *Ibid.*, ¶¶ 809-810.

1433 *Ibid.*, ¶¶ 857-858.

1434 *Ibid.*, ¶ 421.

1435 *Ibid.*, ¶¶ 813-819, 858.

1436 *Ibid.*, ¶¶ 812, 176. *See also Russian Government May Revoke YUKOS Unit's Licenses*, FWN SELECT (Sept. 10, 2004) (Annex (Merits) C-701).

1437 Claimants' Memorial on the Merits, ¶¶ 857-858.

1438 *Ibid.*, ¶¶ 811-812.

1439 *Ibid.*, ¶¶ 803-804.

4. Article 21(5) ECT Applies To Article 13 ECT Claims Based On "*Taxes*," Not Article 13 ECT Claims Based On Other "*Taxation Measures*"

879. Article 21(5)(a) ECT provides:

"Article 13 shall apply to taxes."

880. Pursuant to the ordinary meaning of the terms of Article 21(5)(a) ECT, the expropriation claw-back in Article 21(5) ECT applies only to "*taxes*," not to other "*Taxation Measures*." As a result of joint discussions between the Legal and Taxation Sub-groups on June 22, 1993, the term "*Taxation Measures*" consistently used in previous versions of draft Article 21(5) was replaced by the term "*taxes*" in a "*substantially revised version*" of draft Article 21,[1440] which is reflected in Room Document 3, Plenary Session, June 28 – July 2, 1993.[1441] As stated by the European Court of Justice:

> "[W]ithout evidence to the contrary, it must be presumed that every difference in wording connotes a difference in meaning."[1442]

881. Claimants cannot and have failed to show that the difference in wording in Article 21(1) and Article 21(5) ECT does not connote a difference in meaning. First, Claimants' assertion that "a carve-out and a claw-back cannot have a different scope"[1443] is simply wrong. Certainly, an exception to an exception is necessarily narrower than the exception itself. What is impossible is the suggestion in Claimants' Counter-Memorials on Jurisdiction and Admissibility that Taxation Measures is the narrower term and "*taxes*" the

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1440 Craig Bamberger, Memorandum Re: Plenary Meeting of the European Energy Charter Treaty, Negotiations June 28 – July 2, 1993 (July 5, 1993), 8 (Exhibit RME-1034).

1441 European Energy Charter, Conference Secretariat, Room Document 3, Plenary Session (June 28 – July 2, 1993) (Exhibit RME-1035). The same document shows a deliberate change in Article 21(7) from "the" to "any" in identifying "Taxation Measures," further demonstrating the breadth of this term, of which "taxes" is a sub-set.

1442 *Simon v. Court of Justice of the European Communities*, Court of Justice of the European Communities, Judgment (June 1, 1961), 32 I.L.R. 354 (1966), 357 (Exhibit RME-1036); *See also Certain Expenses of the United Nations* (Art. 17, Paragraph 2, of the Charter), Advisory Opinion (July 20, 1962), 1962 I.C.J. Rep. 151, 159 (Exhibit RME-1037): "If it had been intended that paragraph I [using the term 'Budget'] should be limited to the administrative budget of the United Nations organization itself, the word 'administrative' would have been inserted in paragraph I as it was in paragraph 3 [using the term 'administrative budgets']."

1443 Claimants' Memorial on the Merits, ¶ 1040.

broader term.[1444] Under this absurd interpretation, the exception to the exception would be broader than the exception itself.

882. Second, Claimants' current theory that the ECT uses the terms "*taxes*," "*tax provisions*" and "*Taxation Measures*" interchangeably to refer to the Contracting Parties' "power to regulate in taxation matters"[1445] is equally mistaken and would lead to manifestly absurd and unreasonable results. For example, the exception to the claw-backs in Article 21(2) and (3) ECT refer to (a) an advantage accorded pursuant to the "*tax provisions*" of an international treaty and (b) "*any Taxation Measure aimed at ensuring the effective collection of taxes*." Obviously, the term "*taxes*" cannot be substituted for the term "*Taxation Measures*" and the terms "*tax provisions*" and "*Taxation Measures*" cannot be substituted for the term "*taxes*."

883. What Article 21(3) ECT (like Article 21(5)) does show, however, is that the term "*Taxation Measures*" covers taxation measures of both general and individual application and the term "*taxes*" is a subcategory of "*Taxation Measures*." Article 21(3) ECT applies Article 10(2) and (7) (national and most-favored-nation treatment) to "*Taxation Measures of the Contracting Parties other than those on income or on capital*." Since the national and most-favored-nation treatment standards require a host State to make no negative differentiation between protected investors and national or third State investors, respectively, when enacting and applying its rules and regulations,[1446] the term "*Taxation*

1444 Counter-Memorial on Jurisdiction and Admissibility (Hulley), ¶ 390: "Taxes, as this term is used in the ECT, is a wider category than Taxation Measures. All Taxation Measures are Taxes, but the reverse is not necessarily true."; Counter-Memorial on Jurisdiction and Admissibility (YUL), ¶ 389; Counter-Memorial on Jurisdiction and Admissibility (VPL), ¶ 391.

1445 Claimants' Memorial on the Merits, ¶ 1042.

1446 For instance, *Bayindir Insaat Turizm Ticaret ve Sanayi AŞ v. Islamic Republic of Pakistan*, ICSID ARB/03/29, Decision on Jurisdiction (Nov. 14, 2005), ¶ 206 (Exhibit RME-1038): "The mere fact that Bayindir had always been subject to exactly the same legal and regulatory framework as everybody else in Pakistan does not necessarily mean that it was actually treated in the same way as local (or third countries) investors. In other words, as is evident from the broad wording of Article II(2) of the BIT, the treatment the investor is offered under the MFN clause is not limited to 'regulatory treatment'."; *United Parcel Service of America Inc v. Government of Canada*, UNCITRAL, Award (June 11, 2007), ¶¶ 80-120 (Exhibit RME-1039) (applying Article 1102 NAFTA to measures enforcing Canadian customs law); RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2008),

Measures" necessarily encompasses both tax legislation and enforcement measures. In addition, Article 21(3) ECT is limited by not imposing most-favored-nation obligations "*with respect to advantages accorded by a Contracting Party pursuant to the tax provisions of any convention, agreement or arrangement* […]," [1447] thus encompassing treatment of a taxpayer pursuant to and not limited to tax provisions.

884. Third, Claimants' reliance on the Italian text of the ECT, [1448] which uses the term "*misure fiscali*" in Article 21(5)(a) ECT, is equally unavailing. The Italian text is the only language version that uses the term Taxation Measures in Article 21(5)(a) ECT. The English, Russian, Spanish, French, and German texts of Article 21(5)(a) ECT use the terms "*taxes*," "*налоги*," "*impuestos*," "*impôts*" and "*Steuern*," respectively. The English, Russian, and Spanish texts also consistently use the terms "*taxes*," "*налоги*" and "*impuestos*" in Article 21(5)(b) ECT. The French, German, and Italian texts use the term "*taxation measures*" in Article 21(5)(b) ECT, though inconsistently. The French text uses "*mesure fiscale*" in Article 21(5)(b)(i) and (ii). The German version uses "*Maßnahme*" in Article 21(5)(b)(i) and "*steuerliche Maßnahme*" in Article 21(5)(b)(ii), and the Italian text uses the term "*misura fiscale*" in Article 21(5)(b) (i) and (ii).

885. Respondent has established that the differences in the French and German texts of Article 21(5)(b)(i) and (ii) ECT, and in the case of the Italian text also of Article 21(5)(a) ECT, are the result of poor translations. All authentic versions of the ECT other than the English text are not more than translations, prepared after agreement was reached on an English text. [1449] Indeed, even when

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178 (Exhibit RME-1040): "[T]he purpose of the [national treatment] clause is to oblige a host state to make no negative differentiation between foreign and national investors when enacting and applying its rules and regulations and thus to promote the position of the foreign investor to the level accorded to nationals."

1447 [emphases added]

1448 Claimants' Memorial on the Merits, ¶ 1041.

1449 Knipler Opinion, ¶ 4: "I clearly recall that the Energy Charter Treaty tax negotiations were undertaken solely in the English language and that the negotiations dealt solely with English language versions of the draft text. The negotiations did not discuss or consider any provisions in French or any other language other than English. The French text was a translation made only after the conclusion of the negotiations and without input from the negotiating teams."; Berman Opinion, ¶ 8: "The United States […] participated in all

there were written exchanges in other languages, they specifically addressed only the English text, as the example concerning Article 21(7) discussed above shows.[1450] The English text therefore reflects the common intentions of the parties at the time of the conclusion of the ECT.

886. Where there are facial differences between equally authentic language versions of a treaty, the normal rules of treaty interpretation reflected in Articles 31 and 32 VCLT, requiring resort to "*supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion*,"[1451] must be applied to resolve any such differences before recourse may be made to the presumption of the same meaning of each authentic text in Article 33(3) VCLT, which Claimants invoke:[1452]

> "[A]ccount must be taken, by way of priority, of the language version or versions in which the disputed provision of the treaty was originally drafted. Automatic and unthinking reliance on the principle of equal authenticity of texts can lead to a failure to give effect to the common intentions of the parties where it is or becomes apparent from the *travaux préparatoires* of the treaty that a disputed provision was originally drafted in a particular language version and that the other language versions are no more than translations; in such a case, it is submitted that the common intentions of the parties are reflected in the original text and that [...] there should be a presumption, the strength of the presumption in favour of the original text depending on the circumstances in which the various language versions of the disputed clause were drawn up."[1453]

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discussions and negotiations of the tax provisions of the ECT, which were conducted entirely in English."; Fremantle Opinion, ¶¶ 10-12: "[I]nterpretation only in English and Russian […] was the usual rule in sub-group meetings. […] The initial texts of the provisions were drafted in English, nearly all by British officials […] Records of the meetings were drafted in English and translated rapidly into Russian […] Most amendments to proposed provisions were drafted by the Secretariat and/or myself to reflect the discussions or propose compromise texts. […] [N]early all such were in English, except, perhaps, one or two in Russian."

1450 *See* ¶ 858 *supra*. *See also* Fax from Craig Bamberger to Members of the Legal Sub-Group (Apr. 5, 1993) (Exhibit RME-1041).

1451 Vienna Convention on the Law of Treaties (May 23, 1969), 1155 U.N.T.S. 331 (Exhibit RME-983).

1452 Claimants' Memorial on the Merits, ¶ 1041.

1453 IAN SINCLAIR, THE VIENNA CONVENTION ON THE LAW OF TREATIES (2nd ed. 1984), 152 (Exhibit RME-1003) [italics in original]. *See also*, XXth Legislative Period, Austrian Government Bill No. 56, Enclosures No. 56 to the Transcripts of the National Council [56 der Beilagen der

"Il se peut, par exemple, que l'application des articles 31 et 32 révèle des circonstances qui portent à favoriser certains textes au détriment des autres en décelant l'incapacité de ces derniers à exprimer exactement ce que les parties ont vraiment voulu. Il est en effet possible qu'un texte déclaré égal aux autres ne puisse être en réalité un moyen de valeur égale pour discerner ce que les parties ont vraiment voulu, ainsi un texte déclaré authentique peut en fait n'être qu'une traduction subséquente et mal contrôlée des textes élaborés en commun."[1454]

"L'appel au texte original est certes possible d'après l'article 32 qui prévoit le recours aux moyens complémentaires: les travaux préparatoires et les circonstances dans lesquelles le traité a été conclu. Il peut apparaître du recours à l'un ou l'autre de ces moyens complémentaires que le traité a été rédigé d'abord dans une langue et traduit ensuite dans les autres langues pour constituer d'autres textes authentiques. Dans un cas pareil, il est

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Stenographischen Protokolle], 114, 144 (GP XX RV 56 AB 238 S. 36) (Exhibit RME-1042): "Der ECV ist gem. seinem Art. 50 gleichermaßen in englischer, deutscher, französischer, italienischer, russischer und spanischer Sprache authentisch, wodurch Art. 33 des Wiener Übereinkommens über das Recht der Verträge hinsichtlich der Auslegung der Vertragstexte zur Anwendung kommt. Nichtsdestoweniger ist zu beachten, daß der Vertrag ausschließlich in englischer Sprache verhandelt wurde, sodaß ein Rückgriff auf den englischen Text das Verständnis der Bestimmungen erleichtert." "According to Art. 50, the Treaty is equally authentic in the English, German, French, Italian, Russian, and Spanish language and thus Art. 33 of the Vienna Convention on the Law of Treaties applies with respect to the interpretation of the treaty texts. Nevertheless one needs to take into account that the Treaty was negotiated exclusively in the English language so that a recourse to the English text facilitates the understanding of the provisions." [unofficial translation]; *Mavrommatis Palestine Concessions (Greece v. Great Britain)*, Judgment (Aug. 30, 1924) 1924 P.C.I.J. (Ser. A) No. 2, 19 (Exhibit RME-1043): "The Court is of the opinion that, where two versions possessing equal authority exist one of which appears to have a wider bearing than the other, it is bound to adopt the more limited interpretation which can be made to harmonise with both versions and which, as far as it goes, is doubtless in accordance with the common intention of the Parties. In the present case this conclusion is indicated with especial force because the question concerns an instrument laying down the obligations of Great Britain in her capacity as Mandatory for Palestine and because the original draft of this instrument was probably made in English."; *Interpretation of the Convention of 1919 Concerning Employment of Women during the Night*, Advisory Opinion (Nov. 15, 1932), 1932 P.C.I.J. (Ser. A/B) No. 50, 379 (Exhibit RME-1044).

1454 "For example, the application of Articles 31 and 32 may reveal circumstances that give rise to a priority of certain texts over others by detecting the incapacity of the latter to express exactly what the parties really intended. It is effectively possible that one text, declared equal to another, may in reality not be a means of equal value of determining what the parties really intended; thus a text declared authentic may in fact be a subsequent and improperly controlled translation of the jointly elaborated texts." [unofficial translation]. Mustafa K. Yasseen, *L'interprétation des traités d'après la Convention de Vienne sur le droit des traités*, 151 Rec. des cours 1 (1976), 106 (Exhibit RME-1002).

logique que le texte original jouisse, en cas de divergence, d'une certaine primauté."[1455]

887. Specifically with respect to the Italian language version relied upon in Claimants' Memorial on the Merits,[1456] it should be noted that the phrase "*misure fiscali*" in Article 21(5) ECT is not used in Italian investment treaties, but is an inaccurate translation of the English term "*taxes*." In fact, none of the Italian bilateral investment treaties in force contain the term "*misure fiscali*." The language typically used in Italian bilateral investment treaties is "*imposizione*," "*tassazione*" and "*obblighi fiscali*."[1457]

888. It follows that Article 21(5) ECT applies only to a subcategory of Taxation Measures -- taxes -- and does not apply to other Taxation Measures. As discussed above,[1458] the predicate of Claimants' expropriation claim is such

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1455 "The reference to the original text is indeed possible according to Article 32 which provides for resort to complementary means: the *travaux préparatoires* and the circumstances of conclusion of the treaty. It may become apparent from the resort to one or the other of these complementary means that the treaty was drafted first in one language and subsequently translated into the other languages to constitute other authentic texts. In such a case, it is logical that the original text should enjoy, in case of divergence, a certain primacy." [unofficial translation]. *Ibid.*, 108. S*ee also* ANTHONY AUST, MODERN TREATY LAW AND PRACTICE (2000), 205-06 (Exhibit RME-1045): "If the treaty was negotiated and drafted in only one of the authentic languages, it is natural to place more reliance on that text, particularly if it is unambiguous. This approach is not incompatible with [Article 33] paragraph 4 [VCLT], and the jurisprudence of the International Court of Justice would seem to support it in suitable cases."

1456 Claimants' Memorial on the Merits, ¶ 1041.

1457 *E.g.*, Agreement between the Government of the Republic of Italy and the Government of the Russian Federation on Promotion and Reciprocal Protection of Investments (Apr. 9, 1996), Art. 3 and 8 (Exhibit RME-1046); Agreement between the Government of the Republic of Italy and the Government of the Republic of Albania on Promotion and Reciprocal Protection of Investments (Sept. 12, 1991), Art. 3 and 6 (Exhibit RME-1047); Agreement between the Government of the Republic of Italy and the Government of the Democratic and Popular Republic of Algeria on Promotion and Reciprocal Protection of Investments (May 18, 1991), Art. 3 and 5 (Exhibit RME-1048); Agreement between the Government of the Republic of Italy and the Government of the Popular Republic of Poland on Promotion and Reciprocal Protection of Investments (May 10, 1989), Art. 3 and 6 (Exhibit RME-1049); Agreement between the Government of the Republic of Italy and the Government of the Kingdom of Saudi Arabia on Promotion and Reciprocal Protection of Investments (Sept. 10, 1996), Art. 3 and 5 (Exhibit RME-1050); Agreement between the Government of the Republic of Italy and the Government of the Republic of Uganda on Promotion and Reciprocal Protection of Investments (Dec. 12, 1997), Art. 4 and 7 (Exhibit RME-1051); Agreement between the Government of the Republic of Italy and the Government of the Oriental Republic of Uruguay on Promotion and Reciprocal Protection of Investments (Feb. 21, 1990), Art. 3, 6 and 8 (Exhibit RME-1052).

1458 *See* ¶¶ 875-878 *supra*.

Taxation Measures other than taxes. Their only argument that they fall within the claw-back is based on their failed assertion that "*Taxation Measures*" and "*taxes*" are equivalent terms, which cannot be the case for reasons just discussed.

889. Claimants' Article 13 ECT claims premised on Taxation Measures other than taxes are thus outside the scope of the claw-back in Article 21(5) ECT and must, as stated at the outset, be dismissed for lack of jurisdiction, as inadmissible, and on the merits.

C. The Tribunal Lacks Jurisdiction Or The Claims Are Inadmissible Because Of Claimants' Illegal Conduct And Illegal Conduct Attributable To Them

890. Claimants cannot claim relief from this Tribunal because, as shown above, their claims are based on (i) their own illegal conduct and (ii) illegal conduct attributable to them, including illegal conduct perpetrated by Yukos officials whom Claimants installed to manage their investment in Yukos, and who Claimants unquestionably had the power to control.

891. As fully set forth in the Statement of Facts, the illegal acts and bad-faith conduct through which Claimants' investments were first made and which they continued to perpetrate throughout the course of their investments in and control over Yukos to enrich the Oligarchs and themselves through those investments, and for which they are otherwise responsible as the result of their control over Yukos, include at least the following:

(i) Violating the legal requirements governing the loans-for-shares program that allowed Menatep to gain its controlling interest in Yukos (*see* ¶¶ 18-31 *supra*);

(ii) Using shell company proxies to feign competition in the loans-for-shares auction and a simultaneous investment tender for Yukos shares (*see* ¶¶ 27-28 *supra*);

(iii) Precluding actual competitors from bidding on Yukos shares in the loans-for-shares auction and investment tender, including through

the abuse of Menatep's role as auction organizer to disqualify Russian competitors (*see* ¶¶ 24-26 *supra*);

(iv) Rigging of a subsequent auction for the Yukos shares being held as collateral since the initial loans-for-shares auction, which deprived the Russian Government of substantial revenue (*see* ¶¶ 29-30 *supra*);

(v) Conspiring with Yukos' pre-existing managers to facilitate the unlawful acquisition of Yukos by the Oligarchs, including by entering into an agreement whereby "*Yukos Universal*" committed to pay them compensation consisting of 15% of Menatep's beneficial interest in Yukos, worth billions of dollars, for "*services rendered to 'Yukos'*" (*see*¶¶ 32-39 *supra*);

(vi) Colluding with others to predetermine the post-privatization ownership of Yukos (*see* ¶¶ 22-25 *supra*);

(vii) Skimming profits from Yukos and its production subsidiaries for their own self-enrichment (*see* ¶¶ 46-49 *supra*);

(viii) Abusing Russian corporate law and principles of corporate governance by squeezing-out minority shareholders in Yukos' production subsidiaries through ruthless and self-enriching share dilutions, asset stripping, and transfer pricing (*see* ¶¶ 51-60 *supra*);

(ix) Siphoning off from Yukos proceeds from the sale of oil and oil products for the benefit of the Oligarchs, while concealing related-party transactions from Yukos' own auditor (*see* ¶¶ 81-95 *supra*);

(x) Further mistreatment of minority shareholders by manipulating shareholder meetings, pressuring the Russian Federal Securities Commission not to pursue its challenges against illegal misconduct, relying on fraudulently determined stock and asset values and deceiving shareholders, the Government, and domestic

and foreign courts about the nature and control of offshore companies that were created to benefit Claimants and their cohorts from the abuse of minority shareholders (*see* ¶¶ 64-69 *supra*);

(xi) Manipulating Yukos' stock value to devalue and reacquire the interests of creditors to which Yukos stock had been pledged (*see* ¶¶ 74-75 *supra*);

(xii) Submitting fraudulent claims under, or otherwise abusing, the Russia-Cyprus Tax Treaty to evade hundreds of millions of dollars in Russian taxes payable on dividends involving Yukos shares, thereby also violating Russian and Cypriot criminal laws (*see* ¶¶ 154-224 *supra*);

(xiii) Entering into hundreds of sham transactions involving the sale and repurchase of Yukos shares between Claimants and their affiliates, the sole purpose of which was to fraudulently suggest that Claimants beneficially owned dividends declared on Yukos shares, and thereby further Claimants' fraudulent claims for favorable tax treatment under the Russia-Cyprus Tax Treaty (*see*, *e.g.*, ¶¶ 115, 176-189 *supra*);

(xiv) Evading hundreds of millions of dollars in Russian taxes on profits from transactions and profits from sales of Yukos shares (*see* ¶¶ 204-208 *supra*);

(xv) Engineering through management installed by Claimants the massive Yukos tax evasion scheme to avoid paying hundreds of billions of rubles in Russian taxes (*see* ¶¶ 225-277 *supra*);

(xvi) Diverting the proceeds of the Yukos tax evasion scheme into highly opaque Cypriot and British Virgin Islands entities and trusts to conceal the unlawful provenance of those proceeds, including through dividend distributions to undisclosed Cypriot parent

companies of trading shells, thereby further abusing the Russia-Cyprus Tax Treaty (*see* ¶¶ 266-277 *supra*);

(xvii) Engaging in abusive corporate restructurings to conceal Yukos' affiliation with trading shells, thereby preventing Russian authorities from identifying and addressing Yukos' tax abuses (*see, e.g.,*¶¶ 281-287 *supra*);

(xviii) Concealing Yukos' continued control of trading shells by resorting to call-options or other artifices and by fabricating corporate and other transactional documents (*see, e.g.,* ¶¶ 237-243 *supra* and 1013-1014 *infra*);

(xix) Repeatedly obstructing the conduct of the tax authorities' audits of Yukos by refusing to provide documents and information which would show the extent of Yukos' abuses, and by causing Yukos' producing subsidiaries and other related entities to be similarly obstructive (*see* ¶¶ 355-363 *supra*);

(xx) Failing to pay Yukos' tax liabilities for tax year 2000 and following years, despite having received ample notice that Yukos would be required to pay these amounts and despite the fact that Yukos had abundant resources to do so (*see* ¶¶ 381-394 *supra*);

(xxi) Dissipating assets to frustrate the Russian authorities' collection of the tax assessments, including by way of paying dividends of "unprecedented" amounts, making spontaneously accelerated loan "prepayments" to Oligarch-owned Moravel, and foisting upon YNG an upstream guarantee up to US$ 3 billion for the repayment of Yukos' alleged "debts" to Moravel (*see*, *e.g.*, ¶¶ 349-352, 390-391 *supra*);

(xxii) Offering to the Russian authorities assets which Yukos knew to be tainted to settle its tax liabilities (*see* ¶¶ 417-430, 433-434 *supra*);

(xxiii) Concealing the share registers of Yukos' subsidiaries to obstruct bailiffs' enforcement of Yukos' tax obligations (*see* ¶¶ 403 *supra*);

(xxiv) Sabotaging the YNG auction through litigation threats and a spurious bankruptcy filing in the United States that effectively prevented all but one bidder from placing a bid at the auction and artificially depressed the amount of the auction proceeds (*see* ¶¶ 490-506, 484-488 *supra*);

(xxv) Implementing asset-stripping measures by diverting Yukos' valuable assets to Dutch trusts-like structures managed by former Yukos' officers and representatives of Claimants in anticipation of Yukos' bankruptcy (*see* ¶¶ 528-539 *supra*);

(xxvi) Failing to repay Yukos' debt to the SocGen syndicate and frustrating the banks' attempts to collect against Yukos' Dutch assets (*see* ¶¶ 551-556 *supra*); and

(xxvii) In the process of all of the foregoing, lying to Yukos' auditors PwC about core aspects of their misconduct and, through PwC's certification of Yukos' financial statements based on this deception of Yukos' auditors, to Yukos' creditors and other members of the investing public who relied upon those financial statements and PwC's certification of them (*see*, *e.g.*, ¶¶ 736-781 *supra*).

892. It is difficult to conceive of a more extensive record of repeated and consistent illegal conduct for which a claimant in an arbitration -- let alone one seeking an unprecedented amount in damages -- could be responsible, either directly or through those whom the claimant installed to manage the investment that is the subject of the claimant's claims. It is well-settled in this context that a claimant who is guilty of illegal conduct is deprived of the necessary *ius standi* to complain of corresponding illegalities of the respondent State, especially if -- as is the case here -- the illegalities are a consequence of claimant's own illegality. As stated by Sir Gerald Fitzmaurice, then the Legal Adviser of the Foreign and Commonwealth Office, in lectures at the Hague Academy of International Law:

> "[A] State which is guilty of illegal conduct may be deprived of the necessary *locus standi in judicio* for complaining of corresponding illegalities on the part of other States, especially if these were consequential on or were embarked upon in order to counter its own illegality -- in short were provoked by it."[1459]

893. The principle of "*unclean hands*" finds its expression in the maxims *ex delicto non oritur actio*, *nullus commodum capere potest de injuria sua propria* and *ex injuria jus non oritur*. The requirement of "*clean hands*" is widely viewed as a general principle of law within the meaning of Article 38(1)(c) of the Statute of the International Court of Justice.[1460]

894. There are ample examples in the jurisprudence of various mixed claims commissions of claims sought to be enforced by individuals or espoused by their home States that have been found inadmissible based on the individual's violation of the host State's law, the home State's law or international law.[1461] The *Clark Case* is a good example:

1459 Gerald Fitzmaurice, *The General Principles of International Law Considered from the Standpoint of the Rules of Law*, 92 Rec. des Cours 1 (1957-II), 119 (Exhibit RME-1053).

1460 BIN CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS (1953), 155 (Exhibit RME-1054); Richard Kreindler, Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine, *in* BETWEEN EAST AND WEST: ESSAYS IN HONOUR OF ULF FRANKE (Kaj Hobér, Annette Magnusson and Marie Öhrström, eds. 2010), 317 (Exhibit RME-1055): "As the Unclean Hands Doctrine is encountered in the domestic legal orders of many States, it should as a rule qualify as a general principle of law, and thus as a source of international law pursuant to Article 38(1)(c) of the ICJ Statute."

1461 *Brannan v. Mexico*, U.S.-Mexico Mixed Claims Commission, Opinion of the Umpire (1868), HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Volume 3 (John Bassett Moore, ed. 1898) 2757, 2758 (Exhibit RME-1056): "The umpire can not [*sic*] believe that this international commission is justified in countenancing a claim founded upon the contempt and infraction of the laws of one of the nations concerned."; *The "Lawrence" Case*, U.S.-Great Britain Mixed Claims Commission, Judgment of the Umpire (Jan. 4, 1855), Hornby's Report 397 (1856), 398 (Exhibit RME-1057) (declaring inadmissible a claim for diplomatic protection on the grounds that "[t]he African Slave Trade at the time of this condemnation, being prohibited by all civilized nations, was contrary to the law of nations, and being prohibited by the laws of The United States, the owners of the 'Lawrence' could not claim the protection of their own Government, and therefore, in [the Umpire's] judgment, can have no claim before this Commission."); *William Whitty v. The United States*, U.S.-British Claims Commission, Decision of the Commissioners, *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 2820, 2823 (Exhibit RME-1058): "The claimant having been actively engaged in the late rebellion against the United States, has no standing before this commission for the prosecution of a claim like this, and the claim is therefore disallowed."; *Frederick G. Fitch v. Mexico*, U.S.-Mexico Mixed Claims Commission, Opinion of the Umpire (June 21, 1876), *in*

"What right, under these circumstances, has Captain Clark, or his representatives, to call upon the United States to enforce his claim on the Colombian republics? Can he be allowed, as far as the United States are concerned, to profit by his own wrong? *Nemo ex suo delicto melioram suam conditionem facit.* […] He has made himself liable to be prosecuted and punished as a pirate; and now he presents himself before our government with the request to collect for him the proceeds of his misdemeanors. Will our government, by doing so, offer a reward to evil doers for the violation of its own laws and treaties? What would be the object of enacting penal laws, if their transgression were to entitle the offender to a premium instead of a punishment? […] I hold it to be the duty of the American Government and my own duty as commissioner to state that in this case Mr. Clark has no standing as an American citizen. A party who asks for redress must present himself with clean

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HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 4 (John Bassett Moore, ed. 1898) 3476, 3477 (Exhibit RME-1059) (dismissing a claim for payment of services rendered to Mexico by an American citizen in breach of the law of neutrality: "[T]he umpire is of opinion that this commission can not [*sic*] take cognizance of the case, and he therefore awards that the abovementioned claim be dismissed."); *Jarvis Case*, U.S.-Venezuela Mixed Claims Commission, Opinion of the Commissioner, 9 U.N.R.I.A.A. 208, 212 (Exhibit RME-1060) (in which relying on the *Clark case* the American commissioner held that the claim must be disallowed because: "It is not deemed necessary, however, to determine whether Jarvis violated the letter as well as the spirit of the neutrality laws of the United States. He did violate the treaty then existing between the United States and Venezuela. He did violate the established rule of international law, that when two nations are at peace all the subjects or citizens of each are bound to commit no act of hostility against the other."); *Cucullu's case*, U.S.-Mexico Mixed Claims Commission (1868), Opinion of Mr. Palacio, *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 4 (John Bassett Moore, ed. 1898) 3477, 3480 (Exhibit RME-1061): "The citizens of a country could not [...] by the same act violate its laws and become entitled to its protection against foreign governments."); *Case of the Brig 'Mary Lowell,'* U.S.-Spain Claims Commission, Opinion of the Umpire (Dec. 9, 1879), Spain-U.S. Claims Commission *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 2772, 2775, 2777 (Exhibit RME-1062) (holding that Claimants who aided insurgents by supplying arms "forfeited their right to the protection of the American flag" and were "estopped from asserting any of the privileges of lawful intercourse in times of peace and any title to individual benefit of indemnity" and denied an application for re-hearing because "*Was the capture of the Mary Lowell and cargo unlawful?* is subordinate to the other question, viz, *Were the Mary Lowell and cargo engaged in a lawful enterprise*" and "no case of the *United States v. Spain* has been or could, in the opinion of the umpire, properly be presented to this tribunal") [italics in original]; *Robert Eakin v. United States*, No. 118, U.S.-Great Britain Claims Commission, 3 Papers Relating to the Foreign Relations of the United States 15 (1874), 15 (Exhibit RME-1063): "[T]he undersigned is advised that a majority, at least, of the commission were of opinion that such holding of office under the rebel government [which by the then laws of Mississippi, could only be held by a citizen of the Confederate States] was of itself a violation of neutrality, and debarred the claimant from a standing before the commission."

hands. His cause of action must not be based on an offense against the very authority to whom he appeals for redress."[1462]

895. States have also frequently raised the "*unclean hands*" doctrine in direct inter-State cases before the International Court of Justice.[1463] In no case has the Court denied the existence of the doctrine under international law. To the contrary, the principle *ex injuria jus non oritur* has been upheld by the Court in the

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1462 *Clark Case* (*The Medea and The Good Return*), U.S.-Ecuador Claims Commission (1862), Opinion of Mr. Haussurek, *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 2729, 2738-2739 (Exhibit RME-1064); The views of Commissioner Haussurek were adopted by the U.S.-Colombia Claims Commission, *ibid*., 2743, and the U.S.-Venezuela Claims Commission (1885), *ibid*., 2743-2751. *See also* TRAVERS TWISS, THE LAW OF NATIONS CONSIDERED AS INDEPENDENT POLITICAL COMMUNITIES (1884), 311 (Exhibit RME-1065): "In ordinary cases indeed, when a merchant ship has been seized on the open seas by the cruizer of a Foreign Power, when such ship was approaching the coasts of that Power with an intention to carry on illicit trade, the Nation, whose mercantile flag has been violated by the seizure, waives in practice its right to redress, those in charge of the offending ships, being considered to have acted with *mala fides* and consequently to have forfeited all just claim to the protection of their Nation."

1463 *See, e.g., Legality of Use of Force (Yugoslavia v. United States)*, Request for the indication of provisional measures, Oral submission of Agent of the United States, Verbatim Record, CR 99/24 (May 11, 1999), 23 ¶ 3.18 (Exhibit RME-1066): "The principle that a party in litigation may not attempt to reap advantages from its own wrong is well established in international law."; *Legality of Use of Force (Yugoslavia v. United Kingdom)*, Request for the indication of provisional measures, Oral submission of Agent of the United Kingdom, Verbatim Record, CR 99/23 (May 11, 1999), 16 ¶ 24 (Exhibit RME-1067): "In weighing up all the equities, the Court would pay attention as to whether the party seeking its assistance came with clean hands. The Court would not, however, allow its process to be used as an engine to assist turpitude. I can see no reason why exactly the same principles should not be applied by this honourable Court. They are deeply rooted in the essential nature of the judicial function. They should be regarded as 'general principles of law' within the meaning of Article 38 of the Statute."; *Legality of Use of Force (Yugoslavia v. Germany)*, Request for the indication of provisional measures, Oral submission of Agent of Germany, Verbatim Record, CR 99/18 (May 11, 1999), 10 ¶ 1.6 (Exhibit RME-1068): "The Federal Republic of Yugoslavia does not come to the Court with 'clean hands'."; *Legality of Use of Force (Yugoslavia v. Portugal)*, Request for the indication of provisional measures, Oral submission of Agent of Portugal, Verbatim Record, CR 99/21 (May 11, 1999), 11 ¶ 3.1.4 (Exhibit RME-1069): "Bearing in mind the 'clean hands' criterion, the request of the Federal Republic of Yugoslavia is not legitimate."; *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Request for an Advisory Opinion, Written Statement of the Government of Israel (Jan. 30, 2004), 114 ¶ 9.4 (Exhibit RME-1070): "It cannot be open to a party to seek a remedy from a court in circumstances in which it has committed the wrong that has brought about the very situation which is under examination. This follows from the principle *nullus commodum capere de sua injura proprio* [*sic*]- no one can be allowed to reap advantage from his own wrong - a principle which is just as pertinent in advisory proceedings which seek to raise for assessment questions which are essentially contentious." [italics in the original]

Case concerning the Gabcíkovo-Nagymaros Project[1464] and endorsed by numerous ICJ judges.[1465]

896. The principle that a party that has engaged in wrongful conduct is deprived of *locus standi* is also recognized in scholarly writings.[1466]

1464 *Case Concerning the Gabcíkovo-Nagymaros Project (Hungary v. Slovakia)*, Judgment (Sept. 25, 1997), 1997 I.C.J. Rep. 7, 76 ¶ 133 (Annex (Merits) C-948).

1465 *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, Judgment on the Merits (June 27, 1984), Dissenting opinion of Judge Schwebel, 1986 I.C.J. Rep. 259, 392, 394 ¶¶ 268, 272 (Exhibit RME-1071): "Nicaragua has not come to Court with clean hands. On the contrary, as the aggressor, indirectly responsible – but ultimately responsible – for large numbers of deaths and widespread destruction in El Salvador apparently much exceeding that which Nicaragua has sustained, Nicaragua's hands are odiously unclean. Nicaragua has compounded its sins by misrepresenting them to the Court. Thus both on the grounds of its unlawful armed intervention in El Salvador, and its deliberately seeking to mislead the Court about the facts of that intervention through false testimony of its Ministers, Nicaragua's claims against the United States should fail […] Its conduct accordingly should have been reason enough for the Court to hold that Nicaragua had deprived itself of the necessary *locus standi* to complain of corresponding illegalities on the part of the United States, especially because, if these were illegalities, they were consequential on or were embarked upon in order to counter Nicaragua's own illegality - 'in short were provoked by it'."; *Case Concerning Arrest Warrant of 11 April 2000 (Democratic Republic of the Congo v. Belgium)*, Judgment (Feb. 14, 2002), Dissenting Opinion of Judge van den Wyngaert, 2002 I.C.J. Rep. 137, 185 ¶ 84 (Exhibit RME-1072): "The Congo did not come to the International Court with clean hands, and its Application should have been rejected." *See also Legal Status of Eastern Greenland (Denmark v. Norway)*, Judgment (Apr. 5, 1933), Dissenting Opinion of Judge Anzilotti, 1933 P.C.I.J. (Ser. A/B) No. 53, 76, 95 (Exhibit RME-1073): "[A]n unlawful act cannot serve as the basis of an action at law."; *Interpretation of Peace Treaties with Bulgaria, Hungary and Romania*, Advisory Opinion (18 July, 1950), Dissenting Opinion of Judge Read, 1950 I.C.J Rep. 231, 244 (Exhibit RME-1074) (stating that where a government which defaulted in the appointment process objects to the competence of a tribunal to be constituted under a treaty "there can be doubt" as to the obligation for such a tribunal "to apply existing international law and refuse to let such a government profit from its own wrong" and equally for the Court to "to apply existing legal principles and recognize that it [this government] was estopped from alleging its own treaty violation in support of its own contention.").

1466 Luis Garcia-Arias, *La doctrine des "clean hands" en droit international public*, 30 Annuaire A.A.A. 14 (1960), 17 (Exhibit RME-1075): "Ces opinions de spécialistes les plus qualifiés de différentes nations prouvent qu'il existe une doctrine cohérente, que nous pouvons synthétiser sous la forme suivante: La personne physique ou juridique étrangère doit avoir eu une conduite correcte envers l'Etat territorial, s'en tenant à ses lois et ne se mêlant pas à ses affaires politiques internes, pour pouvoir se réclamer de la protection diplomatique de son propre Etat. Ou encore sous cette autre forme: Un Etat ne peut pas présenter une réclamation en faveur d'une personne physique ou juridique, qu'il ait le droit de protéger diplomatiquement face à un autre Etat, si cette personne n'a pas observé une conduite correcte envers cet autre Etat." "These opinions of most qualified specialists of different nations prove that there exists a coherent doctrine, which we can synthesize under the following form: The foreign natural or legal person must have had a correct conduct toward the territorial State, following its laws and not interfering with its internal political affairs, in order to be able to claim the diplomatic protection of its own State. Or also under this other form: A State cannot present a claim in favor of a natural or legal person, which it might have the right to protect diplomatically

897. In the context of the ECT, a claimant who has unclean hands in relation to its investment, including a claimant who makes, controls, or conducts an illegal investment, may not invoke the protections in Part III, including the host State's consent to arbitrate.

898. In accordance with the basic rule of treaty interpretation codified in Article 31(1) of the Vienna Convention on the Law of Treaties, the ECT must be interpreted "*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*."[1467] The object and purpose of the ECT does not include promotion and protection of illegal investments. On the contrary, as stated in the introductory note to the ECT:

> "The fundamental aim of the Energy Charter Treaty is to strengthen the rule of law on energy issues."

899. Accordingly, as held by the tribunal in *Plama v. Bulgaria*, "*the ECT should be interpreted in a manner consistent with the aim of encouraging respect for the rule of law*."[1468]

900. It follows that the host State's consent to arbitrate in Article 26(3) ECT must be deemed to offer access to international arbitration only to investors who abide by their reciprocal obligation to make and perform the investment in a legal manner. As stated in *Phoenix v. Czech Republic*:

> "In the Tribunal's view, States cannot be deemed to offer access to the ICSID dispute settlement mechanism to investments made in violation of their laws. If a State, for example, restricts foreign

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against another State, if this person did not observe a correct conduct towards that other State." [unofficial translation]; Richard Kreindler, Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine, *in* BETWEEN EAST AND WEST: ESSAYS IN HONOUR OF ULF FRANKE (Kaj Hobér, Annette Magnusson and Marie Öhrström, eds. 2010), 317-318 (Exhibit RME-1055); DAVID RUZIÉ, DROIT INTERNATIONAL PUBLIC (19th ed. 2008), 103 (Exhibit RME-1076); Stephen M. Schwebel, Clean Hands in the Court, *in* THE WORLD BANK, INTERNATIONAL FINANCIAL INSTITUTIONS, AND THE DEVELOPMENT OF INTERNATIONAL LAW (E. Brown Weiss et al. eds. 1999), 74 (Exhibit RME-1077).

1467 Vienna Convention on the Law of Treaties (May 23, 1969), 1155 U.N.T.S. 331 (Exhibit RME-983).

1468 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID ARB/03/24, Award (Aug. 27, 2008), ¶ 139 (Annex (Merits) C-994).

> investment in a sector of its economy and a foreign investor disregards such restriction, the investment concerned cannot be protected under the ICSID/BIT system. These are illegal investments according to the national law of the host State and cannot be protected through an ICSID arbitral process. And it is the Tribunal's view that this condition – the conformity of the establishment of the investment with the national laws – is implicit even when not expressly stated in the relevant BIT."[1469]

901. Investment treaty tribunals have emphasized the importance of the legal maxims *ex injuria jus non oritur* or *ex dolo malo non oritur actio* that underlie the principle of unclean hands in determining whether the host State has consented to arbitrate a dispute. For example, the tribunal in *Inceysa v. El Salvador* held:

> "[T]here are various maxims that clearly apply to the present case:
>
> a) '*Ex dolo malo non oritur actio*' (an action does not arise from fraud).
>
> b) '*Malitiis nos est indulgendum*' (there must be no indulgence for malicious conduct).
>
> c) '*Dolos suus neminem relevat*' (no one is exonerated from his own fraud).

1469 *Phoenix Action Ltd v. The Czech Republic*, ICSID ARB/06/5, Award (Apr. 15, 2009), ¶ 101 (Exhibit RME-1078). *See also Gustaf F W Hamester GmbH & Co KG v. Republic of Ghana*, ICSID ARB/07/24, Award (June 18, 2010), ¶ 123 (Exhibit RME-1079); Richard Kreindler, Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine, *in* BETWEEN EAST AND WEST: ESSAYS IN HONOUR OF ULF FRANKE (Kaj Hobér, Annette Magnusson and Marie Öhrström, eds. 2010), 313 (Exhibit RME-1055): "It should follow from the context, object, and purpose of the ECT and the ICSID Convention that only legal investments will enjoy protection under these treaties."; Rahim Moloo and Alex Khachaturian, *The Compliance with the Law Requirement in International Investment Law*, SSRN Paper (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1683523), 11-12 (Exhibit RME-1080); Carolyn B. Lamm, Hansel T. Pham, Rahim Moloo, Fraud and Corruption in International Arbitration, *in* LIBER AMICORUM BERNARDO CREMADES (M.A. Fernandez-Ballesteros and David Arias eds. 2010), 720 (Exhibit RME-1081): "The consent of a host-State to resolve disputes with investors is governed by certain overarching principles, including transnational public policy. Transnational public policy is relevant to the interpretation of a host-State's consent to arbitrate a dispute by way of the Vienna Convention on the Law of Treaties."; Bernardo Cremades, Corruption and Investment Arbitration, *in* GLOBAL REFLECTIONS ON INTERNATIONAL LAW, COMMERCE AND DISPUTE RESOLUTION: LIBER AMICORUM IN HONOUR OF ROBERT BRINER (Gerald Asken *et al.* eds. 2005), 215 (Exhibit RME-1082): "Where the investor has acted corruptly, the right to arbitrate can be treated in exactly the same manner as the other substantive treaty rights, *i.e.* the investor lacks clean hands and is estopped from claiming the benefit of the right to arbitration."

d) '*In universum autum haec in ea re regula sequenda est, ut dolos omnimodo puniatur*' (in general, the rule must be that fraud shall be always punished).

e) '*Unusquique doli sui poenam sufferat*' (each person must bear the penalty for his fraud).

f) '*Nemini dolos suusprodesse debet*' (nobody must profit from his own fraud).

All of the legal maxims indicated above are based on justice and have been created on the basis of decisions in concrete cases.

Applying the first principle indicated above to the case at hand, we can affirm that the foreign investor cannot seek to benefit from an investment effectuated by means of one or several illegal acts and, consequently, enjoy the protection granted by the host State, such as access to international arbitration to resolve disputes, because it is evident that its act had a fraudulent origin and, as provided by the legal maxim, 'nobody can benefit from his own fraud.'"[1470]

902. The *Inceysa* tribunal emphasized that "[i]*t is not possible to recognize the existence of rights arising from illegal acts, because it would violate the respect for the law which, as already indicated, is a principle of international public policy*."[1471]

903. Similarly, the tribunal in *Hamester v. Ghana* held:

"An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or deceitful conduct; or if its creation itself constitutes a misuse of the system of international investment protection under the ICSID Convention. It will also not be protected if it is made in violation of the host State's law (as elaborated, *e.g.* by the tribunal in *Phoenix*)."[1472]

904. Thus, interpreted in accordance with the principle of good faith, as it must be,[1473] Article 26(3) ECT cannot be deemed to offer arbitration to an investor who has "*unclean hands*" in relation to the investment.

1470 *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID ARB/03/26, Award (Aug. 2, 2006), ¶¶ 240-242 (Exhibit RME-1083). [emphasis added]

1471 *Ibid.*, ¶ 249.

1472 *Gustaf F W Hamester GmbH & Co. KG v. Republic of Ghana*, ICSID ARB/07/24, Award (June 18, 2010), ¶ 123 (Exhibit RME-1079).

1473 *See, e.g.*, *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID ARB/03/26, Award (Aug. 2, 2006), ¶¶ 230, 233 (Exhibit RME-1083): "Good faith is a supreme principle, which governs

905. If a claimant were nevertheless allowed to rely on the host State's consent to arbitrate, the illegality attributable to the claimant and its investment would render the claim inadmissible:

> "To the extent that a tribunal finds that a claimant is permitted to rely on the consent to arbitration provided in an investment treaty, a claimant that has unclean hands in relation to its investment may not seek the protection of substantive legal rights contained in the applicable investment treaty. International legal scholars have long explained that, 'A Party who asks for redress must present himself with clean hands.' Under this principle, if an investor is shown to have engaged in significant misconduct directly related to its investment, it should not be able to pursue its claim."[1474]

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legal relations in all of their aspects and content.[…] This implicit confidence that should exist in any legal relation is based on the good faith with which the parties must act when entering into the legal relation, and which is imposed as a generally accepted rule or standard. Asserting the contrary would imply supposing that the commitment was assumed to be breached, which is an assertion obviously contrary to the maxim *Pacta Sunt Servanda*, unanimously accepted in legal systems." [emphasis added]; *Phoenix Action Ltd. v. Czech Republic*, ICSID ARB/06/5, Award (Apr. 15, 2009), ¶¶ 109, 113 (Exhibit RME-1078): "The Washington Convention as well as the BIT have to be construed with due regard to the international principle of good faith. The principle of good faith is also recognized in most, if not all, domestic legal systems. […] In the instant case, no question of violation of a national principle of good faith or of international public policy related with corruption or deceitful conduct is at stake. The Tribunal is concerned here with *the international principle of good faith as applied to the international arbitration mechanism of ICSID*. The Tribunal has to prevent an abuse of the system of international investment protection under the ICSID Convention, in ensuring that only investments that are made in compliance with the international principle of good faith and do not attempt to misuse the system are protected." [italics in original]; *Cementownia 'Nowa Huta' SA v. Republic of Turkey*, ICSID ARB(AF)/06/2, Award (Sept. 17, 2009), ¶¶ 153-157 (Exhibit RME-1084). *See also Europe Cement Investment & Trade SA v. Republic of Turkey*, ICSID ARB(AF)/07/2, Award (Aug. 13, 2009), ¶¶ 171-175 (Exhibit RME-1085).

1474 Carolyn B. Lamm, Hansel T. Pham, Rahim Moloo, Fraud and Corruption in International Arbitration, *in* LIBER AMICORUM BERNARDO CREMADES (M.A. Fernandez-Ballesteros and David Arias eds. 2010), 723 (Exhibit RME-1081). *See also*, *ibid.*, 727: "Breaches of transnational public policy may also prevent the admissibility of any claim that relates to an investment that involved fraud and corruption by the investor. […] [A]llowing claimants who have engaged in fraud or corruption in relation to their investment to rely on substantive legal rights to protect that investment would undermine the legal process." *See also* Rahim Moloo, Alex Khachaturian, *The Compliance with the Law Requirement in International Investment Law*, SSRN Paper (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1683523) 28 (Exhibit RME-1080): "Indeed, as cases have rightly articulated, there is a substantive obligation to have made one's investment in accordance with the law. In its administration of justice, an arbitral tribunal should not lend its support to a claimant whose claims arise from an investment which was not legally made under the law of the host-State or international law."

906. Thus, even if a host State commits an expropriation or fails to provide fair and equitable treatment, claims based on Articles 13 or 10 ECT are inadmissible where a claimant has "*unclean hands*" in relation to its investment:

> "Illegal investments are not protected by the ECT. Therefore, even if an arbitral tribunal were to find that a respondent committed an expropriation, such expropriation might not constitute an actionable breach of Article 13 ECT. The illegality attributable to the claimant and its investment could render a claim for ECT protection inadmissible. Where the respondent failed to provide fair and equitable treatment in breach of Article 10 ECT, the same consequence could still follow."[1475]

907. Applying these established principles of law regarding "*unclean hands*" to Claimants' claims here, the illegal acts and bad faith conduct that stain both the making and the performance of Claimants' investments in Yukos preclude Claimants from seeking relief under the Treaty, as they must not profit from their own wrongdoing.

908. As set forth in the Statement of Facts, Claimants are mere shell companies controlled by a handful of Russian Oligarchs through a complex and obscure structure of holding companies and trusts. The Oligarchs created Claimants as part of a vast network of sham Russian and offshore entities designed for the purposes of numerous illegal activities, including: (i) obscuring the Oligarchs' role in the acquisition, ownership, and management of Yukos, in order to avoid pertinent legal restrictions and hide illegalities they perpetrated in the process of acquiring Yukos; (ii) once they acquired control over Yukos, the diversion of revenues, profits, and assets from Yukos and its production subsidiaries and their minority shareholders; (iii) the seclusion of property the Oligarchs unlawfully acquired; (iv) the abuse of fundamental principles of corporate governance and other corporate law to the detriment of the minority shareholders and Yukos' creditors; (iv) rampant and fraudulent tax evasion, in violation of Russian tax law and perverting and misapplying international tax law as embodied in the Russia-Cyprus Tax Treaty; (v) and ultimately frustrating

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1475 Richard Kreindler, Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine, *in* BETWEEN EAST AND WEST: ESSAYS IN HONOUR OF ULF FRANKE (Kaj Hobér, Annette Magnusson and Marie Öhrström, eds. 2010), 326 (Exhibit RME-1055).

the enforcement and collection of evaded taxes, while at the same time continuing to divert assets for the Oligarchs' continued self-enrichment, at the expense of Yukos' creditors, including financial institutions around the globe, and the Russian Treasury.

909. Claimants are both the perpetrators of illegal acts directly -- for example, in connection with their fraudulent, and indeed criminal, abuse and baseless reliance upon the Russia-Cyprus Tax Treaty to evade Russian taxes, and Hulley's related evasion of Russian corporate income taxes arising from its transactions in Yukos stock -- as well as essential instrumentalities of illegal acts, through Claimants' control over Yukos and its management, that allowed the Oligarchs' global network of fraud and deception to function and yield enormous profits to them over the years. Claimants now seek even greater benefits from investments they and their cohorts have effectuated and managed, and from which they have benefited through this unrelenting history of illegality and bad faith, a result that Claimants' "*unclean hands*" does not permit.

1. The Fraudulent Acquisition Of Yukos

910. Claimants are nothing but, as they admit, shell companies, whose *raison d'être* is to nominally possess the Yukos shares that constitute the subject matter of these proceedings, investments that trace back to and were the product of bad faith, fraud and illegal acts. As shown above, and in Professor Kraakman's expert report, the Oligarchs first acquired their controlling interest in Yukos through fraudulent and illegal conduct during the loans-for-shares program in 1995 and 1996. If not for these illegal acts, Claimants -- mere instrumentalities of the Oligarchs -- would never have acquired the investments from which they now wish to profit further.[1476]

911. The loans-for-shares program was intended to raise funds for the Russian Government through transparent and competitive auctions, which would provide the winner the right to hold and manage shares of major State-owned companies as collateral for loans to the Government. If the Government

1476 *See* Section ¶¶ 18-43 *supra*; Kraakman Report ¶¶ 14-27.

could later not pay back the loans, the lender was to sell the shares to the highest bidder and provide the Government with 70% of the difference between the sale price and the amount of the original loan. However, as shown above and in Professor Kraakman's report, the Oligarchs' Bank Menatep, which was appointed to organize the initial loans-for-shares auction for 45% of Yukos' stock, as well as a simultaneous investment tender for another 33%, willfully violated the laws requiring transparency and competitiveness.[1477]

912. Ignoring the rules mandating a fair process, Mr. Khodorkovsky and his associates then did everything in their power to rig the outcome, including (i) conspiring with Yukos' pre-existing managers and agreeing to pay them enormous compensation to facilitate the unlawful acquisition of Yukos, (ii) colluding with other commercial banks to divide up assets before the auctions, (iii) taking both public and secret steps to intimidate and dissuade potential competitors, (iv) creating shell companies to feign competition, (v) abusing Bank Menatep's position as organizer to ensure that its proxy won both the loans-for-shares auction and the investment tender, and (vi) exploiting Yukos' and the Government's own resources to fund the proxy's winning bids.[1478]

913. When the Government could not pay back the loan one year later, Menatep again acted in bad faith and in violation of its duties as auction manager by rigging the auction for the shares serving as collateral and depriving the Russian Government of revenue it would have received had there been a transparent and competitive sale. This significant misconduct led to Menatep and the controlling oligarchs securing a controlling stake in Yukos, an investment born of illegality. That the roots of Claimants' investments lie in violations of the law and disdain for principles of good faith should alone deprive this Tribunal of jurisdiction over Claimants' claims, render these claims inadmissible, and otherwise prohibit Claimants' attempt to benefit from these investments.

1477 *See* Section 21-30 *supra*; Kraakman Report ¶¶ 18-24.

1478 *Ibid.*

2. The Fraudulent Consolidation Of Ownership And Control Of Yukos

914. Yet even after the Oligarchs' initial unlawful and bad faith acquisition of Yukos, illegality and bad faith continued to define the process by which they consolidated their control over Yukos and ultimately established Claimants as vehicles for the investments at issue here, and from which the Oligarchs would benefit through continuing and evolving fraud and other misconduct.

915. At least matching their disregard for rules that were meant to protect the legitimacy and fairness of the loans-for-shares privatization process, the Oligarchs abused Russian corporate law and principles of corporate governance. As shown above and in Professor Kraakman's report, they used their network of shell companies, of which Claimants are a part, to skim money from Yukos and its production subsidiaries and engage in rampant tax fraud. Instead of maximizing the value of the subsidiaries, which would have led to a distribution of wealth that included the subsidiaries' minority shareholders, the Oligarchs embarked on an audacious plan to squeeze out the minority shareholders through massive share dilutions, transfer pricing, and asset stripping.[1479]

916. To ensure the success of this plan, the Oligarchs brazenly manipulated shareholder meetings, obstructed the work of Russia's Federal Securities Commission, relied on fraudulent valuations of oil and stock, and hid from shareholders and authorities alike their control over the sham companies that were to assume control over the subsidiaries once the unlawful plan came to fruition. Ultimately, as the Oligarchs showed no signs of wavering in their determination to destroy all minority shareholder value in the subsidiaries, the minority shareholders sold or swapped their shares on the Oligarchs' terms.[1480]

1479 *See* ¶¶ 46-49 *supra*; Kraakman Report ¶¶ 28-42.

1480 *See* ¶¶ 51-61 *supra*; Kraakman Report ¶¶ 44-62.

917. Western creditors who had accepted Yukos shares as collateral for loans to Menatep were subjected to similar abuse when Menatep defaulted on those loans. Menatep risked facing questions about its web of illicit offshore entities from these new, powerful minority shareholders in Yukos itself.[1481] To protect its ongoing illegal conduct and its control over Yukos' activities, Menatep turned Yukos into an empty shell by transferring shares in the production subsidiaries -- its most valuable assets -- to offshore companies secretly controlled by the Oligarchs.[1482] Yukos also failed to file required disclosures with the Federal Securities Commission, which led to the delisting and devaluation of its shares. Using these tactics, the Oligarchs were able to force out potentially troublesome non-Russian creditors-turned-minority shareholders, and secretly buy back Yukos shares at fraudulently low prices.[1483]

918. This consolidation of Menatep's Yukos shares in Claimants would not have been possible if not for the bad faith, deception, and illegality with which the Oligarchs treated minority shareholders and creditors. Claimants cannot be permitted to continue to profit from this misconduct.

3. Claimants' Perversion And Baseless Reliance Upon The 1998 Russia-Cyprus Tax Treaty, Violating Russian And Cypriot Criminal Laws To Evade Russian Taxes

919. The manner in which the Oligarchs acquired, protected, and exploited the investments at issue in these proceedings is no less rife with illegal conduct and bad faith than the means by which Claimants came to hold these investments. While unlawfully consolidating their control over Yukos, the Oligarchs used scores of Russian and offshore shell companies, including Claimants, both to disguise past misconduct and to implement new illegal schemes.[1484] Tax evasion was the purpose of many of these schemes, which involved abuses not only of Russia's low-tax regions, but also of other jurisdictions' tax regimes. This illegal conduct continued unabated into the

1481 *See* ¶ 50 *supra*; Kraakman Report ¶¶ 63-68.

1482 *See* ¶¶ 71-75 *supra*; Kraakman Report ¶¶ 63-68.

1483 *See* ¶¶ 74-75 *supra*; Kraakman Report ¶¶ 63-68.

1484 *See* ¶¶ 81-95, 112-117, 166-203, 271-277 *supra*.

Twenty-First Century, even after Mr. Khodorkovsky and Yukos purported to embrace transparency and respect for the law.

920. As just one example, until at least 2003 Claimants and their parent company, GML, exploited the investments at issue here in order to pervert the Russia-Cyprus Tax Treaty and to claim benefits under that Treaty to which they were not entitled. As shown above and in the expert reports of Professor Rosenbloom and Professor Lys, Claimants fraudulently abused the Treaty to deprive the Russian Government of hundreds of millions of dollars in taxes and to claim the benefits of reduced taxation in Russia by falsely representing to Cypriot and Russian authorities that Claimants met the requirements for invoking the Treaty, though they did not, thereby also violating Russian and Cypriot criminal law.[1485]

921. As shown above, the Russia-Cyprus Tax Treaty allows genuine Cypriot businesses to avoid the double taxation of their Russian-sourced income. But as is inherent in the purpose of this and other treaties designed to foster international trade by avoiding double taxation, a Cypriot company claiming benefits under the Treaty (i) must be the beneficial owner of the income for which it claims Treaty benefits, and (ii) must not have a permanent establishment in Russia to which that income is attributable.[1486] But instead, completely perverting the Treaty and exploiting it for self-enriching purposes for which it was not intended, and despite not complying with either of two core requirements for invoking the Treaty's benefits even if they were exploiting it for its intended purpose, Claimants Hulley and VPL -- shell companies controlled from Russia and existing for the benefit of the Russian Oligarchs -- fraudulently claimed that Russian income worth billions of dollars, generated by the investments that are the subject of these Arbitrations, was eligible for favorable treatment under the Treaty.[1487]

1485 *See* ¶¶ 209-224 *supra*.

1486 *See* ¶¶ 154-163 *supra*; Rosenbloom Report ¶ 90-92, 117-134.

1487 *See* ¶¶ 154-199 *supra*; Rosenbloom Report ¶¶ 109-134.

922. First, as shown above and in the Rosenbloom report, Claimants exploited the Russia-Cyprus Tax Treaty not for its intended purpose of promoting international trade by removing "*obstacles that double taxation presents to the development of economic relations between countries*," but rather they perverted the Treaty to avoid payment of Russian taxes on income in the form of dividends paid on Yukos shares, despite the fact that this income "*derived from economic activities occurring solely in Russia and only Russian nationals and residents enjoyed the economic benefit of that income*." As Professor Rosenbloom states, Claimants and the Oligarchs who control them abused the Treaty to create the appearance of double taxation by "*using artificial Cypriot entities in a structure geared exclusively to Russian income of Russian persons*."[1488]

923. Second, as also shown above and in the Rosenbloom report, even if Claimants were relying on the Treaty for a proper purpose, they did not satisfy the requirements for gaining favorable tax treatment under the Treaty because they were not the beneficial owners of the Russian dividend income for which they claimed Treaty benefits, and all of that income was attributable to Claimants' Russian permanent establishment.[1489]

924. And as shown above and in the Lys report, Claimants were far from subtle in designing and then implementing the ludicrous subterfuges by which they attempted to foster the fiction that they were the beneficial owners of this income, by funneling Yukos shares to Hulley, VPL, and other Cypriot entities owned and controlled by the Oligarchs through hundreds of completely contrived transactions involving the back-and-forth sale and repurchase of the shares before and after the dates as of which dividends were declared, at times in multiple transactions on the same or consecutive days, at artificially set prices.[1490]

925. The sole purpose of these sham transactions was to allow YUL's Cyprus affiliates, including Hulley and VPL, to claim Russia-Cyprus Tax Treaty benefits on dividends paid by Yukos with respect to the shares purportedly sold

1488 *See* Rosenbloom Report ¶ 89.

1489 *See*, *e.g.*, ¶¶ 173-199 *supra*; Rosenbloom Report ¶¶ 109-133.

1490 *See* ¶¶ 177-189 *supra*; Lys Report, ¶¶ 43-87.

to the Cypriot affiliates. As just one example of these shams -- which also expose as a blatant lie Claimants' assertions that the Oligarchs were devoted to transparent and lawful corporate conduct in the new millennium -- Hulley purchased over 74 million Yukos shares from YUL on November 11, 2002, dividends were payable to shareholders as of November 15, 2002, and YUL repurchased all of those shares on November 22, 2002.[1491] Thereafter, Hulley claimed that it was the Cypriot beneficial owner of this dividend income and therefore was entitled to pay only reduced withholding taxes on that income under the Russia-Cyprus Tax Treaty. The only "transparency" this misconduct evidences is the transparency of its bad faith and illegality.

926. As shown above, Claimants' abuse of the Treaty and their false invocation of its benefits resulted in massive losses for the Russian treasury, in excess of US$ 245 million, not including interest and fines.[1492]

927. But that is not all. As shown above and in the expert report of Polyvios Polyviou, a leading expert in Cypriot law, by representing to Cypriot and Russian tax authorities that they qualified for benefits under the Russia-Cyprus Tax Treaty and by causing the filing of those representations for the purpose of evading Russian taxes, Claimants and the directors and officers they installed to manage their investment violated both Russian and Cypriot criminal laws.[1493]

928. In sum, Claimants' investments are a product and the instruments of widespread and unrelenting bad faith, fraud, deception and illegality. In pursuing their claims here, Claimants are attempting to profit from this unlawful activity and blatant disregard for their obligation to conduct their investment in accordance with the law, seeking a mindboggling sum of money for individuals already made enormously wealthy by their past misconduct. The doctrine of

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1491 *See* ¶ 179(v) *supra*.

1492 *See* ¶¶ 200-203.

1493 *See* ¶¶ 209-224 *supra*; Polyviou Report, ¶¶ 8-18.

"*unclean hands*" ensures that the system of international investment protection, established here by the ECT, cannot be relied upon to reward such behavior.

4. Claimants' Unlawful Evasion Of Russian Taxes On Proceeds Of Transactions Involving Yukos' Shares

929. In addition to Claimants' abuses of the Russia-Cyprus Tax Treaty, Claimant Hulley evaded hundreds of millions of dollars in Russian taxes on proceeds of transactions involving Yukos shares.[1494]

930. As explained in the expert report of Oleg Konnov, a leading expert in Russian tax law, non-Russian entities are subject to Russian corporate income taxes with respect to income attributable to their Russian permanent establishment.[1495]

931. As shown above, Hulley had a permanent establishment in Russia to which the income relating to its Yukos shares was attributable.[1496]

932. It is clear from the record of these Arbitrations that in 2003 Hulley earned profits from securities transactions involving Yukos shares in excess of US$ 2.9 billion. Although these profits were attributable to the Russian permanent establishment of Hulley, Hulley never reported these profits as Russian taxable income, thereby evading Russian corporate income taxes in excess of US$ 690 million.[1497]

5. Yukos' "Tax Optimization" Scheme

933. Throughout the period in which Yukos' illegal Russian "tax optimization" scheme was in effect, Claimants owned a majority of Yukos shares and appointed the totality of the members of its board of directors, including the company's Chief Executive Officer, Mikhail Khodorkovsky.[1498]

1494 *See* ¶¶ 204-208 *supra*.

1495 *See* Konnov Report, ¶¶ 29-30.

1496 *See* ¶¶ 191-199 *supra;* Rosenbloom Report, ¶¶ 117-123, 126-132.

1497 *See* ¶ 208 *supra*.

1498 Annual General Meeting of Yukos (June 24, 2004) (Exhibit RME-714).

934. Thus, in addition to bearing full responsibility for their own direct evasion of taxes on the Yukos dividends they received and their transactions in Yukos shares, Claimants also bear full responsibility for the engineering of Yukos' "tax optimization" scheme, which resulted—year after year—in the evasion of hundreds of billions of rubles in Russian taxes,[1499] as well as in a myriad of other related illegal actions and subterfuges aimed at concealing from Russian authorities the magnitude of the tax abuses that have been perpetrated through that scheme.[1500]

6. Yukos' Asset-Stripping Measures And Failure To Pay Its Tax Debts

935. Likewise, Claimants bear full responsibility for the devastating consequences that Yukos was forced to suffer when -- following the handing down of the December 29, 2003 tax audit report[1501] -- Yukos' management irresponsibly decided upon and repeatedly pursued ill-advised and self-injurious measures to avoid paying or mitigating the company's tax liabilities and fines,[1502] resolving instead not only to pursue a series of baseless legal challenges, but also to pay out the largest dividend in Yukos' corporate history, literally a giga-dividend, yielding Claimants at least US$ 1.4 billion,[1503] thereby siphoning off from Yukos as much money as possible, as quickly as possible,[1504] while at the same time advancing the fiction that Yukos did not have the financial resources to pay its overdue taxes.[1505]

936. This deliberate dissipation of the assets of a company that was delinquent on its tax debts is an unlawful act and would constitute a violation of the criminal laws of most countries, including Russia.[1506]

1499 *See*, *e.g.*, ¶¶ 225-277 *supra*.

1500 *See*, *e.g.*, ¶¶ 237-277 *supra*.

1501 *See* ¶¶ 356-360 *supra*.

1502 *See* ¶¶ 366-372, 381-386 *supra*.

1503 *See* Lys Report, Exhibit 19.

1504 *See* ¶¶ 349-352 *supra*.

1505 *See* ¶¶ 381-394 *supra*.

1506 *See*, *e.g.*, ¶¶ 537 *supra*.

937. Indeed, soon thereafter (on April 16, 2004, and again on June 30, 2004), Yukos failed to pay its 2000 tax assessment (issued on April 14, 2004), despite the fact that it had been on notice of its obligation to pay since December 29, 2003 and that it had ample and unrestricted resources to discharge this debt.[1507] As shown above, Yukos' management -- acting at the Oligarchs' and Claimants' behest -- made a conscious decision to defy the authorities' demand for Yukos to pay its overdue tax bill, in gross violation of Russian law, while falsely claiming that that default was due to the April Injunction.[1508]

938. While Yukos remained delinquent on its tax debts, and refused to pay these debts, management deliberately diverted corporate assets in favor of Oligarch-controlled Moravel. Thus, in May 2004, Yukos caused YNG to issue a guarantee in the amount of up to US$ 3 billion for "repayment" of "debts" that Yukos had allegedly incurred vis-à-vis Moravel.[1509] No legitimate business purpose has ever been alleged for this maneuver, which entailed the pledge of the credit of YNG in favor of only the Oligarchs, to the exclusion of Yukos' other shareholders and creditors, under conditions which provided no corresponding benefits to YNG.

939. Moreover, in May and June 2004, Yukos made spontaneous "pre-payments" to Moravel in the amount of US$ 225 million, voluntarily accelerating the relevant loan repayment schedule.[1510] This transaction cheated not only the Russian treasury, but also Yukos' other shareholders and creditors.

940. In spite of all of that unrelenting misconduct, and in spite of the commencement of the tax audit report for the year 2001 (March 23, 2004) and the Arbitrazh Court's upholding the Tax Ministry's 2000 tax assessment (May 26, 2004), on June 24, 2004 Claimants unanimously re-appointed as board members the same individuals whom Claimants had appointed for the previous years,

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1507 *See* ¶¶ 374-376, 381-382 *supra*.

1508 *See* ¶¶ 393-394 *supra*.

1509 *See* ¶¶ 391, 486 *supra*.

1510 *See* ¶ 390 *supra*.

with the exception of those who in the meantime had been arrested or left Russia to avoid prosecution.[1511]

7. Yukos' Tainted Settlement Offers

941. Furthermore, while Yukos was under the management of those same directors installed by Claimants, it attempted to cheat the Russian authorities by offering, at various stages, as security or partial payment of its 2000 tax debt, Yukos' holdings of Sibneft shares that were already subject to court orders securing third-party claims or whose title was otherwise disputed by third parties. Critically, Yukos, when offering these assets, failed to disclose these encumbrances and disputes.[1512]

8. Yukos' Sabotage Of The YNG Auction

942. Further still, it was under the management of those same directors that Yukos sabotaged the auction of the YNG shares, thwarting the enforcement authorities' efforts to achieve maximum value for those shares, to apply towards reducing Yukos' tax debts.

943. First, starting immediately after the authorities' announcement of their intention to sell YNG in July 2004, Yukos burdened its subsidiary with additional multi-billion dollar liabilities. This further "bleeding" was implemented by stopping payments for the oil YNG delivered to Yukos and Yukos-controlled companies. As a result, YNG's accounts receivables ballooned from US$ 314.5 million as of July 1, 2004 to US$ 2.1 billion as of October 1, 2004, an amount that any bidder would have taken into account when preparing its auction bid.[1513]

944. Second, starting around the same time (July 2004) and all the way to the auction itself (December 19, 2004), the management of Yukos, together with the Oligarchs, mounted an aggressive media campaign, threatening

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1511 Annual General Meeting of Yukos (June 24, 2004) (Exhibit RME-714).

1512 *See* ¶¶ 417-430, 433-434 *supra*.

1513 *See* ¶ 487 *supra*.

potential auction participants with "*a lifetime of litigation*" in Russia and abroad. This campaign achieved its intended goal of effectively discouraging the major oil companies that had expressed an interest in bidding in the YNG auction from actually participating.[1514]

945. Third, on December 14, 2004, five days before the auction, the management of Yukos compounded their litigation threats by causing the company to file a spurious bankruptcy petition in the United States, based on a sham jurisdictional nexus to the United States, which triggered an automatic stay and exposed any successful bidder to the risk of damages actions. The petition was signed by Yukos' Chief Executive Officer, Bruce Misamore.[1515] Yukos' board resolution authorizing that filing was expressly "supported" by GML.[1516] Simultaneously, Yukos also requested and obtained from the U.S. Bankruptcy Court the TRO that enjoined prospective bidders and the banks financing their bids from participating in the auction.[1517]

946. As result of these actions, Yukos' management, acting at the behest of the Oligarchs and Claimants, succeeded in preventing all but one bidder from placing a bid, with predictable dampening consequences on the competitiveness of the auction and the monies gained to apply against Yukos' overdue tax debts.

9. Yukos' Further Asset-Stripping Measures

947. Claimants reinstalled for the subsequent years as stewards of Yukos' affairs the very same directors who had implemented Yukos' "tax-optimization" scheme, had diverted corporate assets to Claimants, had attempted to cheat the authorities with tainted settlement offers and had effectively sabotaged the YNG auction.[1518]

1514 *See* ¶¶ 490-496 *supra*.

1515 *See* ¶¶ 497-506 *supra*.

1516 *See* ¶ 498 *supra*.

1517 *See* ¶¶ 502-504 *supra*.

1518 Annual General Meeting of Yukos (June 24, 2004) (Exhibit RME-714).

948. It was under those directors' management that in April and September 2005 Yukos' non-Russian assets of a value of as much as US$ 8 billion were stripped from Yukos and segregated into two Dutch Stichtings managed by Yukos' senior managers, including witnesses appearing on Claimants' behalf in these proceedings, for the avowed purpose of preventing the satisfaction of:

> "any illegitimate claim, judgment or transaction including but not limited to those resulting from or connected with the tax assessments made against Yukos Oil Company and members of the Group in the Russian Federation on or after the fourteenth day of April two thousand four."[1519]

949. As discussed above, the shielding of those valuable assets in the Stichtings constituted a blatant violation of Russian criminal law,[1520] and had devastating consequences for Yukos, in that it effectively prevented Yukos from discharging its overdue taxes, thereby opening the door to the involuntary bankruptcy of Yukos in Russia.

10. Yukos' Frustration Of The SocGen Syndicate's Collection Efforts

950. On March 31, 2005, Yukos deliberately defaulted on its loan repayment obligations *vis-à-vis* the SocGen syndicate, even though it admittedly had sufficient resources to discharge its debt and had meanwhile continued to make generous voluntary payments to Oligarchs' company Moravel.[1521] Yukos effectively frustrated the SocGen's efforts to collect its claim against Yukos' valuable Dutch assets, by then effectively shielded in the Stichtings, thereby prompting the banks to petition for Yukos' bankruptcy in Russia and its eventual liquidation.[1522]

11. Yukos' Deception Of PwC

951. Finally, in addition to perpetrating the broad array of illegal and bad faith misconduct catalogued above, the Yukos directors and officers

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1519 *See* ¶ 534 *supra*.

1520 *See* ¶¶ 537-538 *supra*.

1521 *See* ¶¶ 551-554, 557-558 *supra*.

1522 *See* ¶¶ 555-556, 559 *supra*.

Claimants installed to manage their investment and the Oligarchs endeavored to hide this misconduct by lying about it to PwC, Yukos' auditors, fraudulently inducing PwC to certify Yukos' financial statements from 1999 to 2002 and to issue unqualified audit opinions for these years based on the utterly false pretenses of Yukos' dishonest representations to PwC.[1523] As was the liars' intent, Yukos' creditors and other members of the public relied on these certifications -- which Yukos procured through its lies -- in doing business with Yukos. And as shown above, Yukos' management's repeated lies to PwC were highly material both to the integrity (or lack thereof) of Yukos' financial statements and, in retrospect, to several aspects of certain of the most extreme illegalities that are at issue in these proceedings, including (i) the Oligarchs' kickbacks to Yukos' prior management to foster the Oligarchs' corrupt acquisition of control over Yukos,[1524] (ii) Yukos' evasion of billions of rubles through its unlawful "tax optimization" scheme,[1525] and (iii) the Oligarchs' financial manipulations and diversion of enormous sums from Yukos to their own pockets through the Jurby Lake Structure.[1526]

952. In light of the foregoing, there can be no question that Claimants' responsibility for such a broad range of illegal and bad faith misconduct as is detailed above in this Counter-Memorial renders Claimants' hands as "*unclean*" as can be, deprives them of the necessary *ius standi* to complain of any illegality of the Russian Federation, and requires the Tribunal to conclude that it lacks jurisdiction over, or Claimants' claims are inadmissible, based upon this misconduct, under the well-settled legal principles and precedents presented above.

953. As noted, the Tribunal should apply the ECT "*with the aim of encouraging respect for the rule of law*."[1527]

1523 *See* ¶¶ 705-706 *supra*.

1524 *See* ¶¶ 36-43 *supra*.

1525 *See*, *e.g.*, ¶¶ 278-302, 356-368 *supra*.

1526 *See* ¶¶ 81-94 *supra*.

1527 *See* ¶ 899.

954. This requires that the Tribunal deny access to arbitrate under the ECT to investors such as Claimants who so thoroughly and brazenly failed to make and perform their investment in a legal manner. At a minimum, the Tribunal should conclude that Claimants' illegality renders their claims inadmissible.

955. In either event, the Tribunal should reject the claims for relief in full.

V. IN ANY EVENT, CLAIMANTS ARE NOT ENTITLED TO TREATY PROTECTION

956. As set forth at ¶¶ 890, and 893 to 906 above, a tribunal lacks jurisdiction over, or a claim of a party who acts illegally with respect to the subject-matter of the dispute is inadmissible, especially if the illegalities complained of were a consequence of claimant's own illegality.

957. Even if Claimants were allowed to invoke the Russian Federation's consent to arbitration in Article 26(3) ECT and their claims were admissible, *quod non*, Claimants still would not be entitled to the substantive protections in Part III ECT.

958. As stated by the tribunal in *Plama v. Bulgaria*:

> "[G]ranting the ECT's protections to Claimant's investment would be contrary to the principle *nemo auditur propriam turpitudinem allegans* invoked above. It would also be contrary to the basic notion of international public policy – that a contract obtained by wrongful means (fraudulent misrepresentation) should not be enforced by a tribunal."[1528]

In determining whether the investment should be granted ECT protection, the Plama tribunal examined the conformity of the investment with the host State's law and "*applicable rules and principles of international law*."[1529] Having found that the claimant's conduct was contrary to the principle of good faith, the tribunal concluded:

> "In consideration of the above and in light of the *ex turpi causa* defence, this Tribunal cannot lend its support to Claimant's request

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1528 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID ARB/03/24, Award (Aug. 27, 2008), ¶ 143 (Annex (Merits) C-994). *See also*, *ibid.*, ¶ 139: "The Arbitral Tribunal concludes that the substantive protections of the ECT cannot apply to investments that are made contrary to law."; *World Duty Free Company Limited v. Republic of Kenya*, ICSID ARB/00/7, Award (Oct. 4, 2006), ¶¶ 138-157 (Exhibit RME-1086) (dismissing the claim based on international/transnational public policy on the ground that the investment contract was obtained by corruption); *Wena Hotels Ltd. v. Egypt*, ICSID ARB/98/4, Award (Dec. 8, 2000), 41 I.L.M. 896 (2002), 917 ¶ 111 (Annex (Merits) C-956) (stating that if the allegations of improper influence with regard to the award of leases were true, they would require dismissal of the claims).

1529 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID ARB/03/24, Award (Aug. 27, 2008), ¶ 140 (Annex (Merits) C-994). [original emphasis omitted]

> and cannot, therefore, grant the substantive protections of the ECT."[1530]

959. Or as stated by Professor Orrego Vicuña:

> "Whether the principle of *ex turpi causa non oritur actio*, the doctrine of unclean hands or the policy of eliminating corruption domestically and internationally are relied upon, the result is that an arbitration tribunal cannot find for a claim that is tainted by such practices."[1531]

960. In particular, a claimant is not entitled to relief where, as here, the conduct complained of is the result of its own illegal conduct or illegal conduct attributable to it:

> "[U]ne demande de réparation formulée par un Etat ne doit pas être admise quand celui qui réclame, que l'on protège, a eu une conduite incorrecte et illégale envers l'Etat accusé et qu'il existe une relation de cause à effet entre cette conduite incorrecte et le dommage dont on fait état pour présenter une réclamation."[1532]

961. Again, there are ample examples from the jurisprudence of mixed claims commissions and arbitral tribunals that have dismissed claims on this basis. For example, in the case of *Frierdich and Company*, the French-Venezuelan Mixed Claims Commission dismissed the claim on the basis of the applicant company's misconduct:

> "Whether or not the action of the customs officers at Guiria and of the fiscal court were in fact regular and necessary is a matter of but

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1530 *Plama Consortium Limited v. Republic of Bulgaria*, ICSID ARB/03/24, Award (Aug. 27, 2008), ¶ 146 (Annex (Merits) C-994).

1531 *Waguih Elie George Siag and Clorinda Vecchi v. Arab Republic of Egypt*, ICSID ARB/05/15, Award (June 1, 2009), Dissenting Opinion of Prof. Orrego Vicuña, 4-5 (Annex (Merits) C-998).

1532 "[A] claim for reparation formulated by a State must not be admitted where the one who claims that he be protected has had an incorrect and illegal conduct towards the accused State and where there is a causal relation between this incorrect conduct and the damage alleged as a ground for presenting the claim." [unofficial translation]. Luis Garcia-Arias, *La doctrine des "clean hands" en droit international public*, 30 Annuaire A.A.A. 14 (1960), 21-22 (Exhibit RME-1075). *See also Case Concerning U.S. Diplomatic and Consular Staff in Tehran (United States of America v. Iran)*, Judgment (May 24, 1980), Dissenting Opinion of Judge Morozov, 1980 I.C.J. Reports 51, 52 ¶ 3 (Exhibit RME-1087): "[By invading Iran and imposing sanctions] the United States of America, according to commonly recognized principles of international law, has now deprived itself of any right to refer to the Treaty of 1955 in its relations with the Islamic Republic of Iran."

slight pecuniary importance to the claimant company, and since it was the primary and potent cause of its own misfortunes in connection with this incident and by its own voluntary misconduct brought these inquiries, vexations, and expenses upon the customs officers and the court at Guiria, it is not in position to scrutinize very closely what the officers or court of Venezuela did or did not do.

Here may be applied with a certain degree of propriety one of the most important maxims of equity, viz, 'He who comes into equity must come with clean hands.'[…]

This claim is dismissed for want of equity in the claimant company […]."[1533]

1533 *Frierdich and Company Case*, France-Venezuela Commission, Opinion of the Umpire (July 31, 1905), 10 U.N.R.I.A.A. 45, 54-55 (Exhibit RME-1088) [emphases added]. *See also Paquet Case (concession)*, Belgium-Venezuela Commission, Opinion of the Umpire (1903), 9 U.N.R.I.A.A. 325, 327 (Exhibit RME-1089) (dismissing a claim for the wrongful revocation of a permission granted to Mr. Paquet to use the waste waters: "Mr Paquet himself has abused the permission which was granted him [and that] appears to him (the umpire) to be of sufficient weight to justify its revocation, and it is this fact alone that prevents him from allowing the claim."); *Mary Biencourt v. Mexico*, U.S.-Mexico Mixed Claims Commission, Opinion of the Commissioners, *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 2818, 2819 (Exhibit RME-1090) (in which commissioners concurred on the dismissal of a claim for the value of goods seized and confiscated by Mexican authorities because "the claimant and her husband while domiciled within the territory and military lines of the Republic of Mexico, without license, engaged in unlawful intercourse and illicit trade with the enemy."); *Ben Tillett Case (Belgium v. Great Britain)* (1898), 6 R.G.D.I.P. 46 (1899) (Exhibit RME-1091) (dismissing the United Kingdom's claim on behalf of a British citizen deported from Belgium for disorderly conduct); *Case of Louis Brand*, Peruvian Claims Commission, Award (Nov. 27, 1863), *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 2 (John Bassett Moore, ed. 1898) 1625, 1626 (Exhibit RME-1092) (disallowing the claim of an individual who opposed Peruvian legal forces "who simply maintained their rights when they were assailed by force of arms."); *Charles Heidsieck v. United States*, No. 691, U.S.-France Claims Commission, Majority Opinion (Mar. 26, 1884), *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 4 (John Bassett Moore, ed. 1898) 3313, 3316 (Exhibit RME-1093) (disallowing the claim on the ground that the United States "had good cause for arresting the claimant, and that it was his own fault that his imprisonment was prolonged beyond fifteen days" following his refusal of the American authorities to leave the country in exchange for his liberty); *James Selkirk v. Mexico*, U.S.-Mexico Mixed Claims Commission, Opinion of the Umpire (Apr. 10, 1872), *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 3130, 3131 (Exhibit RME-1094): "The umpire willingly adopts the view which the Mexican court seems to have taken [that until payment of a fine for having entered a port without a special permit, Selkirk's vessel would remain attached] and ascribes the irregular conduct of claimant to a serious want of judgment, or his unfitness, in an intellectual point of view for the part he had assumed as captain or master of his own vessel in foreign ports where the Spanish language is spoken, but neither equity nor justice permits us to allow his claim. He might himself have easily avoided the difficulty."

962. Similarly as set forth at ¶ 1103 below, the French-German Mixed Arbitral Tribunal dismissed several compensation claims based on Article 297(e) of the Versailles Treaty where the claimant was deprived of his property as a result of his violation of applicable German law.

963. Finally, the mere imprudent conduct of claimants or their agents that is attributable to the claimants has been found sufficient by investment tribunals and mixed claims commissions alike to reject their claims on the merits.[1534]

[1534] *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 17 ICSID Rev. 395 (2002), 83 ¶ 345 (Exhibit RME-1095) (in which the tribunal rejected the claimants' claim of breach of the fair and equitable treatment standard for the purchase of the Koidu branch because: "First, there is no legal basis for the demand that the Bank of Estonia compensate EIB for its losses arising from the Koidu branch purchase. […] [T]he officers of EIB [the claimants' investment] who conducted the negotiations regarding the purchase of the branch clearly acted unprofessionally and, indeed, carelessly. A credit portfolio cannot be checked on the spot in a few hours; the buyers should have known that Social Bank was on the verge of bankruptcy and should thus have taken extra precautions, such as insisting on warranties relating to the quality of the assets. The responsibility for the result of EIB's conduct, including its omissions, is EIB's alone."); *Eudoro Armando Olguín v. Republic of Paraguay*, ICSID ARB/98/5, Award (July 26, 2001), 18 ICSID Rev. 169 (2003), 188 ¶ 73 (Exhibit RME-1096) (questioning the possibility for the tribunal to find Paraguay liable even if it had the obligation that the claimant alleged it had because "Claimant contributed significantly, within his own individual circle of action, to the occurrence of the facts that he is also censuring."); *Davis Case,* British Venezuelan Commission, Decision of the Umpire (1903), 9 U.N.R.I.A.A. 460, 463-464 (Exhibit RME-1097): "[T]he umpire holds that it was negligence on the part of the claimant company under all the facts in this case to not forward the bill of lading with the goods to a responsible Venezuelan resident agent, and that this negligence was the real and primary cause of the conditions which followed, and the least that can be said is that this negligence was directly and proximately contributory to the injuries complained of. […] The case, therefore, in justice and equity, should be decide wholly without reference to the actions of the customs-house officer at Guanta, which action, under the circumstances disclosed in this case, could have done the claimant company no harm, and solely with reference to the relations which the claimant company bears to the situation in question. It therefore becomes the duty of the umpire to disallow the claim[…]."; *Weil v. Germany*, French-German Mixed Arbitral Tribunal, Award (July 30, 1926), 6 Recueil des Tribunaux Arbitraux Mixtes Institués par les Traités de Paix 880 (1927), 882 (Exhibit RME-1098): "Attendu que le requérant, qui, sans aucune nécessité, a fait transporter ses marchandises en pays ennemi où elles étaient soumises à l'application des ordonnances contre la spéculation et la cherté de vie, a, par son propre acte, causé le dommage dont il se plaint; Att. que dans ces conditions, il n'est pas en droit, selon la jurisprudence du Tribunal, de réclamer une indemnité; […] Déboute le requérant de sa demande." "Whereas the claimant, who without any necessity, has had its merchandise transported within enemy land where it was subject to the application of ordinances against speculation and expensiveness of life, has, through an act of his own, caused the damage that he complains of; Whereas under these circumstances, he is not entitled, according to the jurisprudence of the Tribunal, to claim indemnification; [...] Dismisses the claimant's claim." [unofficial translation]; *Affaire des biens britanniques au Maroc espagnol (Espagne c/ Royaume-*

964. Here, Claimants are not entitled to the substantive protections in Part III ECT because, as fully set forth in the Statement of Facts and above, Claimants themselves repeatedly and consistently engaged in illegal and bad faith misconduct relating to their holdings in Yukos. The acts that should result in denying Claimants protection under the ECT for this reason include at least the following:

(i) Submitting fraudulent claims under and otherwise abusing the Russia-Cyprus Tax Treaty to evade hundreds of millions of dollars in Russian taxes payable on dividends involving Yukos shares, thereby violating Russian and Cypriot criminal law (*see* ¶¶ 154-224 *supra*);

(ii) Entering into hundreds of sham transactions involving the sale and repurchase of Yukos shares between Claimants and their affiliates, the sole purpose of which was to fraudulently suggest that Claimants beneficially owned dividends declared on Yukos shares, and thereby further Claimants' fraudulent claims for favorable tax treatment under the Russia-Cyprus Tax Treaty (*see* ¶¶ 115, 176-189 *supra*); and

(iii) Evading hundreds of millions of dollars in Russian taxes on profits from transactions and profits from sales of securities involving Yukos shares (*see* ¶¶ 204-208 *supra*).

965. Nor are Claimants entitled to the substantive protections in Part III ECT because, as fully set forth in the Statement of Facts and above, the conduct about which Claimants complain is the by-product of the repeated and consistent illegal and bad faith misconduct perpetrated by the directors and officers of

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Uni), Réclamation No. 27 (May 1, 1925), 2 U.N.R.I.A.A. 615, 698-699 (Exhibit RME-1099) (dismissing claim of English claimants who had negligently waited to inform the police of a theft and were now complaining about the Moroccan authorities' failure to prosecute the thieves); *Casimir Maurin (France) v. United Mexican States*, France-Mexico Commission, Decision No. 49 (June 18, 1929), 5 U.N.R.I.A.A. 545, 546 (Exhibit RME-1100) (dismissing the claim of victim's brother *inter alia* because victim could have saved his life by following a route not under fire from the troops).

Yukos whom Claimants installed to manage their investment and which therefore is attributable to Claimants. These include at least the following:

(i) Engineering the Yukos tax evasion scheme to evade hundreds of billions of rubles in Russian taxes (*see* ¶¶ 225-277 *supra*);

(ii) Diverting the proceeds of the Yukos tax evasion scheme into highly opaque Cypriot and British Virgin Islands entities and trusts to conceal the unlawful provenance of those proceeds, including through dividend distributions to undisclosed Cypriot parent companies of trading shells, thereby further abusing the Russia-Cyprus Tax Treaty (*see* ¶¶ 266-277 *supra*);

(iii) Engaging in abusive corporate restructurings to conceal Yukos' affiliation with trading shells, thereby preventing Russian authorities from identifying and addressing Yukos' tax abuses (*see*, *e.g.*, ¶¶ 281-287 *supra*);

(iv) Concealing Yukos' continued control of trading shells by resorting to call-options and by fabricating corporate and other transactional documents (*see*, *e.g.*, ¶¶ 237-243 *supra*);

(v) Repeatedly obstructing the conduct of the tax authorities' audits of Yukos by refusing to provide documents and information which would show the extent of Yukos' abuses, and by causing Yukos' producing subsidiaries and other related entities to be similarly obstructive (*see* ¶¶ 355-363 *supra*);

(vi) Failing to pay Yukos' tax liabilities for tax year 2000 and following years, despite having received ample notice that Yukos would be required to pay these amounts and despite the fact that Yukos had abundant resources to do so (*see* ¶¶ 381-394 *supra*);

(vii) Dissipating assets to frustrate the Russian authorities' collection of the tax assessments, including by way of paying dividends of

"unprecedented" amounts, making spontaneously accelerated loan "prepayments" to Oligarch-owned Moravel, and foisting upon YNG an upstream guarantee up to US$ 3 billion for the repayment of Yukos' alleged "debts" to Moravel (*see* ¶¶ 349-352, 390-391 *supra*);

(viii) Offering to the Russian authorities assets which Yukos knew were tainted to settle its tax liabilities (*see* ¶¶ 417-430, 433-434 *supra*);

(ix) Concealing the share registers of Yukos' subsidiaries to obstruct the bailiffs' enforcement of Yukos' tax obligations (*see* ¶ 403 *supra*);

(x) Sabotaging the YNG auction through litigation threats and a spurious bankruptcy filing in the United States that effectively prevented all but one bidder from placing a bid at the auction and artificially depressed the amount of the auction proceeds (*see* ¶¶ 490-506, 484-487 *supra*);

(xi) Implementing asset-stripping measures by diverting Yukos' valuable assets to Dutch Stichtings managed by former Yukos' officers and representatives of Claimants in anticipation of Yukos' bankruptcy (*see* ¶¶ 528-539 *supra*);

(xii) Failing to repay Yukos' debt to the SocGen syndicate and frustrating the banks' attempts to collect against Yukos' Dutch assets (*see* ¶¶ 551-556 *supra*); and

(xiii) In the process of all of the foregoing, lying to Yukos' auditors PwC about core aspects of their misconduct and, through PwC's certification of Yukos' financial statements based on Yukos' deception of Yukos' auditors, to Yukos' creditors and other members of the public who relied upon those financial statements and PwC's certification of them (*see*, *e.g.*, ¶¶ 736-781 *supra*).

966. And Claimants are not entitled to the substantive protections in Part III ECT because, as fully set forth in the Statement of Facts and above, their claims are tainted by the illegal acts and bad-faith conduct through which Claimants' investments in Yukos were first made and which they perpetrated to enrich themselves through those investments. The acts that deny Claimants' protection under the ECT for this reason include at least the following:

(i) Violating the legal requirements governing the loans-for-shares program that allowed Menatep to gain its controlling interest in Yukos (*see* ¶¶ 18-31 *supra*);

(ii) Using shell company proxies to feign competition in the loans-for-shares auction and a simultaneous investment tender for Yukos shares (*see* ¶¶ 27-28 *supra*);

(iii) Precluding actual competitors from bidding on Yukos shares in the loans-for-shares auction and investment tender, including through the intimidation of potential non-Russian investors and the abuse of Menatep's role as auction organizer to disqualify Russian competitors (*see* ¶¶ 24-26 *supra*);

(iv) Rigging of a subsequent auction for the Yukos shares being held as collateral since the initial loans-for-shares auction, which deprived the Russian Government of substantial revenue (*see* ¶¶ 29-30 *supra*);

(v) Conspiring with Yukos' pre-existing managers to facilitate the unlawful acquisition of Yukos by the Oligarchs, including by entering into an agreement whereby "*Yukos Universal*" committed to pay them compensation consisting of 15% of Menatep's beneficial interest in Yukos, worth billions of dollars, for "*services rendered to 'Yukos'*" (*see* ¶¶ 32-39 *supra)*;

(vi) Colluding with others to predetermine the post-privatization ownership of Yukos (*see* ¶¶ 22-25 *supra*);

(vii) Skimming profits from Yukos and its production subsidiaries for their self-enrichment (*see* ¶¶ 46-49 *supra*);

(viii) Abusing Russian corporate law and principles of corporate governance by squeezing-out minority shareholders in Yukos' production subsidiaries through ruthless and self-enriching share dilutions, asset stripping and transfer pricing (*see* ¶¶ 51-60 *supra*);

(ix) Siphoning off from Yukos proceeds from the sale of oil and oil products for the benefit of the Oligarchs, while concealing related-party transactions from Yukos' own auditor (*see* ¶¶ 81-95 *supra*);

(x) Further mistreatment of minority shareholders by manipulating shareholder meetings, pressuring the Russian Federal Securities Commission not to pursue its challenges against illegal misconduct, relying on fraudulently determined stock and asset values and deceiving shareholders, the Government, and domestic and foreign courts about the nature and control of offshore companies that were created to benefit Claimants and their cohorts from the abuse of minority shareholders (*see* ¶¶ 64-69 *supra*); and

(xi) Manipulating Yukos' stock value to devalue and reacquire the interests of creditors that had been pledged Yukos stock (*see* ¶¶ 74-75 *supra*).

967. Hence, even if Claimants were permitted to invoke the Russian Federation's consent to arbitrate in Article 26(3) ECT and their claims were admissible, *quod non*, Claimants still should not be permitted to enjoy the substantive protections in Part III ECT in light of their own repeated and consistent illegal and bad faith misconduct, and their responsibility for the repeated and consistent illegal and bad faith misconduct of those Claimants appointed to manage their investment in Yukos.

VI. IN ANY EVENT, CLAIMANTS HAVE FAILED TO ESTABLISH A VIOLATION OF ARTICLE 13 ECT

968. Claimants had no legitimate expectations that could be the subject of "*measures having effect equivalent to nationalization or expropriation*." An investor has no right or legitimate expectation of non-enforcement of the host State's laws in the absence of a specific undertaking by the competent authorities of the host State. Yukos' "tax optimization" scheme was plainly illegal. Claimants' arguments that the Russian tax authorities had approved Yukos' "tax optimization" scheme have no basis in Russian law and are factually wrong. Indeed, Yukos' management was well aware that its "tax optimization" scheme was unlawful and worked hard to conceal the unlawful aspects of its scheme. In the absence of a specific undertaking by the Russian authorities, Claimants' arguments that Yukos was exempt from enforcement of the tax laws based on an alleged prior failure to enforce those laws, or on alleged selective enforcement of the tax laws, are unavailing. (A)

969. Moreover, because the loss Claimants allege resulted from Yukos' own conduct and conduct that is not attributable to the Russian Federation, the factual predicate of an expropriation claim under Article 13 ECT -- the total or substantial deprivation of Claimants' property caused by the Russian Federation -- is lacking. (B)

970. In any event, the tax assessments confirmed by the Russian courts are not expropriatory. The interpretations adopted by the Russian courts are consistent with Russian law, and the scope and the amount of the tax assessments, fines, and enforcement fees confirmed by the Russian courts are well within the bounds of internationally recognized tax policies and practices. Considering in addition the wide margin of appreciation afforded States in matters of taxation, no claim can lie. (C)

971. Claimants have not alleged, let alone proven, that the Russian court decisions confirming the tax assessments are discriminatory for purposes of Article 13(1)(b) ECT, *i.e.*, on the ground that they discriminated against Yukos based on Yukos' "foreign" ownership or Claimants' foreign residence. Moreover,

selective tax enforcement does not imply an "*unreasonable distinction*" and Yukos presented a logical target for tax enforcement. (C)

972. Claimants have also failed to establish that Yukos was not accorded due process in the proceedings relating to the tax assessments. The treatment of an investor or investment by national courts must be examined in its entirety to determine whether there was a violation of due process. With few exceptions, the alleged due process violations were subject to judicial review by the Russian courts at first instance, appellate, and cassation levels and, in some instances, even at the discretionary level of the Supreme Arbitrazh Court. Claimants do not seem to allege any due process violation with respect to the appellate proceedings before the Arbitrazh Appellate Court, the Federal Arbitrazh Court, or the Supreme Arbitrazh Court. Indeed, Claimants take issue only with respect to four out of 28 first instance court proceedings in which the tax assessments and lower court decisions were scrutinized. (C)

973. Claimants have also failed to establish that the court decisions confirming the tax assessments were not "*for a purpose which is in the public interest*." Claimants have not met their demanding burden of proof for establishing their central theme, concerning a politically motivated, massive conspiracy implicating "all branches," "at all levels" of the Russian Federation. (C)

974. Claimants fare no better as to the other measures alleged. The Russian court decisions that upheld the YNG auction and other measures aimed at the effective collection of taxes are consistent with Russian law and the auction process and the enforcement and collection measures themselves were in accordance with international practice. The YNG auction was held because Yukos resisted paying its overdue taxes, and obstructed tax enforcement measures, and the price achieved was the fair market value that could be obtained in light of contemporaneous appraisals, YNG's own tax burden, and Yukos' success in restricting the field of potential bidders. (D)

975. Again, with few exceptions, all of Claimants' alleged due process violations with respect to the YNG auction were fully reviewed by the Russian courts, through several layers of appeals. Claimants do not allege any procedural improprieties with respect to any of the numerous court proceedings that confirmed the legality of the auction process and its results. With respect to the nearly 40 court proceedings that confirmed the legality of the other tax enforcement and collection measures, Claimants allege procedural improprieties with respect to only one, the proceedings in the first instance court initiated upon Yukos' challenge of the 2001 tax assessment, an allegation which is without merit. (D)

976. Claimants have utterly failed to establish "*measures having effect equivalent to nationalization or expropriation*" based on the Yukos-Sibneft de-merger or the criminal prosecutions of Messrs. Khodorkovsky and Lebedev. The conduct of Sibneft, Sibneft's management, and Sibneft's shareholders in declining to proceed with the merger and unwinding the preliminary steps that had been taken is not attributable to the Russian Federation and Claimants have failed to allege or establish that the Russian court decisions that granted the claims brought by NP Gemini Holdings Limited and Nimegan Trading Limited were expropriatory. Likewise, Claimants have failed to establish that the criminal investigations deprived Claimants of their rights as Yukos' shareholders and were not the result of the normal exercise of the Russian Federation's power to investigate and prosecute criminal actions. (E-F)

977. Finally, Claimants do not show that the Bankruptcy Proceedings were expropriatory. Critical actions complained of are not attributable to the Russian Federation because the conduct of Rosneft and YNG does not constitute State action. Moreover, the conduct of the Russian tax authorities in the creditors' meetings and the Bankruptcy Proceedings is conduct *iure gestionis* which does not amount to a treaty violation. In any event, the Bankruptcy Proceedings were conducted in full compliance with Russian law and in accordance with international practice. All measures and court decisions adopted in the course of the Bankruptcy Proceedings were subject to full review

by the Russian courts and, where challenged, have been fully reviewed by the courts. Claimants have failed to allege or establish any due process violation in the course of those court proceedings. (G)

A. Claimants Had No Legitimate Expectations That Could Be The Subject Of "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1. No Expropriation Can Occur Unless An Investor Is Deprived Of An Economic Benefit Reasonably Expected From The Investment In The Host State

978. The deprivation of a reasonably to be expected benefit from the lawful operation of an investment in the host State is pivotal to a determination of expropriation. As stated in the treatise INTERNATIONAL INVESTMENT LAW: SUBSTANTIVE PRINCIPLES:

> "Since the *Metalclad* award, international tribunals have generally considered the 'reasonably to be expected' economic benefit of property as being one of the touchstones for an assessment of the validity of an expropriation claim."[1535]

979. Specifically, State measures do not constitute "*measures having effect equivalent to nationalization or expropriation*" unless they frustrate expectations represented by the investment that are legitimate and reasonable:

> "At least as important as the effect of a governmental measure on private property is its effect on *the investor*, that is, the extent to which the measure may undermine the investor's reasonable and legitimate expectations represented by the investment. Indeed, legitimate expectations are inseparable from the concept of private property rights –essentially the rights to use, enjoy the fruits of, and alienate one's property –and are part and parcel of the legal order."[1536]

1535 CAMPBELL MCLACHLAN, LAURENCE SHORE, MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2007), 302 ¶ 8.104 (Exhibit RME-986). *See also LG&E Energy Corp. et al. v. Argentine Republic*, ICSID ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 190 (Annex (Merits) C-981): "In evaluating the degree of the measure's interference with the investor's right of ownership, one must analyze the measure's economic impact – its interference with the investor's reasonable expectations – and the measure's duration."

1536 L. Yves Fortier and Stephen L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or* Caveat Investor, 19 ICSID Rev. 293 (2004), 306 (Exhibit RME-1101). [italics in original; other emphasis added]

980. As set forth below, the scope and nature of the investor's legitimate expectations depend on the rights acquired by the investor under the law of the host State. Expectations that are not grounded in the host State's laws are not protected under Article 13 ECT.

2. There Can Be No Legitimate Expectations Based On Benefits Resulting From Conduct In Breach Of Host State Law

981. Investors must operate their investment in compliance with the host State's laws and regulations.[1537] Expectations based on benefits resulting from investments involving illegality or the operation of an investment in breach of host State law are not legitimate and the State is entitled to enforce its law without incurring responsibility for any damage to the investment as a result of such law enforcement. For example, in *Maffezini v. Spain*, the tribunal dismissed Mr. Maffezini's claim for damages resulting from enforcement of regulations applicable to the investment:

> "There can be no doubt that EAMSA's project required an EIA [environmental impact assessment] and that both Mr. Maffezini and his employees were aware that this was so. The record is abundantly clear with regard to the exchange of correspondence and other communications on the issue of environmental requirements. Apart from the general principle that ignorance of the law is no defense, there is evidence in this case that the Claimant was informed of these requirements. […]
>
> The Kingdom of Spain and SODIGA have done no more in this respect than insist on the strict observance of the EEC and Spanish law applicable to the industry in question. It follows that Spain cannot be held responsible for the decisions taken by the Claimant with regard to the EIA. Furthermore, the Kingdom of Spain's action is fully consistent with Article 2(1) of the Argentine-Spain Bilateral Investment Treaty, which calls for the promotion of investment in compliance with national legislation. The Tribunal accordingly also dismisses this contention by the Claimant."[1538]

1537 *E.g.*, Peter Muchlinski, "*Caveat Investor*"*? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard*, 55 Int'l and Comp. L. Q. 527 (2006), 552 (Exhibit RME-1102).

1538 *Emilio Augustin Maffezini v. Kingdom of Spain*, ICSID ARB/97/7, Award (Nov. 13, 2000), ¶¶ 70-71 (Annex (Merits) C-955).

982. Legitimate expectations must in general be based on a legally enforceable right:

> "It can be said that the investor's fair expectations have the following characteristics: they are based on the conditions offered by the host State at the time of the investment; they may not be established unilaterally by one of the parties; they must exist and be enforceable by law;"[1539]

983. In the absence of a right enforceable under the laws and regulations of the host State, investment treaty tribunals have required that legitimate expectations be based upon a specific undertaking by the competent authorities of the host State. For example, the tribunal in *PSEG v. Turkey* stated:

> "Although the Claimants, as noted above, provide a long list of legitimate expectations that in their view have not been met, the Tribunal is not persuaded that all such complaints relate to legitimate expectations. Legitimate expectations by definition require a promise of the administration on which the Claimants rely to assert a right that needs to be observed."[1540]

A consistent line of awards supports this proposition.[1541]

1539 *LG&E Energy Corp. et al. v. Argentine Republic*, ICSID ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶ 130 (Annex (Merits) C-981). [emphasis added]

1540 *PSEG Global et al. v. Republic of Turkey*, ICSID ARB/02/5, Award (Jan. 19, 2007), ¶ 241 (Annex (Merits) C-982). [emphasis added]

1541 *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Republic of Hungary*, ICSID ARB/07/22, Award (Sept. 23, 2010), ¶ 9.3.17 (Exhibit RME-1103): "The enquiry [as to the existence of legitimate expectations] therefore turns to whether: (a) there were government representations and assurances made or given to Claimants at that time, and upon which they relied, of the sort alleged; and (b) Hungary acted in a manner contrary to such representations and assurances." [emphasis added]; *Metalpar S.A. and Buen Aire S.A. v. The Argentine Republic*, ICSID ARB/03/5, Award on the Merits (June 6, 2008), ¶¶ 185-186 (Exhibit RME-1104): "However, in all of [the cases considered by the tribunal: *PSEG Global Inc. Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID ARB/02/5, Award (Jan. 19, 2007); *Técnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID ARB(AF)/00/2, Award (May 29, 2003); *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary*, ICSID ARB/03/6, Award (Oct. 2, 2006); *Azurix Corp. v. Argentine Republic,* ICSID ARB/01/12, Award (July 14, 2006); *Siemens A. G. v. Argentine Republic*, ICSID ARB/02/8, Award (Feb. 6, 2007); *LG&E Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, ICSID ARB/02/1, Award (July 25, 2007); and *Enron Corporation, Ponderosa Assets L.P. v. Argentine Republic*, ICSID ARB/01/3, Award (May 22, 2007)], the conflict arose out of a state of facts different to the one under analysis in this case: in some of them, the relevant governments had invited the foreign investors to participate in a bidding process that was awarded to each of those investors and ended with the signing of a contract. In other cases, there were other types of contractual relations which created legitimate expectations; in all of

984. Thus, in the absence of a specific commitment from the host State, an investor has no right nor any legitimate expectation that a tax regime will not change to its disadvantage:

> "In the first place, foreign investments like other activities are subject to the taxes and charges imposed by the host State. In the absence of a specific commitment from the host State, the foreign investor has neither the right nor any legitimate expectation that the tax regime will not change, perhaps to its disadvantage, during the period of the investment."[1542]

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them, the Government refused to renew or to comply with the contract, license or permit. In this specific case, there was no bid, license, permit or contract of any kind between Argentina and Claimants, and the Tribunal considers that there were no legitimate expectations entertained by Claimants that were breached by Argentina."; *Merrill & Ring Forestry L.P. v. The Government of Canada*, UNCITRAL, Award (Mar. 31, 2010), ¶ 150 (Exhibit RME-1112): "Legitimate expectations are no doubt an important element of a business undertaking, but for such expectation to give rise to actionable rights requires there to have been some form of representation by the state and reliance by an investor on that representation in making a business decision. And here there is no evidence whatsoever that Canada made any sort of representation to the Investor that it would enjoy a certain price level at the international market or the making of a certain profit thereon." [emphasis added]; *EDF (Services) Limited v. Romania*, ICSID ARB/05/13, Award (Oct. 8, 2009), ¶ 217 (Annex (Merits) C-1001): "Except where specific promises or representations are made by the State to the investor, the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable." [emphasis added]; *Continental Casualty Company v. Argentine Republic*, ICSID ARB/03/9, Award (Sept. 5, 2008), ¶ 260 (Exhibit RME-1105): "By contrast, in most cases invoked by Continental as 'precedents,' specific undertakings were at issue, legislative, administrative or contractual (some of them by local authorities) directed or agreed with the investor, on the basis of which and in reliance upon the aggrieved investor had actually made its investment and committed long term resources. Without here entering into an evaluation of those cases, there are significant factual and contextual differences with the present case as to the application of the abstract concept of 'reasonable legitimate expectations.'"; *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID ARB/05/8, Award (Sept. 11, 2007), ¶ 331 (Exhibit RME-1106): "The expectation is legitimate if the investor received an explicit promise or guaranty from the host-State, or if implicitly, the host-State made assurances or representation that the investor took into account in making the investment."; *Methanex Corporation v. United States* , Final Award of the Tribunal on Jurisdiction and Merits (Aug. 3, 2005) 44 I.L.M. 1345 (2005), 1456, Part IV, Chapter D, ¶ 7 (Annex (Merits) C-974): "[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation."

1542 *EnCana Corp. v. Republic of Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 173 (Annex (Merits) C-976).

A fortiori, in the absence of a specific commitment from the host State, an investor has no right nor any legitimate expectation to non-enforcement or exemption from tax legislation, including fines or penalties.

985. Investment treaty tribunals have rejected expropriation claims where the investor failed to comply with the host State's tax laws and sought to rely on *de facto* tolerance by the tax authorities of such non-compliance, in the absence of proof of a specific commitment of the tax authorities:

> "The Article 4 invoice requirements have been part of the IEPS law at least since 1987, that is, for at least three years *before* CEMSA was first registered as an export company in 1991. Since the operation of its export business depended substantially on the terms of the IEPS law, the Claimant was or should have been aware at all relevant times that the separate invoice requirement existed, as there has been no *de jure* change in it at any time relevant to this dispute. Equally important, the Tribunal is reluctant to find an expropriation based largely on the failure of Mexican government officials to comply with an agreement in which those officials allegedly waived an explicit requirement of a tax law, even though there is some evidence, albeit contested by the Respondent, that the requirement was *de facto* ignored at some times both for the Claimant and for other cigarette resellers, including but not limited to members of the [so-called] Poblano group. This, however, is not in the view of the Tribunal evidence of expropriatory action and will be dealt with below in the section on national treatment."[1543]

986. Given the "*complex and exacting nature of tax laws and regulations*," investors who do not benefit from a specific commitment from the tax authorities of the host State act "*at* [their own] *peril*" if they fail to obtain a formal, binding ruling of the tax authorities on the interpretation and application of the host State's tax laws and regulations:

> "Moreover, the Claimant could have availed himself early on of the procedures available under Mexican law to obtain a formal, binding ruling on the invoice issue from SHCP, but apparently chose not to do so […]. Despite the legal uncertainties of the issues upon which the success of his business depended, the Claimant asked for clarification of the legal issues under Article 4 of the IEPS law only when effectively forced to do so, in April 1998 after SHCP

1543 *Marvin Feldman v. The Government of Mexico*, ICSID ARB(AF)/99/1, Award (Dec. 16, 2002), ¶ 128 (Annex (Merits) C-964). [italics in original]

> denied the Claimant's request for tax rebates for the October 1997 – January 1998 exports, and in March 1999 when as a result of a tax audit SHCP demanded return of rebates, plus interest, inflation adjustment and penalties, for rebates earlier received in 1996 and 1997. It is unclear why he refrained from seeking clarification, but he did so at his peril, particularly given that he was dealing with tax laws and tax authorities, which are subject to extensive formalities in Mexico and in most other countries of the world."[1544]
>
> "Under the circumstances, therefore, the Claimant would have been wise to seek a formal administrative ruling on the applicability of Article 4 of the IEPS, and court review if the ruling were adverse, far before he was forced to do so in 1998, but for whatever reason he chose not to do so. Formal administrative procedures and the courts, according to the record, were at all times available to him, and have not been challenged here as being inconsistent with Mexico's international law obligations. Moreover, in Mexico, as in the United States and most other countries, oral or informal opinions are not binding on the tax authorities […]."[1545]

Claimants' allegation that the tax authorities knew of Yukos' abuse of tax shelters and failed to take action, in the absence of a formal tax ruling or other undertaking by the tax authorities, is thus unavailing and, for the avoidance of doubt, is denied.

3. Claimants Were Not Deprived Of Any Legitimate Expectations

987. As shown below, it was clear from the outset that Yukos' "tax optimization" scheme was vulnerable in its entirety to attack by the Russian tax authorities if and when they ever discovered it, and that such an attack would entail very large assessments of taxes and fines. Although it is possible that Yukos' managers may have hoped that their scheme would avoid detection (or if it were detected, that they would be able to use their influence, or threats or bribes, to avoid the consequences), neither Yukos nor Claimants which controlled Yukos at the time) could have had any legitimate expectation that their scheme would be found to be lawful.

1544 *Ibid.*, ¶ 114. [emphasis added]

1545 *Ibid.*, ¶ 134.

988. We address the subject of Yukos' tax fraud in four main subsections. In the first part (subsection a), we provide background regarding the low-tax region program, the anti-abuse doctrines existing in Russian tax law (which mirror in all material respects analogous doctrines in other countries), and the features of Yukos' "tax optimization" scheme that made it improper under those anti-abuse doctrines; we also retrace the history of the Russian authorities' attempts to combat abuses of the low-tax region program by Yukos and other taxpayers inside and outside the oil industry.[1546]

989. In the second part (subsection b), we review the evidence that Yukos' management realized from the beginning that the company's "tax optimization" scheme was unlawful, and for this reason took great pains to conceal it.

990. In the third part (subsection c), we show that Claimants' arguments that Russian tax and other authorities had approved Yukos' "tax optimization" scheme are (1) meritless as a matter of Russian law and international practice, because tax authorities are not estopped by prior knowledge (or even prior approval) of taxpayer practices, and (2) unsustainable as a factual matter, because Claimants have failed to adduce any evidence that any Russian official actually knew of, or understood, the features of Yukos' scheme that made it abusive and therefore vulnerable to challenge.

991. In the fourth part (subsection d), we refute Claimants' various charges of improprieties in the tax assessments that were handed down by the authorities and subsequently approved by the Russian courts, including (1) the attribution of income and revenues purportedly earned by Yukos' trading shells to Yukos itself as the real party in interest, (2) the assessments of VAT on exports, and (3) the levying of various fines. In each instance, we show that the authorities' actions were consistent with Russian law as well as international practice. Alleged improprieties in the collection of those taxes (as distinguished from their assessment) are discussed in Section V.D.4.

1546 *See* ¶¶ 279-302 *supra*.

a) The Low-Tax Region Program, Russian Anti-Abuse Doctrines, And The Features Of Yukos' "Tax Optimization" Scheme That Made It Improper Under Those Doctrines

992. As discussed in Section II.H *supra*, the low-tax region program was adopted in the 1990s.[1547] The program, which exists to this date, has allowed regional and local governments in designated, economically underdeveloped regions[1548] to adopt regional and local laws, and to enter into agreements with local taxpayers, exempting them from all or part of the relevant region's share (in the relevant period, up to two-thirds) of the federally-collected tax on corporate profits.[1549] In order to benefit from the low-tax region program, a local taxpayer therefore had to comply with: (i) the specific requirements relating to the establishment of business activities in accordance with the relevant region's laws; (ii) the specific agreements entered into with the local or regional authorities (if any); and (iii) the federal statute authorizing the low-tax regions program and applicable federal anti-avoidance rules.[1550]

993. The dispute between Yukos and the Russian authorities, like one of the key controversies in these proceedings, involves primarily Yukos' violations of federal law (rather than of local requirements or specific agreements). Specifically, it involves the application by the Russian authorities of jurisprudential anti-abuse doctrines to challenge Yukos' "tax optimization" scheme as a massive abuse of the low-tax region program.[1551]

994. The abuses that were highlighted by the authorities were varied and pervasive. A common denominator was secrecy. Yukos took pains to conceal the existence of its scheme so as to make it difficult, if not impossible, for the authorities to understand it. In particular, those abuses included four key features:

1547 *See* Konnov Report ¶¶ 32-38.

1548 *See* Konnov Report, ¶ 38.

1549 In the case of ZATOs, the exemption could also include a portion of the federal share. *See* Konnov Report, ¶ 37.

1550 *See* ¶ 228 *supra*; *see also* Konnov Report ¶¶ 35, 39-52.

1551 *See* ¶¶ 279-296 *supra*.

(i) the fact that Yukos' trading companies in the low-tax regions were mere shells, managed out of Yukos' Moscow headquarters, that did no business of their own and had no business purpose other than enabling Yukos, by misusing the low-tax region program, to avoid profits taxes that it otherwise needed to pay;[1552]

(ii) the fact that, in order to allow those trading shells to make large and only lightly taxed profits, Yukos caused its production companies to sell oil and products to the trading shells at artificially low prices, *i.e.*, prices much lower than would have been paid in arm's length transactions;[1553]

(iii) the fact that neither Yukos nor the trading shells ever made significant contributions to the local economies of the relevant regions[1554] ("significance" being measured for this purpose by comparing those contributions the tax benefits that Yukos was deriving from the program), even though the sole purpose of the program was to promote local economic growth; and

(iv) various artifices to exfiltrate the ill-gotten profits of the trading shells in ways that would make it difficult or impossible for the authorities to detect and understand the foregoing abuses. These subterfuges included (a) purported "donations" by those trading shells to a "Production Development Financial Support Fund" maintained by Yukos (which Yukos treated as its own cash), on terms antithetical to arm's length conditions, (b) non-arm's length transfers of funds from the trading shells to Yukos in the guise of "borrowings" evidenced by promissory notes, and (c) diversion of the profits of some of the trading shells in the form of dividends paid through complex chains of non-transparent Yukos-controlled

1552 *See* ¶¶ 237-243 *supra.*

1553 *See* ¶¶ 244-248 *supra*.

1554 *See* ¶¶ 249-255 *supra*.

> Cypriot and British Virgin Islands entities, which either accumulated or "loaned" those profits to Yukos in ways that concealed their origin.[1555]

995. Claimants' position is not so much that the foregoing activities did not happen -- most of these facts, though initially denied by Yukos, do not seem to be contested[1556] -- but rather that Yukos' "tax optimization" scheme did not violate Russian law, or at least Russian law as it existed at the times when Yukos and its affiliates were making heavy use of the low-tax region program (basically from 1999 until 2004).[1557] At bottom, Claimants' position is that, at that time, Russian law did not include the jurisprudential anti-abuse doctrines upon which the authorities grounded their reassessments of Yukos starting in December 2003. To the contrary, they claim, those doctrines had no antecedents in Russian law and were devised by the authorities "on entirely new and fictitious bases" solely for the purpose of destroying Yukos.[1558]

996. This entire line of argument is simply wrong, as can easily be demonstrated. As explained by Oleg Konnov, one of Russia's leading tax

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1555 *See* ¶¶ 258-277 *supra.*

1556 In particular, Claimants do not seriously suggest that the trading shells had any purposes other than "tax optimization" and have in any event submitted no evidence of a non-tax purpose. Likewise, they do not deny that the trading shells were essentially managed by Moscow-based affiliates of Yukos nor that the prices that they paid for their purchases of inventory were far below the world market prices at which the goods were resold to genuine third-party customers (which is how the trading companies generated the huge profits upon which the low-tax region benefits were claimed). And Claimants seem to concede that neither Yukos nor its affiliates never made investments in local economies that constituted a large percentage of the tax benefits that they realized thanks to the low-tax region program. Their witness on this point, Mr. Vladimir Dubov, reports that contributions in Mordovia were on the order of RUB 80 million per month (approximately US$ 32 million per year) (*See* Dubov Witness Statement, ¶ 21), a trifling amount compared to Yukos' tax savings in Mordovia during that period, which involved several billion dollars per year. *See* ¶¶ 251-255 *supra.* Claimants have offered no evidence of any investments in regions other than Mordovia, even though it is known that Yukos had trading shells at one time or another in Evenkiya, Kalmykia, ZATOs (Lesnoy, Trekhgorny and Sarov) and the City of Baikonur.

1557 *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 6-8 (Exhibit RME-137).

1558 *See, e.g.*, Claimants' Memorial on the Merits, ¶ 707 ("[F]or the purposes of disposing of a political opponent and dismantling for its own benefit one of the most flourishing companies in Russia, it decided to use its taxation arm to reassess the Company's taxation, on entirely new and fictitious bases -- first and foremost the Russian Federation's self-serving new theory of the re-attribution to Yukos of the revenues of its trading companies.")

experts, the Russian courts, including at the highest levels, had recognized *abus de droit* doctrines, and applied them in the tax area as early as in the 1990s.[1559] As is typical for jurisprudential doctrines, their development was evolutionary, as the courts applied them on a case-by-case basis to increasingly varied scenarios. Their use by the authorities to combat Yukos' "tax optimization" scheme was entirely predictable.

997. One of the key anti-abuse concepts applied came to be known as the "good (or bad) faith taxpayer" doctrine. Claimants' suggestion that this doctrine was applied for the first time to Yukos is patently counterfactual. According to a survey published in 2007 by Mr. Savseris, a leading Russian tax lawyer (who at one point served on Yukos' defense team), at least 262 "bad faith taxpayer" cases were handled by the Russian courts in the year 2001, and this total grew steadily in the ensuing years, reaching 2,235 cases in 2004 (the year when the courts first upheld the assessments against Yukos).[1560] These multitudinous pre-Yukos "bad faith taxpayers" cases covered a broad range of *abus de droit* schemes, including abuses of the low-tax region program.[1561]

1559 *See* Konnov Report, ¶¶ 39-52. *See also* ¶¶ 279-296 *supra.*

1560 *See* Savseris S.V., *Bad Faith Category In Tax Law*, Statut (2007), 47 (Exhibit RME-310).

1561 In particular, in numerous cases the courts ruled against taxpayers on the basis that disproportion between the tax benefits granted to the taxpayer and amounts of investment into the relevant low-tax region economy is an indication of an abuse of rights and evidence of the bad faith of the taxpayer. *See*, *e.g.*, Resolutions of Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-1682/2002-623A (May 21, 2002) (Exhibit RME-313), Case No. F08-1674/2002-627A (May 21, 2002) (Exhibit RME-314), Case No. F08-1793/2002 (May 28, 2002) (Exhibit RME-316), Case No. F08-3949/2002-1374A (Oct. 22, 2002) (Exhibit RME-317). *See also* Resolution of Federal Arbitrazh Court of the Moscow District, Case No. KA-A41/6270-03 (Oct. 10, 2003) (Exhibit RME-319) and Decision of the Moscow Arbitrazh Court, Case No. A41-K2-10055/02 (Nov. 17, 2004) (Exhibit RME-320). *See also, e.g.* Konnov Report, ¶¶ 46, 49. Other schemes involved VAT fraud or payment of taxes through insolvent banks or other fraudulent schemes applied by the taxpayers. *See, e.g.*, Resolution of the Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-485/2001 (Mar. 1, 2001) (Exhibit RME-1467). In 2004, the Russian Constitutional Court noted that it would be inadmissible for bad faith taxpayers to manipulate the civil law institutions and operate schemes for unlawful enrichment at the expense of the state budget (*see* Ruling of Russian Constitutional Court, Case No. 168-O (Apr. 8, 2004) (Exhibit RME-1468)). The Constitutional Court also concluded that entering into transactions with no valid purpose other than tax evasion is evidence of a taxpayer's bad faith (s*ee* Ruling of Russian Constitutional Court, Case No. 169-O (Apr. 8, 2004) (Exhibit RME-1469)). In addition, the Supreme Arbitrazh Court noted that law enforcement agencies may apply bad faith as a test in the resolution of tax-related disputes (s*ee* Letter of the Supreme Arbitrazh Court No. S5-7/uz-1355 (Nov. 11, 2004)

998. In fact, the Russian authorities' first reported challenge to abuses of the low-tax region program goes back to 1999, soon after the program's inception.[1562] As it happened, the attack involved several Yukos-controlled sham companies in the ZATO of Lesnoy, notably a company named OOO Business-Oil that played a significant role in the early phase of Yukos' "tax optimization" scheme.[1563] In due course, those shell companies were found to have abused the low-tax region program, *inter alia*, because they had no production facilities (and therefore never took possession of the oil they purported to trade), had insignificant fixed assets, kept their cash assets in banks located outside of the ZATO of Lesnoy, and employed only a few local residents, none of which was actively involved in the company's activities.[1564] Accordingly, the authorities issued tax reassessments. As discussed in greater detail in Section II.M.2.B *supra*, however, rather than paying or appealing these assessments, Yukos reacted by merging and demerging the trading shells out of existence, so that by the time the authorities finally sought to compel payment of the assessment, there was no solvent entity left from which the collection could be made.[1565] Yukos has never alleged any business purpose -- other than the evasion of taxes for those mergers and demergers, nor indeed for the initial creation of the Lesnoy trading shells.[1566]

(Exhibit RME-1470)). *See also* Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2076/04-AK (May 25, 2004) (Exhibit RME-1471), Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2075/04-AK (May 25, 2004) (Exhibit RME-1472), Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2074/04-AK (May 25, 2004) (Exhibit RME-1491).

1562 *See* Memorandum on the results of the audit of the legality of additional tax incentives granted to OOO Mitra, Business-Oil, and OOO Forest-Oil registered in the ZATO of Lesnoy (Sverdlovsk Region) for 1998 and nine months of 1999 (Exhibit RME-294]). *See also* ¶¶ 281-282 *supra.*

1563 E-mail from Stanislav Zaitsev to Alexey Zubkov (June 24, 2004) with attachment "Source of funds," Structure of Funds Flow in 2000-2001, 4-5 (Exhibit RME-286).

1564 *See* ¶ 282 *supra.*

1565 In the meantime, the ill-gotten profits of Business Oil had been spirited out of Russia. E-mail from Stanislav Zaitsev to Alexey Zubkov (June 24, 2004) with attachment "Source of funds," Structure of Funds Flow in 2000-2001, 4-5 (Exhibit RME-286).

1566 *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 6-8 (Exhibit RME-137). *See also* ¶¶ 283, 286 *supra.*

999. By early 2002, courts in several regions had applied the "bad faith taxpayer" doctrine (which had in the meantime been upheld at the Constitutional Court level)[1567] to deny low-tax region benefits to various other taxpayers found to have abused the program.[1568] As discussed in Section II.H.2.d *supra*, one of these cases also involved a Yukos-controlled company -- this time a company registered in the Region of Kalmykia by the name of Sibirskaya -- whose connection with Yukos was successfully concealed from the authorities. In 2001, Sibirskaya had been assessed back taxes on grounds that included its failure to make "proportional" investments in the local economy, *i.e.*, investments in amounts proportional to the tax benefits reaped by it under the low-tax region program.[1569] That assessment was duly upheld by the Federal Arbitrazh Court on May 20, 2002. On this occasion too, rather than appealing this decision, or terminating its abuses (*e.g.*, by starting to make "proportionate" local investments), Yukos simply phased out its reliance on trading shells in Kalmykia, and increased its use of similar shells in other, more friendly low-tax regions, such as Mordovia.[1570]

1000. Around the same time, other oil companies began to back away from similar tax minimization schemes. Thus, for instance, Lukoil -- Yukos' main private sector competitor -- publicly acknowledged as early as mid-2002 (the year for which Yukos was assessed approximately RUB 193.8 billion (US$ 6.7 billion) that it had abandoned the use of low-tax regions to minimize its taxes

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1567 *See* Ruling of the Constitutional Court, Case No. 138-O (July 25, 2001) (Exhibit RME-307).

1568 *See, e.g.*, Resolution of Federal Arbitrazh Court of North Caucasian District, Case No. F08-1134/2002-402 (Apr. 16, 2002) (Exhibit RME-1473), Resolution of Federal Arbitrazh Court of North Caucasian District, Case No. F08-1368/2002-506A (Apr. 29, 2002) (Exhibit RME-318).

1569 Resolution of Federal Arbitrazh Court of North Caucasian District, Case No. F08-1678/2002-614A (May 20, 2002) (Exhibit RME-311), where the court found: "*The amount of investments made by the claimant comprises 0.4% of the amount of* [taxes underpaid]. *Such investments neither have any effect on the economy nor cover any of the losses of the budget relating to the granting of tax incentives to taxpayers. On the contrary, those investments result in unjust enrichment (saving) of funds at the expense of budgetary funds. Therefore, knowing a clear disproportion between the amount of investment and the amount of tax incentives applied, the claimant has abused its right, i.e. the claimant acted in bad faith.*".

1570 *See* ¶¶ 254-255 *supra*.

effective from December 31, 2001.[1571] In these and similar disclosures, Lukoil also acknowledged that:

> "if the various initiatives we have used to reduce our tax burden are successfully challenged by the Russian tax authorities, we will face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which would have a material impact on our financial condition and results of operations."[1572]

1001. The low-tax region program was not limited to oil companies, and it gave rise to abuses by companies in other industries. Consistently with the reasoning underlying the authorities' position in the *Business-Oil* (Yukos) and *Sibirskaya* (Yukos) matters, the authorities used their anti-avoidance powers to condemn abuses of that program in other industries. Most of the ensuing court decisions upheld the authorities' assessments and, insofar as they were publicly available, were known to Yukos' tax specialists. Those cases included the *Zernoimpexinvest* case (May 2002),[1573] the *Agrochimtrade* case (June 2002)[1574], and the Eastern Reinsurance Company (*Vostochno Perestrakhovochnaya Kompania)* case (February 2003).[1575]

1571 *See* ¶¶ 297-302 *supra*. *See also* OAO Lukoil, Annual Report 2001, 93 (Exhibit RME-321), noting that "[i]*n the past, the Group has been able to establish strategies which have reduced its overall cost of taxation. It may not be possible to establish other arrangements which facilitate similar tax efficiencies in the future to replace the arrangements which have reduced the cost of taxation in the years ended December 31, 2001, 2000 and 1999.*" Lukoil made a similar announcement in its November 2002 offering circular for a bond placement -- a document with which Yukos' management was no doubt familiar. Specifically, Lukoil disclosed that, "[i]*n 2002 substantially all of the tax-planning initiatives that we formerly used were phased out, and we expect to pay higher taxes in 2002 and thereafter. Accordingly, our results of operations may be adversely affected*" (*see* OAO Lukoil, Securities Filing, Offering Circular (Nov. 26, 2002), 36 (Exhibit RME-322).

1572 OAO Lukoil, Securities Filing, Offering Circular (Nov. 26, 2002), 36 (Exhibit RME-322). Lukoil was ultimately assessed taxes for US$ 103 million for year 2002, which it voluntarily paid (*see* Alexander Tutushkin, *Pay Taxes and Live a Calm Life*, Vedomosti (Jan. 14, 2004) (Exhibit RME-361)).

1573 *See* Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-1679/2002-622A (May 21, 2002) (Exhibit RME-312).

1574 *See* Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-2048/2002-755A (June 20, 2002) (Exhibit RME-1474).

1575 Resolution of the Federal Arbitrazh Court of the North Caucasian District, Case No. F08-270/2003-91A (Feb. 20, 2003) (Exhibit RME-315).

1002. In sum, long before the authorities first notified Yukos of the assessments at issue in these proceedings (on December 29, 2003), and also long before the arrest of Mr. Khodorkovsky on charges that included tax evasion on October 25, 2003, tax authorities and federal courts in various regions of Russia had repeatedly condemned abuses of the low-tax region program similar to Yukos', relying on rationales similar to those that they used with respect to Yukos, including the condemnation of sham local companies and of the absence of "proportional" local investments.[1576] Claimants' argument that Yukos' "tax optimization" scheme was "in keeping with legislation in force"[1577] and that the authorities' challenges to it rested on "entirely new and fictitious bases"[1578] is thus factually unsustainable, and in fact, was repudiated in June 2004, by one of Yukos' most senior Russian executives, Mr. Yuri Beilin.[1579]

b) Yukos' Management Realized From The Beginning That The Company's "Tax Optimization" Scheme Was Unlawful, And For This Reason Took Great Pains To Conceal It

1003. The record makes clear that the tax risks described above were fully understood by Yukos' management from the outset, and that Yukos therefore never had grounds for a legitimate expectation that its "tax optimization" scheme would be recognized as legal. The evidence of Yukos' knowledge of the illegality of its scheme is of six major types:

1576 The numerous "bad faith taxpayer" cases discussed above, together with the Yukos cases, were an integral part of the continuous evolution of Russian anti-abuse doctrines, an important milestone in which was the adoption by the Russian Supreme Arbitrazh Court on October 12, 2006 of Resolution No. 53 which synthesized the prior court rulings based on the bad faith taxpayer and related doctrines, articulating a general "business substance" doctrine (Exhibit RME-1475). *See also* Konnov Report, ¶¶ 49(p).

1577 Claimants' Memorial on the Merits, ¶¶ 292, 757.

1578 *Ibid.*, ¶ 707.

1579 On June 9, 2004, Deputy Chief Executive Officer Yuri Beilin, in a letter to Mikhail Fradkov, Russia's Prime Minister at the time, conceded that Yukos' tax schemes in 2000 and subsequent years had "*resulted in significant tax underpayments*." *See* Letter from Y. Beilin to M.E. Fradkov, No. 401-658 (June 9, 2004) (excerpt published in the June 18, 2004 edition of Finansovye Izvestia) (Exhibit RME-587). But other Yukos managers soon distanced themselves from that letter, claiming it was not the company's official position. *See* Gregory L. White, Guy Chazan, *Yukos, Russian Officials Discuss Payment Terms for Back Taxes,* Wall St. J. (June 22, 2004), 3 (Exhibit RME-586).

(i) the fact that the scheme was on its face "too good to be true" and that it would have been obviously illegal anywhere else, along with the absence of any contemporaneous legal or accounting opinions approving the scheme;

(ii) the evidence of lies by Yukos to its own auditors, and evidence of other attempts by Yukos to conceal key elements of the scheme, so as to reduce its tax audit risk;

(iii) Yukos' cancellation in 2003 of a plan to list its shares on the New York Stock Exchange, *inter alia*, because of fears that the extensive disclosure required by the United States securities laws would alert the Russian tax authorities to the Yukos scheme and result in large levies of taxes and penalties; and

(iv) the behavior of other companies, which confirmed that Yukos' strategy involved legal risks that other companies were not prepared to run.

1004. We review each of these in turn.

(1) The Fact That The Scheme Was "Too Good To Be True"

1005. As previously noted, eligibility for the low-tax region program that Yukos massively abused was not limited to Yukos, or even to oil companies. Indeed, benefits were potentially available to virtually all corporate taxpayers in Russia.[1580] Thus, if Yukos' managers genuinely believed that, thanks to the low-tax region program, it was possible for Yukos, without making any significant investments in local economies, to legally reduce its tax burden by up to two thirds, simply by creating locally-incorporated shell companies to buy inventories at less than arm's length prices and then resell them at full market price, they must also have believed that every other Russian business was legally entitled to do the same. The result would have been that the low-tax regions would have ceased to receive any corporate tax revenues, even though -- again, if

1580 *See* ¶¶ 226-228, 295-296 *supra.*

Claimants are to be believed -- neither Yukos nor any other beneficiary of that tax incentive program was required to make a significant investment in the local economies. This is much "too good to be true." Yukos' managers, who were anything but naïve, could not have believed it, all the more so as most of the senior managers were expatriates who would have known that similar schemes would obviously be illegal in their home countries.[1581]

(2) The Absence Of Contemporaneous Legal Or Accounting Support For The Scheme

1006. It is telling that, neither in this case nor any of the parallel arbitral and judicial proceedings, have Yukos' defenders ever produced a single contemporaneous opinion from a tax lawyer or accountant -- or even an internal memorandum -- supporting their claim that Yukos' "tax optimization" scheme, as implemented, was legal under Russian tax law at the time. Yet if such opinions existed, they would presumably have surfaced long ago.[1582]

1007. The obvious reason for Claimants' failure to produce any contemporaneous evidence to support their claim that "what Yukos did was legal" is explained in an article recently co-authored by Dmitry Gololobov, one of Yukos' former chief legal officers, in which he reports that, at the time of the "tax optimization" scheme, Yukos' management did indeed consult numerous experts, but "[n]*one* […] *gave an unconditional seal of approval to those schemes*," notwithstanding ample incentives to do so and a general climate in which, he

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1581 This applies, for example, to Messrs. Misamore (U.S.), Theede (U.S.) and Rieger (Germany), all of whom have submitted witness statements on behalf of Claimants. Other Western executives on Yukos' staff with knowledge of Yukos' scheme included Stephen Wilson (U.K.) and David Godfrey (U.S.). *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 8 (Exhibit RME-137). Still other key Yukos managers, including the group's Chief Financial Officer at the time of creation of the scheme, Mr. Michel Soublin, were Western-trained. Claimants' Memorial on the Merits, ¶ 21, Witness Statement of Jacques Kosciusko-Morizet (Sept. 15, 2010) ("Kosciusko-Morizet Witness Statement"), ¶7. For a discussion of the illegality in other countries of schemes such as Yukos', *see* Section VI.C.9.c *infra*.

1582 If any such document existed, Yukos' former managers, including Messrs. Misamore, Theede, Nevzlin, and Dubov, who control Claimants, would have kept copies. They retained control over Yukos' files through August 2006, when Mr. Rebgun finally took over as Yukos' receiver. *See* ¶ 633 *supra*. It is also noteworthy that Yukos did not rely on any such opinion when the company was litigating against the tax authorities before the Russian courts.

writes, opinions "*stretching*" the law were commonplace.[1583] The conclusion is inescapable: Yukos' management reviewed those opinions, realized that its scheme was illegal, and implemented it anyway.

1008. Ironically, the lone tax/accounting opinion that Claimants have so far adduced in these proceedings -- a January 15, 2004 "comment" from the Moscow office of PwC -- simply confirms the utter bad faith of Yukos' managers.[1584] Issued after Yukos' scheme had been unraveled by the authorities, it is in any event incapable of comforting the fiction that Yukos' managers thought their scheme was legal at the time when it was being implemented.

(3) Evidence Of Lies To Yukos' Own Auditors

1009. Further proof -- if any were needed -- of the fact that Yukos' managers knew that their "tax optimization" program would not have been viewed as legal by anyone with knowledge of its full details, comes from Yukos' own auditors, PwC. As described above, PwC certified the accounts of the Yukos

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1583 *See* Svetlana Bakhmina and Dmitry Gololobov, *Law and Rights: Oligarchs and Legal Counsel*, Vedomosti (Aug. 19, 2010), 2 (Exhibit RME-1476), in which Mr. Gololobov reports that the "[o]*utside consultants would make their opinions rife with so many conditions precedent for their validity that anyone reading those through would immediately wonder as to why pay the kind of money requested for such judgments if the conditions in questions could never be met in the real world anyway*."

1584 Letter from M. Kubena to B. Misamore (Jan. 15, 2004) (Annex (Merits) C-609), cited by Claimants in Claimants' Memorial on the Merits, ¶¶ 310, 315. This curious document purports to be a "comment" addressed to Mr. Misamore by Mr. Michael Kubena of PwC's audit group on January 15, 2004, a few weeks after Yukos had received the authorities' December 29, 2003 audit report for tax year 2000, unmasking its scheme. Mr. Kubena's letter, which recites that it is written in response to a request from Mr. Misamore of January 8, 2004 (which is not in the file), is almost comically overcautious, and makes clear the extreme discomfort that PwC evidently felt with respect to Yukos' scheme. Almost half of the "comment" consists of caveats and disclaimers -- including a warning that no third party (a term that would include this Tribunal) should ever rely on it. Mr. Kubena goes on to claim (implausibly) that "*we have not analyzed any potential civil, criminal or other aspects of this issue (e.g. the legal status of the relevant regional tax benefits, observance of the terms and conditions under which such benefits were applied* […], *or any possible affiliation of* [the trading shells] *with OAO NK Yukos, as alleged*" by the authorities in the December 29, 2003 audit report -- thereby conveniently assuming away most of the facts that made Yukos' scheme illegal. He then opines that under "*RF tax legislation*" effective during the year 2000, Yukos (subject to a series of enumerated exceptions) would not be liable for any taxes avoided by its trading shells. Thanks to the reference to "*RF tax legislation*," Mr. Kubena was able to avoid commenting on the jurisprudential anti-abuse doctrines on which the authorities had relied in support of their December 29, 2003 audit report, which were jurisprudential rather than "legislative" (*see* ¶¶ 353-365 *supra*). In sum, after having previously assumed out of his opinion all the sensitive facts, Mr. Kubena also removed from its scope all of the sensitive law.

group for years up to and including 2002,[1585] but in 2007 withdrew those certifications, among other reasons because it had learned in the meantime that Yukos' management had lied to or misled PwC in several material respects. In particular, PwC complained that Yukos' management had represented to PwC during the course of audits "*that key issues of the activities of* [the trading shells] *were under supervision and control of their own management*," while, in fact, "*management of certain Russian legal entities affiliated with the Company did not control the activities of these entities, rather these legal entities were fully controlled directly by the Company's management.*"[1586] Yukos' control over the trading shells was of course a critically important element of the "tax optimization" scheme, and the decision by Yukos' managers to conceal facts relevant to this issue from PwC confirms they were aware that the scheme was illegal.[1587]

1010. Claimants contend that PwC withdrew its certification under pressure from the Russian authorities.[1588] This charge is contradicted by the evidence.[1589] In any event, even if it were true, there is no reason to believe -- let alone any evidence -- that PwC was lying when it said that Yukos' management had concealed from PwC Yukos' direct management of the trading shells. If such a statement were untrue, PwC would have been exposed to suit by Yukos' managers and potentially also by public authorities.

1011. In sum, it is clear that, despite the obvious risks, Yukos concealed critical details regarding the companies involved in its tax-evasion scheme from its own auditors. General declarations, such as those of Messrs. Kosciusko-

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1585 PwC certified Yukos' Russian accounts up to and including 2004 and Yukos' U.S. GAAP accounts up to and including 2002.

1586 *See* Letter of ZAO PwC Audit to Mr. Rebgun (June 15, 2007), 2 (Annex (Merits) C-611).

1587 The fact that Yukos' management was keen to minimize disclosure of Yukos' control over trading shells is confirmed by complaints that had been made by PwC's Cypriot affiliate, which had lamented the fact that two locally-incorporated companies controlled by Yukos, *i.e.* Dunsley and Nassaubridge, were refusing to disclose the identity of the Russian companies from which their dividend income was being derived, as well as the fact that they were ultimately owned by Yukos. As it turns out, the dividend-paying companies were Ratibor and Fargoil, two of the most important trading shells. *See* ¶¶ 266-277 *supra.*

1588 Claimants Memorial on the Merits, ¶¶ 143-151.

1589 *See* ¶¶ II.N *supra.*

Morizet, Rieger and Misamore[1590] to the effect that Yukos cooperated closely with PwC, even if true, do not contradict the evidence that, at least on some occasions and with respect to some critical facts, Yukos not only did not cooperate with PwC, but also lied to it.

(4) Other Attempts By Yukos To Conceal Key Elements Of Its Scheme

1012. Yukos' "tax optimization" scheme was deliberately structured from the very beginning in ways that made it very difficult for it to be uncovered upon audit. The fact that Yukos' management took these precautions, some of which were elaborate, is fatal to any claim of good faith, because one does not take pains to hide something that one believes to be fully "in keeping with the legislation in force."[1591] Put another way, one cannot have a legitimate expectation that, upon audit, the tax authorities will uphold a scheme if one has gone to great lengths to prevent the tax authorities from ever discovering it.

1013. Several features of Yukos' "tax optimization" scheme had no purpose other than to conceal its sensitive features. For example, with a few exceptions, none of Yukos' numerous trading shells bore names, or had managers, that would reveal their Yukos connection.[1592]

1014. Often, Yukos used the subterfuge of "call options" to conceal the fact that the shells were beneficially owned by Yukos.[1593] This ploy involved designating nominees -- individuals or legal entities with no obvious links to Yukos -- to serve as the nominal shareholders of the shell companies, while at the same time having them sign "option agreements" entitling a Yukos-controlled entity or nominee to "call" (*i.e.*, buy) the underlying shares at any time and at a

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1590 Kosciusko-Morizet Witness Statement, ¶¶ 15-25, Rieger Witness Statement, ¶¶ 15–19 and Misamore Witness Statement, ¶¶ 25-29, all of which are discussed in greater detail at ¶ 1065 *infra.*

1591 Claimants' Memorial on the Merits, ¶ 292.

1592 *See* ¶¶ 242-243 *supra.*

1593 *See*, *e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 7 (Exhibit RME-140). *See* ¶ 243 *supra.*

nominal price. No business purpose has ever been alleged to justify these subterfuges, whose effect -- and evident purpose -- was to make it possible, if a shell company were ever audited, to deny any connection between it and Yukos, and therefore to reduce the risk that the audit of that shell might lead to discovery of other components of Yukos' "tax optimization" scheme.

1015. Still another technique was to interpose not one, but several low-taxed trading shells between the taxable producers of the oil and oil products and the ultimate customer. Here too, one of the evident purposes was to ensure that, if any link in the chain were audited, only a portion of the overall mark-up that was being sheltered from normal taxation would be revealed.[1594]

1016. A similar technique involved the creation in Cyprus and the British Virgin Islands of layers upon layers of holding companies and trusts -- all empty shells that served no legitimate business purpose, but would be useful in stalling or frustrating any attempt by Russian tax authorities, even with the help of the Cypriot or BVI authorities, to trace back to Yukos the beneficial ownership of the underlying Russian trading shells.[1595]

1017. Finally, there is evidence that, even within Yukos' management team, extreme precautions were taken to limit to a handful of senior executives the dissemination of any information regarding certain aspects of the tax scheme.[1596]

1594 *See* ¶¶ 243 *supra.* Yukos' internal communications confirm that it was Yukos' employees' "*headache*" to ensure that the transactions among the trading shells were structured in a way that would prevent detection of the scheme by the tax authorities. *See*, *e.g.*, E-mail by A.V. Brazhkov to A.P. Kuchusheva (Oct. 9, 2001) (Exhibit RME-325). The use of chains of shells also increased the likelihood that every branch in the chain, if audited, could avoid tax thanks to the 20% "safe harbor" in Article 40 of the Tax Code (the transfer pricing statute). *See* Konnov Report, ¶41.

1595 *See* ¶¶ 266-277 *supra.*

1596 *See* Record of Interrogation of S.E. Uzornikov, former Head of the Department for International Accounting and Controlling of Yukos-Moscow (July, 11 2007), 6-7 (Exhibit RME-358): "*Question: There are units named Stichting Wellgen, Alastair Trust, Stephen Trust, James Trust in the chart. What do they mean? Answer: None of the trusts sound familiar to me, we never consolidated any trusts in YUKOS. I was never involved in the creation of YUKOS consolidation structure, and do not know the trust functionality. That is why there is nothing I can say about them, and I am not aware of why, how and who established and managed them. I have never heard about*

1018. Obviously, none of these machinations would have been necessary if Yukos' management had genuinely believed that their "tax optimization" scheme was legitimate.

(5) The Express Internal Acknowledgement By Yukos Of The Tax Risks At The Time Of Its Aborted Project To List Yukos Shares On The New York Stock Exchange (2002)

1019. In the summer of 2002, Yukos' owners and managers explored the feasibility of listing Yukos shares (including Claimants' shares) on the New York Stock Exchange. The project was ultimately abandoned, for reasons that are highly relevant in these proceedings because they included fears that, as a result of the extensive disclosures required by the U.S. Securities and Exchange Commission, the process would publicly reveal Yukos' "tax optimization" program, and this in turn would lead to major tax reassessments.

1020. The files for the U.S. listing project contain several "smoking guns" attesting to the awareness of Yukos' managers of the risks inherent to their "tax optimization" scheme. One is a damning internal memorandum that was addressed on May 14, 2002 to one of Yukos' Vice Presidents (Mr. O.V. Sheyko) by another Yukos manager (Mr. P.N. Maliy). The memorandum enumerates various risks that Yukos would run if it were to register its securities with the U.S. Securities and Exchange Commission. The foremost of these was the requirement that Yukos disclose all of its affiliates -- including the covert ones -- as a result of demands for clarifications by the SEC. The memorandum does not mince words: it warns that any such disclosure "*may be used by the Russian tax*

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them in any conversations, and never discussed them with anyone." *See also* ¶¶ 271-272 *supra*. *See also, e.g.*, Record of Interrogation of a Witness the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 13:19), 3 (Exhibit RME-17): "*Under these structures, Yukos management demonstrated that they could control the international companies (which also owned many of the domestic 'operational' companies) and that OAO NK Yukos was ultimately entitled, through a chain of ownership and control, to the profits recognized in the companies.* […] *as I understand, most of the information about the ownership structure, including the control mechanisms, and on the companies themselves, was maintained outside of Russia.*" *See also* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 15:56), 11 (Exhibit RME-140): "*We were supposed to have this information* [on the ownership structure] *during the audit. However, if someone came to the company and they were not provided with full information, it would be impossible to have a full picture of the structure.*"

authorities to challenge our approach to certain transactions and, consequently, will result in substantial tax claims against the Company," and perhaps even against its officers, individually.[1597] That, of course, is what ultimately happened.

1021. Equally devastating is a contemporaneous draft of the filing with the SEC that Yukos would have needed to make if the New York listing had gone forward. The available copy is a "blackline" version sent on July 23, 2002 by Natalia Kuznetsova of PwC to Stephen Wilson, at that time Yukos' International Tax Director, which shows proposed deletions from an earlier draft. With the pitiless, lawyerly clarity that is typical of documents of this sort, the draft proposes deletion of language including the following subtitle [bold print in original]:

> "**We use tax optimization mechanisms that may be challenged by the tax authorities** […]."[1598]

Language following that statement made clear that the concern involved the low-tax region program.

1022. Another subtitle proposed for deletion reads as follows [again, bold print in original]:

> "**If a number of regional tax incentives we have used to reduce our tax burden are successfully challenged by the Russian tax authorities, we will face significant losses associated with the**

1597 (Exhibit RME-184) [emphasis added]. This memorandum was prepared on April 22, 2002 and was transmitted on May 14 by P. N. Maliy to O.V. Sheyko, at that time Vice President/Director of Corporate Finance Department. The devastating passage in question reads as follows:

> "**2. *Group Structure***: *We understand that the Company has set up a complex structure of subsidiaries in various jurisdictions primarily with the purpose of maximizing tax efficiency. This structure enables the Company to exploit inconsistencies between legal regimes and treat certain entities differently for the purposes of Russian legal and tax regime and, say, U.S. accounting rules. There is a risk (whose extent we are now trying to ascertain) that the filings with the SEC and publicly available materials would have to disclose the names of such entities and their affiliation with the Company. Such information may be used by the Russian tax authorities to challenge our approach to certain transactions and, consequently, will result in substantial tax claims against the Company. In the worst case (but not very likely) scenario this may result in attempts to impose administrative and tax liability on the Company's officers. It is not clear today to what extent such attempts may succeed. To minimize these risks we will need to carefully review the group structure prior to the SEC filing*." [emphasis added]

1598 Extract from Yukos' Draft F-1 Form, 133 (Exhibit RME-1477).

> **additionally assessed amount of tax and related interest and penalties**."[1599]

1023. It is clear that these issues were extensively debated at the time when the New York listing project was under consideration. As reported by Douglas Miller of PwC:

> "Most of our time was spent on tax risk factors, most significantly disclosures of the risks surrounding Yukos' international structure and of the regional tax incentives enjoyed by the operating entities."[1600]

1024. Not surprisingly, none of the quoted statements were ever made public by Yukos. Instead, the entire project of listing Yukos shares on the New York Stock Exchange was abandoned.

1025. The above quoted documents destroy Claimants' contention in these proceedings that the tax assessments at issue involved "*entirely new and fictitious*" concepts of Russian law. Instead, they prove that Yukos and its advisors were well aware of the fact that Russian tax law included doctrines that made it highly likely that the tax authorities would challenge Yukos' scheme successfully if they ever learned how it operated.

1026. By the same token, the foregoing documents make it impossible for Claimants to argue that Yukos' managers, at the time, believed in good faith that their "tax optimization" program was perfectly legal. At the very minimum, those managers knew that their scheme was subject to challenge if the authorities ever discovered it. It is perhaps telling, in this connection, that although Claimants have submitted in these proceedings lengthy witness statements from five former owners and/or managers of Yukos -- Messrs. Nevzlin, Dubov, Misamore, Theede, and Rieger -- none of these individuals claims (at least so far) to have ever been under the illusion that Yukos' scheme was legal or that, if it

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1599 *Ibid*., at 134.

1600 Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007, 13:19), 4 (Exhibit RME-17). Mr. Miller refers to the trading shells as "the operational entities."

had been discovered by the authorities, it would have been approved by them. Instead, as discussed below, all of them avoid the subject.

(6) Behavior Of Other Companies

1027. Although Claimants have suggested that what Yukos did was not different from the behavior of other companies,[1601] in reality, the majority of Russian companies, including other oil companies, refrained from Yukos-like abuses of the low-tax region program.[1602] Several oil companies, in fact, do not appear to have used the program at all -- a category that would seem to include Tatneft and Surgutneftegaz, as well as Rosneft.[1603] While it is clear that a few other oil companies did make use of the program to reduce their taxes, there is no evidence indicating that any of them engaged in abuses even remotely equivalent to Yukos', *e.g.*, because, as in the case of Lukoil discussed above, they discontinued their programs long before Yukos did,[1604] or because, like Sibneft, they made sure that a sufficiently large proportion (*e.g.*, 50%) of their tax savings were invested in the local economy to reduce or eliminate the risk of a finding of "bad faith."[1605]

1028. If Claimants are to be believed, those other companies, out of sheer incompetence or insufficient devotion to their shareholders, passed up a perfectly lawful opportunity to drastically reduce their tax burden and/or, like Sibneft, made investments in local economies that were entirely unnecessary. This is an absurd proposition. The truth, of course, is that the managers of the companies that did not abuse the low-tax region program were neither stupid nor indifferent to their shareholders' welfare. Instead, they simply realized that schemes such as

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1601 Claimants' Memorial on the Merits, ¶¶ 290-293.

1602 *See* ¶¶ 1260-1274 *infra*.

1603 *See* ¶¶ 301, 1260.

1604 *See* ¶¶ 297-302 *supra*.

1605 For instance, in 2002, the amount of tax benefits granted to Sibneft by the Chukotka Autonomous District, the low-tax region where the trading entities of Sibneft were mainly located, totaled RUB 17.9 billion, whereas the value of Sibneft's investments in hospitals and other public works in that region in the same year amounted to RUB 8.9 billion (*i.e.*, 50% of its overall tax benefits). *See* Audit Chamber Report on Yukos, Lukoil, and Sibneft for 2003 and January-March 2004, 17 (Exhibit RME-266). *See also* ¶ 1262 *infra*.

Yukos' represented obvious abuses of the low-tax region program and that, as such, they were unlikely to withstand scrutiny if challenged by the tax authorities.

1029. Yukos' equally intelligent managers saw the same risks, but recklessly chose to take them anyway, gambling that they would avoid detection or punishment. If Yukos had simply followed the example of its more prudent competitors, it would undoubtedly have avoided bankruptcy, as well as the forced sale of YNG.[1606]

c) Claimants' Arguments That Russian Tax And Other Authorities Knew And Approved Yukos' "Tax Optimization" Scheme Are Meritless

1030. In these proceedings, Claimants lay great emphasis on their contention that Russian authorities, both at the highest levels of the Government and at the working level, knew of Yukos' "tax optimization" scheme and approved of it.[1607] This argument –- which is presented as central to Claimants' case in these proceedings -– is meritless both as a legal and factual matter.

1031. Legally, the argument is to no avail because under Russian tax law and practice (which is consistent with the position of tax authorities around the

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1606 If one totals up all of the tax assessments against Yukos that are contested in these proceedings, around two thirds of the corporate profit and other taxes (other than VAT), interest and fines assessed on Yukos for the 2000-2004 tax years involved abuses perpetrated by Yukos after January 1, 2002, the effective date of Lukoil's abandonment of the same. Yukos' managers had made a grave mistake when they first adopted the "tax optimization" scheme, but committed an even graver one when they chose to part way with Lukoil in 2002. Specifically, Yukos was assessed taxes, including default interest and fines, in excess of RUB 691.9 billion (US$ 24.3 billion) for the years 2000-2004. Two-thirds of these liabilities (including fines and default interest) were assessed against Yukos after Lukoil had ceased to use the low-tax region program. Specifically, Yukos was assessed taxes, interest and fines totaling: (i) RUB 193.8 billion or US$ 6.8 billion for 2002; (ii) RUB 170.4 billion (US$ 6.1 billion) in 2003; and (iii) RUB 108. 4billion (US$ 3.9 million) in 2004. *See* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/896 (Nov. 16, 2004), 165-167 (Annex (Merits) C-175), and Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 52/985 (Dec. 6, 2004), 143-146 (Annex (Merits) C-190). Decision to hold the taxpayer fiscally liable for a tax offence No. 521292 (Mar. 17, 2006), 129-132 (Exhibit RME-1539).

1607 *See, e.g.*, Claimants' Memorial on the Merits, ¶¶ 296-297, 301, 710, 747, 757.

world), the authorities' prior knowledge of a practice does not prevent a subsequent assessment of taxes.[1608]

1032. As discussed in the following sub-sections, Claimants' argument is also demonstrably groundless as a factual matter. No Russian authority ever approved Yukos' abuses of the low-tax region program -- not even implicitly, let alone expressly. Indeed, there is no evidence that the tax authorities even understood before the Fall of 2003 the nature or magnitude of those abuses. As noted above, Yukos had taken pains to conceal -- successfully -- from the authorities and from the public key features of the scheme that made it abusive, *i.e.*, artificial pricing, companies that were shams, the absence of significant investments, and the artifices used to extract the profits of the trading shells, without revealing Yukos' ownership of most of those companies.[1609] In reality, Yukos' disclosures -- such as they were -- and the authorities' knowledge were confined to facts that would have been consistent with the lawful use of the low-tax region program.

(1) As A Matter Of Russian Law, Which Is Fully Consistent With International Practice, Tax Authorities Are Not Estopped By Prior Knowledge Of Taxpayer Practices

1033. Claimants' argument that the assessments at issue were improper because the Russian authorities were familiar with Yukos' scheme would be unsustainable under Russian law even if, *quod non*, it were true. In Russia, then and now, knowledge by the tax authorities of a particular tax practice is entirely irrelevant unless the practice is not only known to them, but the relevant legal norms have been the subject of a formal "clarification" (*razyasnenie*) that has been duly issued pursuant to Article 21(1) of the Tax Code, after disclosure by the taxpayer of all relevant circumstances.[1610] Even in such cases, moreover, the legal effect of "clarifications," if the authorities later change their position, is limited

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1608 *See* discussion at ¶ 1033 *infra* of limited effect of "clarifications" issued by the tax authorities. *See* Konnov Report, ¶ 59, note 115.

1609 *See* ¶¶ 237-277 *supra*.

1610 Specifically, at the relevant time Article 21(1) provided: "*Taxpayers have the right to obtain from the tax authorities and other authorized state bodies written clarifications on the issues of application of legislation on taxes and levies*". (*See* Russian Tax Code, Article 21(1)(2) (Exhibit RME-1478).

only to the non-assessment of fines.[1611] In all other cases, the tax authorities are free, subject only to the statute of limitations, to tax schemes that they had previously failed to contest or that they had condoned.

1034. The fact that Russian tax authorities can and sometimes do reverse position regarding the legality of certain practices was repeatedly and publicly acknowledged by Yukos' own managers in their periodic U.S. GAAP financial statements, which included the following warning to investors:

> "Russian tax legislation is subject to varying interpretations and constant changes, which may be retroactive. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Company may not coincide with that of management. As a result, transactions may be challenged by tax authorities and the Company may be assessed additional taxes, penalties and interest."[1612]

1035. The tax authorities' right "to change their minds" is widely recognized in other countries as well.[1613] There, as in Russia, this reflects a strong public policy against tax-avoidance schemes, which would be difficult to combat if the authorities were bound by their initial tolerance of novel strategies (or simple misunderstanding or inattention). Tax evaders the world over are constantly searching for new ways to cheat the fisc, and typically do so -- as Yukos did here -- in ways that seek to avoid attention as much as possible.[1614] It is thus generally difficult for tax authorities to understand immediately the mechanics of novel schemes, or to assess quickly their potential for harm. If, as Claimants implicitly contend, a failure by the authorities to react immediately to

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1611 Under Article 111 of the Russian Tax Code (Exhibit RME-1479), one of the exculpatory factors (which prevent imposition of penalties for a tax offense) is the "*fulfillment by the taxpayer or tax agent of written clarifications on the issues of application of legislation on taxes and levies provided by the tax body or other authorized state body or their officials within their competence*".

1612 Yukos Annual Report 2000, 58 (Annex (Merits) C-24) [emphasis added]. *See also* Yukos Annual Report 2001, 67 (Annex (Merits) C-25); Yukos Annual Report 2002, 62 (Annex (Merits) C-26); Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements (Sept. 30, 2003), 8 (Annex (Merits) C-31).

1613 *See* discussion at ¶¶ 1166-1179 *infra*.

1614 Yukos' internal communications confirm that it was the "headache" of Yukos' employees to conceal its tax evasion scheme. *See*, *e.g.*, e-mail dated by A.V. Brazhkov to A.P Kuchusheva (Oct. 9, 2001) (Exhibit RME-325). *See* ¶¶ 237-248, 256-277 *supra*.

a new scheme would preclude condemnation at a later date, the cleverness of tax evaders would always be rewarded -- to the detriment of honest taxpayers -- and tax enforcement would be crippled. Not surprisingly, virtually all countries vigorously reject such a line of defense, the exceptions being limited to instances where taxpayers have obtained a formal ruling after having "put all their cards on the table."[1615] That was certainly not done in Yukos' case.

(2) As A Factual Matter, The Russian Authorities Never Approved Yukos' Scheme, And Their Knowledge Did Not Include The Features Of The Scheme That Made It Unlawful

1036. Even if, *quod non*, knowledge of Yukos' scheme on the part of the Russian authorities could constitute an excuse for non-payment of taxes otherwise due, Claimants' argument in this regard would fail because it lacks the requisite factual support. We address and refute, *seriatim*, Claimants' contentions that (a) Yukos' U.S. GAAP financials were "transparent" in this regard, (b) the tax authorities knew of Yukos' scheme thanks to their processing of VAT refund claims and other routine contacts with Yukos officials and/or their audits of Yukos prior to December 2003, and (c) senior Russian officials, both at the national and local level, were aware of Yukos' scheme and had approved it. All of these claims are meritless because there is no evidence that the tax authorities ever understood, let alone approved, the features of Yukos' scheme that made it unlawful, namely sales at artificial prices, local companies that were mere shams, insignificant local investments, and subterfuges to make it extremely difficult, if not impossible, for the authorities to unravel the scheme. Evidence that the authorities knew (or could have known) of the lawful aspects of Yukos' scheme is irrelevant, yet all of the evidence submitted by Claimants is of this latter kind.

(a) The Alleged "Transparency" Of Yukos' U.S. GAAP Financial Statements

1037. Claimants repeatedly boast that, under the management of Messrs. Khodorkovsky, Nevzlin, Dubov, Misamore, *et al*., Yukos became "*Russia's most transparent company*," thanks to its leadership in presenting U.S. GAAP financial

1615 *See* ¶ 1171 *infra.*

statements. Several witness statements submitted by Claimants endorse this claim.[1616] The argument is audacious, and founded on a truly Orwellian redefinition of the concept of "transparency."[1617]

1038. The truth is that Yukos was "transparent" only insofar as its controlling shareholders -- Claimants -- wanted it to be, and those shareholders were adamant about concealing some extremely important information. Thus, throughout the period in which Yukos published U.S. GAAP financials, Claimants were successful in concealing the fact that the Jurby Lake companies were controlled by the Oligarchs, and in this connection, made flagrantly untrue written or oral representations to PwC.[1618] Claimants were also eager to avoid disclosure -- in Yukos' U.S. GAAP financials or otherwise -- of Yukos' control of most of the trading shells and of the Cyprus/British Virgin Islands structures, and the associated tax risks, and were largely successful in doing this.[1619] Most importantly for purposes of these proceedings, the U.S. GAAP financial

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1616 *See, e.g.*, Rieger Witness Statement, ¶ 14; Misamore Witness Statement, ¶ 14; Kosciusko-Morizet Witness Statement, ¶¶ 12-13.

1617 In reality, Yukos was not the first Russian company to publish U.S. GAAP financials; the pioneers were Tatneft, another oil company, which in 1996 published Audited Consolidated Financial Statements for Years Ended December 31, 1995 and 1994 (Nov. 21, 1996) (Exhibit RME-1480) and Vimpel-Communications, a Russian cellular communications provider, which in 1997 published audited consolidated financials as of December 31, 1995 and 1996 (*see* Vimpel-Communications Annual Report 1996 (Exhibit RME-1481)). Another Russian oil company, Sibneft, began issuing U.S. GAAP financials in 1998, *i.e.* at the same time as Yukos (*see* Sibneft Consolidated Financial Statements as of December 31, 1997 and 1996 (Apr. 28, 1998) (Exhibit RME-1482). Leaving aside Claimants' incorrect recollection in this regard, Yukos' alleged "transparency" in issuing U.S. GAAP financials did not, of course, spring from any philanthropic desire to set an example for the Russian business community -- as suggested in the witness statements submitted on the Claimants' behalf (*see, e.g.*, Misamore Witness Statement, ¶ 14) -- but was simply a byproduct of the strategy of Yukos' owners to maximize their already colossal personal fortunes by enhancing the attractiveness of Yukos stock (and hence its price) on world capital markets.

1618 The Jurby Lake companies were Baltic, Behles, South, and others. *See* Section II.D.1 *supra.*

1619 Mr. Miller of PwC reports how the initial reporting under U.S. GAAP financials was delayed by a year because of Yukos' unwillingness to discuss its trading shells with PwC. *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 4, 2007), 8 (Exhibit RME-137). *See also* discussion at ¶¶ 303-304 *supra* concerning Yukos' abandonment of plans to list shares on the New York Stock Exchange after it became clear that the U.S. Securities and Exchange Commission's rules required disclosure of Yukos' domestic trading shells and its Cyprus/British Virgin Islands holding companies, as well as of the associated tax risks.

statements[1620] would not have informed Russian tax officials of Yukos' abuses of the low-tax region program -- even if one assumes that such officials, few of whom speak English, ever read such documents, which were never published in Russian and which never had any official status in the Russian tax or accounting systems.

1039. At most, a careful reader of the final two editions of the U.S. GAAP Financial Statements (2001-2002) could have learned that, somewhere within the perimeter of "affiliated companies" that were included in those consolidated accounts, some use had been made of the low-tax region program to reduce the overall income tax burden borne by the Yukos group below the rate that would have applied if OAO Yukos NK, the group's parent company, had realized the totality of the group's worldwide consolidated income and paid full Russian profits taxes thereon.[1621] Even this limited information, however, was provided in ways that were calculated to conceal Yukos' extremely heavy reliance on the low-tax region program. Thus, for instance, in years prior to 2001, no reference at all was made to the low-tax regions, and the tax savings attributable to Yukos' scheme were hidden behind misnomers such as "[i]*nvestment tax credits and other rate effects*."[1622] In later years, those savings were referred to under the opaque rubric "[i]*ncome taxed at other rates.*"[1623] The closest that Yukos ever came to expressly disclosing its use of the low-tax region program was a statement accompanying its 2001 financials to the effect that the group's taxes had been lowered thanks to the fact that Yukos' "*subsidiaries operate in several tax*

1620 As used herein, this term also includes the related Management's Discussion and Analysis, which is technically a separate document.

1621 *See, e.g.*, Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2001), 19 (Annex (Merits) C-28), Yukos Oil Company Management Discussion and Analysis (Dec. 31, 2001), 11 (Annex (Merits) C-33). *See also* Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2002), 18 (Annex (Merits) C-29), Yukos Oil Company Management Discussion and Analysis (Dec. 31, 2002), 14 (Annex (Merits) C-34).

1622 *See* Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2000), 18 (Annex (Merits) C-27).

1623 *See* Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2001), 19 (Annex (Merits) C-28). *See also* Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2002), 18 (Annex (Merits) C-29).

jurisdictions both within Russia and internationally,"[1624] and for 2002, a declaration that Yukos' "*effective tax rate is affected significantly by enacted rates in the several tax jurisdictions both within Russia and internationally where we have operations.*"[1625] Leaving aside the highly misleading suggestion that a significant part of the tax savings came from activities outside Russia, these "disclosures" falsely represented that Yukos was conducting genuine "operations" in low-tax regions, whereas one of the critical vulnerabilities of Yukos' scheme was precisely the fact that its low-tax region affiliates were shams that carried out no business activities at all.

1040. Moreover, none of the editions of Yukos' U.S. GAAP financial statements ever disclosed, or even hinted at, the other Achilles' heel of Yukos' scheme -– namely, the failure to make any significant investments in local economies. Thus, a reader of Yukos' U.S. GAAP financials would have had no way of knowing that the company was not using the low-tax region program legitimately, but abusing it. This false impression would have been reinforced by the fraudulent misrepresentation in Yukos' annual report for 2002 that "*all transactions with related parties*" within the Yukos group were being carried out "*on an arm's length basis*" and publicly "*reported* […] *when applicable,*"[1626] whereas

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1624 The same paragraph went on to state: "*Many of our subsidiaries are resident in tax jurisdictions in Russia where statutory tax rates are lower or where we benefit from regional tax incentives. In addition several other factors have had a significant impact in reducing our effective tax rate during these years*" (*see* Yukos Oil Company Management's Discussion and Analysis (Dec. 31, 2001), 11 (Annex (Merits) C-33)). [emphasis added]

1625 [emphasis added] That statement went on to add: "*Many of the companies in our consolidated group are resident in tax jurisdictions in Russia and internationally where statutory tax rates are lower than the statutory maximum in Russia or where we benefit from regional tax incentives.*" (*see* Yukos Oil Company Management Discussion and Analysis (Dec. 31, 2002), 14 (Annex (Merits) C-34). Similar statements were replicated in Yukos' Management's Discussion and Analysis for the first quarter and semester of 2003. Yukos Oil Company Management Discussion and Analysis (Mar. 31, 2003), 10 (Annex (Merits) C-35), Yukos Oil Company Management Discussion and Analysis (June 30, 2003), 11-12 (Annex (Merits) C-36).

1626 *See* Yukos Annual Report 2002, 33 (Annex (Merits) C-26). Equally false assurances of this kind had been included in earlier public statements. Thus, a Resolution of the Board of Directors on Good Corporate Governance dated June 3, 2000, which was posted on Yukos website, claimed: "*In addition to the strict application of all laws and regulations applicable to the company and its governing bodies, and in order to enforce the above principles as soon as possible, the Board has decided the following:* [...] *4) Transactions with friendly parties, if any, will be on an arm's length basis and reported when applicable.*"(*see* Resolution of the Board of Directors on Good Corporate Governance (June 3, 2000) (Annex (Merits) C-37). The 2000 Annual Report claimed that Yukos carried out "*arm's-length transactions with all related parties, and reporting of all such*

the truth was that (i) all of the sales of oil and products to the trading shells were at prices that never would have been offered to unrelated parties (since sales to the trading shells at low prices was the method by which those lightly-taxed companies were able to generate artificially high profits), and (ii) large portions of those profits were remitted to Yukos by means of "donations," promissory notes and other subterfuges that were the antithesis of arm's length transactions -- but which were essential, and unlawful, elements of Yukos' "tax optimization" scheme. Finally, Yukos' U.S. GAAP financial statements also failed to disclose the identity of most of Yukos' trading shells, even though they played a critical role in generating profits within the Yukos group.

1041. In sum, Claimants' argument that, thanks to Yukos' "*transparent*" U.S. GAAP financial statements, the Russian tax authorities (assuming, *quod non*, that they ever looked at them) were somehow put on notice of the company's "tax optimization" scheme is contradicted by the language of those financial statements themselves (and the material omissions therefrom).

(b) Alleged Knowledge On The Part Of Working-Level Tax Authorities

1042. Claimants effectively concede that Yukos never sought a "clarification" of the legality of its "tax optimization" scheme, as contemplated by the Russian Tax Code.[1627] Instead, Claimants make the legally irrelevant argument that working-level tax officials knew of its scheme and, by remaining silent, implicitly approved it. This "silence equals consent" argument would be considered risible by tax authorities in Russia as well as anywhere else in the world,[1628] and no doubt for this reason, Yukos does not seem to have ever raised it in the Russian proceedings.

1043. This argument is in any event indefensible as a factual matter. As discussed above, the owners and managers of Yukos went so far as to cancel the plan to list Yukos stock on the New York Stock Exchange because they feared

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transactions as required." (Yukos Annual Report 2000, 29 (Annex (Merits) C-24).).

1627 *See* ¶ 1033 *supra*.

1628 *See* ¶¶ 1180-1181 *infra.*

that the disclosures mandated by the U.S. securities authorities would result in discovery of Yukos' scheme by the Russian tax authorities. This circumstance alone shows that Yukos knew that the Russian authorities did not know about its scheme.

1044. In any event, Claimants have once again failed to show that the Russian authorities -- even if, *quod non*, they did know something about the scheme -- were aware of the features that made it unlawful. We review separately the main prongs of Claimants' argument in this regard: (1) routine processing of VAT refund claims;[1629] (2) the "table mechanism" for confirming the oil companies' tax burden as a condition for access to export pipelines;[1630] (3) the periodic issuance of routine "certificates" attesting to the fact that Yukos was not delinquent in paying tax assessments;[1631] and (4) prior audits.[1632]

1. Processing Of VAT Refund Claims

1045. Claimants emphasize the fact that the tax authorities responsible for VAT returns had routinely processed VAT refund claims filed by various Yukos affiliates, including the trading shells that were involved in export transactions.[1633] Claimants' argument is that, by paying refunds to those shells -- which often involved large amounts of money -- the tax authorities implicitly confirmed that Yukos' abuse of those trading shells to reduce its profit taxes was legitimate. This argument is specious.

1046. All countries levying value-added taxes make large refunds of VAT on a daily basis, in particular (though not exclusively) to exporters. In order to qualify for such a refund, taxpayers in Russia and elsewhere must, among other things, demonstrate that they have paid more in VAT to their suppliers (so-called "input VAT") than they have been required to collect from their customers

1629 Claimants' Memorial on the Merits, ¶ 712.

1630 *Ibid.*, ¶¶ 243, 713.

1631 *Ibid.*, ¶¶ 244, 705.

1632 *Ibid*.

1633 *Ibid.*, ¶ 712.

(so-called "output VAT").[1634] For this purpose, it is entirely irrelevant whether or not the taxpayer is profitable and, if so, whether it has been paying (or as in Yukos' case, evading) profits taxes; the documentation furnished to the VAT authorities includes no information that would allow them –- even if they were so inclined -– to assess the taxpayer's compliance with tax obligations other than VAT-related ones. And indeed, this is confirmed even by the testimony adduced by Claimants, which shows that the department of the tax inspectorate in charge of indirect taxes, including VAT, quite properly verified whether the requested VAT refunds were appropriate, but did not make any inquiries that would be relevant to profits taxes (which were and are the responsibilities of an entirely separate bureaucratic unit) or more generally, to possible abuses of the low-tax region regime.[1635]

1047. Claimants' attempt in these proceedings to infer from the silence of the VAT authorities that their colleagues in another department would have approved of Yukos' evasion of profits taxes, if they had known about them, is such a weak argument that it simply underscores the vacuity of Claimants' entire "knowledge of the authorities" argument.

2. The Pipeline "Table Mechanism" And The Tax Ministry's Comparisons

1048. An equally feeble argument is based on the fact that Russia's pipeline authorities were allowed to condition each oil company's use of those

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1634 For exporters such as some of Yukos' affiliates, this meant, *inter alia*, providing evidence that the relevant goods or services have been exported. Pursuant to Article 164(1), paragraph 1, of the Russian Tax Code, "[t]*he sale of the following is subject to a tax at a rate of 0 percent: 1) Goods* [...] *placed under the export customs treatment, provided they are actually shipped outside the Russian Federation and the documents provided by article 165 of this Code are submitted*." (Exhibit RME-1483) [emphasis added] Pursuant to Article 165 of the Russian Tax Code, "[i]*n case of sale of the goods provided by sub-clause 1 and (or) sub-clause 8 of clause 1 of Article 164 of this Code, the following documents shall be submitted to the tax authorities to prove eligibility to 0 percent tax rate* [...] *1) Contract (copy of a contract) between the taxpayer and a foreign entity for supply of goods outside the customs territory of the Russian Federation.* [...] 2) *Bank statement (copy of statement) evidencing the actual credit of revenue from the foreign entity, the buyer of the goods (stores), to the taxpayer's account with a Russian bank.* […] 3) *customs declaration (its copy) with marks put by the Russian customs authority releasing the goods in the export treatment and* […] *the border customs authority* […] *4) Copies of shipping, transportation and/or other documents* […] *evidencing the shipment of goods outside the Russian Federation*." (Exhibit RME-1484) [emphasis added]

1635 Dubov Witness Statement, ¶¶ 40-41. *See* Konnov Report, ¶¶ 62-63.

pipelines on presentation of evidence that the oil company had paid its taxes.[1636] Typically, this evidence was provided in the form of "tables" showing the oil company's tax burden at any given time. However, these data provided no indication whatsoever as to the correctness of any taxpayer's self-assessments, and in particular, whether the taxpayer had used fraudulent techniques to reduce its tax liability.

1049. Claimants nevertheless contend that in Yukos' case, officials of the Tax Ministry also made periodic comparisons of the overall amount of taxes paid per ton by Yukos and other major oil companies. According to Claimants, the failure by the authorities to complain on those occasions implicitly suggested approval of Yukos' tax-evasion techniques. Once again, however, the record is bare of any suggestion that the authorities in question had any idea that Yukos was abusing the low-tax region program. Indeed, the only example of the Tax Ministry's comparisons (an attachment to the witness statement of Mr. Dubov) does not mention the low-tax region program at all. To the contrary, as discussed below, it wrongly assumes that all companies listed (including Yukos) were paying profit taxes at a uniform rate of 24% for 2002[1637], which is substantially higher than the rate that Yukos was actually paying, thanks largely to its abuses of the low-tax region program.[1638]

1050. By presenting these specious arguments -- by grasping at straws -- Claimants simply confirm their lack of any convincing evidence to support their allegation that the authorities knew and approved of their scheme.

3. "Certificates"

1051. Equally without merit is Claimants' argument based on the "certificates" issued at various times in 2003 by the Interregional Inspectorate for Major Taxpayers No. 1.[1639] In Russia, as in many other countries, it is possible for

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1636 Claimants' Memorial on the Merits, ¶¶ 243, 712.

1637 *See* Dubov Witness Statement, Exhibit B.

1638 *See* Yukos Annual Report 2002, 89 (Annex (Merits) C-26).

1639 *See* Claimants' Memorial on the Merits, ¶¶ 244, 705.

taxpayers to obtain from the tax administration attestations to the effect that they are not overdue on any tax payment. These computer-based certificates simply show that, at any given moment, that taxpayer has (or has not) paid all of the taxes assessed against it.[1640] They do not (and could not) show, or even imply, that the taxpayer's tax returns, (upon which all assessments, prior to audit, are necessarily based), have been complete, sincere, or otherwise proper.[1641] This reality was well-understood by everyone. Claimants' reliance on this bogus argument again simply underscores the bankruptcy of their claim that Yukos' scheme enjoyed the support, or even merely the tacit consent, of the tax authorities.

4. Prior Audits

1052. Finally, Claimants also cite the regional audit of Yukos that the local tax inspectorate for Nefteyugansk commenced in late 2002.[1642] Claimants try to infer from this audit, and the fact that it did not uncover Yukos' "tax optimization" scheme, that the tax authorities somehow approved of it. To grant such approval, however, those authorities would have needed to know of the scheme, and in particular, of its controversial features. Nothing in that audit report, however, suggests that the auditors were made aware of any of those features.[1643] Thus, for example, the report says nothing at all about whether and how much (or how little) Yukos had invested in the local economies of low-tax regions. Nor does it say anything about any of the trading shells, let alone whether they were endowed with any substance, or had any purpose other than tax evasion. Nor is there the slightest suggestion that Yukos drew any of these issues, or any other sensitive ones, to the auditors' attention.

1053. Yet, absent persuasive evidence that the auditors understood that Yukos and its affiliates were massively abusing the low-tax region program, their

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1640 *See* Konnov Report, ¶ 64.

1641 *See* ¶¶ 297-302 *supra.*

1642 Claimants' Memorial on the Merits, ¶ 244.

1643 *See* ¶¶ 305-308 *supra. See* Field Tax Audit Report No. 66 of OAO Yukos Oil Company (Apr. 28, 2003) (Annex (Merits) C-100).

failure to reassess Yukos' taxes on those grounds is meaningless, and provides no comfort whatsoever to Claimants' theory that the authorities were aware of Yukos' "tax optimization" scheme, let alone that any such awareness can be viewed as evidence that the scheme was ever legal.[1644]

(c) Alleged Knowledge Of Yukos' Scheme By Senior Federal And Local Officials

1054. In support of their claim that the Russian authorities were aware of Yukos' abuses of the low-tax region program, Claimants adduce the testimony of several witnesses, notably: Mr. Mikhail Kasyanov, a former Prime Minister of the Russian Federation and long-time supporter of Mr. Khodorkovsky[1645] and Mr. Vladimir Dubov, one of the Oligarchs who are the beneficial owners of Claimants.[1646] Neither this testimony, nor the testimony in other witness statements, is helpful to Claimants.

1. Kasyanov

1055. In these proceedings, Mr. Kasyanov -- rather than submitting a traditional witness statement -- has taken the unusual step of recycling testimony he previously gave in support of Mr. Khodorkovsky in other proceedings.[1647]

1644 The suggestion (Claimants' Memorial on the Merits, ¶¶ 705-706) that it was somehow improper for the Tax Ministry to conduct a further audit of Yukos in December 2003 is also patently meritless: repeat audits are not only permissible but routine, in Russia as well as in other countries, because pulling the wool over the auditors' eyes on one occasion does not create a legitimate expectation that one will be spared a subsequent visit. Russian tax law explicitly provides for the Tax Ministry's power to conduct "supervisory" or "repeat" audits (*see* Russian Tax Code, Article 87 (Exhibit RME-356). *See* Konnov Report, ¶¶ 59, 65-70. *See also* ¶¶ 1181 *infra.*

1645 *See*, *e.g.*, press articles dating back to 2003 attached to Mikhail Kasyanov's Witness Statement (July 8, 2009) submitted before the European Court of Human Rights in relation to the applications that have been made by Mikhail Khodorkovsky (Application Nos. 5829/04, 11082/06 and 51111/07), in which Mr. Kasyanov supported Mr. Khodorkovsky.

1646 *See* ¶¶ 118-153 *supra.*

1647 *See*, Kasyanov Witness Statement, Mikhail Kasyanov's Witness Statement (July 8, 2009) submitted before the European Court of Human Rights in relation to the applications that have been made by Mikhail Khodorkovsky (Application Nos. 5829/04, 11082/06 and 51111/07) (Annex (Merits) C-446); Transcript of Mikhail Kasyanov's testimony (May 24, 2010) before the Khamovnichesky Court of Moscow in the second criminal case brought against Mikhail Khodorkovsky and Platon Lebedev (Annex (Merits) C-440), Transcripts of video interviews (May 24, 2010) provided by Mikhail Kasyanov to the press following his testimony before the Khamovnichesky Court of Moscow on that date (Annex (Merits) C-591).

The gist of Mr. Kasyanov's statements regarding tax issues is that he thinks Yukos' tax practices must have been legal because the Russian Duma did not abolish the low-tax region program until December 2003, even though Mr. Kasyanov and others had been criticizing it without success for several years.[1648] Mr. Kasyanov is simply wrong.

1056. First, it should be noted that Mr. Kasyanov does not claim that he ever told Yukos that its "tax optimization" scheme was legal. Nor does he say that any tax official ever said any such thing. Instead, he says that he thinks that, if tax officials had been asked to opine regarding the legality of Yukos' practices (and the allegedly similar practices of "*almost all other oil companies*"), they would have confirmed their "*lawfulness*."[1649] Accordingly, he suggests that the tax assessments against Yukos must have involved a politically-inspired[1650] "*retroactive*" application of the cancellation of the low-tax region program that the Duma adopted and which was intended by its terms to have no impact on uses of the low-tax region program prior to December 31, 2003.[1651]

1057. Mr. Kasyanov is manifestly confused. For one, Federal Law No. 163-FZ of December 8, 2003 (the "December 2003 law"), to which Mr. Kasyanov is apparently referring, did not abolish the low-tax region program, which continues to be in effect to this date, albeit in a shrunken form.[1652] This much is

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1648 *See* Kasyanov Witness Statement, Mikhail Kasyanov's Witness Statement (July 8, 2009) submitted before the European Court of Human Rights in relation to the applications that have been made by Mikhail Khodorkovsky (Application Nos. 5829/04, 11082/06 and 51111/07) (Annex (Merits) C-446), ¶ 34, 37, Transcript of Mikhail Kasyanov's testimony (May 24, 2010) before the Khamovnichesky Court of Moscow in the second criminal case brought against Mikhail Khodorkovsky and Platon Lebedev, 6-7 (Annex (Merits) C-440) and Transcript of interview of Mikhail Kasyanov (May 24, 2010) after his testimony in the Khamovnichesky Court, 2-3 (Annex (Merits) C-591).

1649 Kasyanov Witness Statement, Mikhail Kasyanov's Witness Statement (July 8, 2009) submitted before the European Court of Human Rights in relation to the applications that have been made by Mikhail Khodorkovsky (Application Nos. 5829/04, 11082/06 and 51111/07), ¶ 40 (Annex (Merits) C-446).

1650 *See* Section III *supra.*

1651 *See* ¶ 368 *supra.*

1652 Pursuant to Article 284 of the Tax Code in force as of January 1, 2004, "*[t]he tax rate shall be established […] in the amount of 24 percent. […] [T]he amount of tax calculated at the tax rate of 5 percent shall be credited to the federal budget; the amount of tax calculated at the tax rate of 17 percent shall be credited to the budget of the sub-federal unit of the Russian Federation; […] by the laws of the*

clear from its text.[1653] Nor was the December 2003 law the only one that restricted the low-tax region program; an earlier law, promulgated in August 2001, which entered into force in January 2002, had already imposed some limitations.[1654, 1655]

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sub-federal units of the Russian Federation, the rate stipulated by this paragraph may be reduced for particular categories of taxpayers in the part of the tax to be credited to the budget of the sub-federal unit of the Russian Federation. However, the above mentioned rate may not be less than 13%." (Exhibit RME-1485). In other words, even after Law No. 163-FZ entered into force, sub-federal units of the Russian Federation (*i.e.*, the low-tax regions in which Yukos had established its trading shells) would be entitled to grant tax incentives to taxpayers in the amount not exceeding 4% of their taxable income (*i.e.*, the rate of 17% to be "*credited to the budget of the sub-federal units*" minus the 13% minimum threshold). Of course, the laws of the sub-federal units mentioned in the last part of the provision were the laws of the low-tax regions that Yukos had abused in the years 2000-2003 to evade taxes. Pursuant to Article 284 of the Tax Code currently in force (Exhibit RME-1486), the sub-federal units are still entitled to grant tax incentives to taxpayers in an amount not exceeding 4.5% of their taxable income.

1653 *See* Federal Law No. 163-FZ "On Amending Certain Legislative Acts of the Russian Federation on Taxes and Fees" (Dec. 8, 2003) (Exhibit RME-343). As a textual matter, the law simply states that the "*additional tax incentives* […] *with respect to certain categories of taxpayers implementing investment projects under agreements on investment activity and established by the legislative (representative) bodies of the sub-federal units of the Russian Federation and by the representative bodies of local administration* [*i.e.*, the low-tax regions] *as of July 1, 2001, shall be effective until the expiration of the period for which they were granted but no later than January 1, 2004*." In sum, the December 2003 law required any such investment agreements to come to an end on the earlier of their expiration date or January 1, 2004. This compulsory termination rule was imposed on all agreements, including those involving indisputably genuine, substantial investments in the low-tax regions by indisputably *bona fide* companies.

1654 *See* Article 1 of Federal Law No. 110-FZ (Aug. 6, 2001) "On Amending and Supplementing Part Two of the Tax Code of the Russian Federation and Certain Other Acts of the Legislation of the Russian Federation on Taxes and Levies" (Exhibit RME-1466), which restricted the power of the regional tax authorities to grant tax benefits to a cap of 4%. *See also* Konnov Report, ¶¶ 33-36.

1655 The December 2003 law is also important because it was the basis for a claim of retroactivity, similar to the one made by Mr. Kasyanov, in the Report of Ms. Leutheusser-Schnarrenberger (the "Rapporteur") to the Parliamentary Assembly of the Council of Europe: "*I had an interesting exchange of views during my first visit at the State Duma with a representative of the tax ministry. He described to me the 'abusive' techniques used by Yukos to minimise taxes by letting part of the profits of the mother company accrue to dependent companies domiciled in inner-Russian tax havens.* [...] *The law making such 'abuses' possible has* [...] *been changed, so as to make such techniques impossible in practice. In reply to my explicit question, he confirmed that the new law entered into force only in 2004. This clearly raises an issue of the retroactive application of changes in tax laws, which is quite problematic, under property protection aspects, even when it is merely a matter of retroactively charging higher taxes for the past.*" (Annex (Merits) C-490), ¶66 [emphasis added]. As discussed above, these allegations are misplaced. The Rapporteur appears not to have understood the December 2003 law, and, in fact, not to have even read it; by her own admission, she based her discussion largely on press articles, which themselves had been greatly influenced by the extensive lobbying efforts of Yukos managers: "*I am aware that the information pointing at Yukos (and thereby its former leading executives and main shareholders) being deprived of their main asset, its oil-producing subsidiary Yugansneftegaz, must be treated with utmost caution: apart from some factual elements obtained from Yukos' current CEO, Steven Theede, and*

1058. The main flaw in Mr. Kasyanov's testimony, however, is another one: like Claimants, he too totally ignores the distinction between lawful use of the low-tax region program and unlawful abuses. Abuses are an issue that none of the Duma's laws relating to the low-tax regions ever addressed, because in Russia as in many other countries, anti-abuse doctrines are the province of the tax authorities and the courts, not the parliament. By ignoring the critical distinction between lawful use and abuse, Mr. Kasyanov implausibly suggests that he believes that all uses and abuses of the program prior to December 2003 by Yukos and others were *ipso facto* lawful -- even the most egregious ones.[1656] This counter-intuitive conclusion, however, overlooks the incontrovertible evidence that, long before the December 2003 audit of Yukos, the tax authorities (and courts) repeatedly invoked jurisprudential anti-abuse doctrines to combat abuses of the low-tax region program, including abuses by Yukos' own affiliates (Business-Oil (Lesnoy) and Sibirskaya, *see* ¶¶ 281-287, 291-294 *supra*), as well as

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CFO, Bruce Misamore, and Yukos' international lobbyists on the one side, as well as the head of the Federal Tax Service, Mr. Serdyukov, on the other, I am basing myself entirely on reports in the press, which are in turn a reflection of sometimes incomplete or contradictory public declarations by different actors, or of leaks that may be intended to test national and international public opinion, and market reaction." (Annex (Merits) C-490), ¶ 62 [emphasis added]. As the Rapporteur also made clear: "[A]*n examination of the substance of the tax claim exceeds my possibilities and my mandate*." (*Ibid.*, ¶ 65) This fundamentally flawed Report was taken as the basis for Resolution 1418 (2005) of the Parliamentary Assembly of the Council of Europe (Jan. 25, 2005), (Annex (Merits) C-491), as well as for the Opinion of the Committee on Economic Affairs and Development (Annex (Merits) C-495). *See* Section III.A. *supra*

1656 The December 2003 law, however, neither expressly nor implicitly legalized any pre-2004 abuses of the low-tax regions. In fact, the December 2003 law said nothing at all about such abuses. It certainly did not grant, expressly or implicitly, any kind of amnesty to taxpayers who had improperly taken advantage of the tax regimes in the low-tax regions. To the contrary, by its silence, the December 2003 law left the tax authorities entirely free to challenge any such abuses on the basis of prior law. Notably, Yukos' lawyers do not seem to have ever raised before Russian courts the argument that the December 2003 law somehow legalized its prior illegal conduct. Further confirmation, if any were needed, that the December 2003 law did not legitimize pre-2004 abuses (or imply their legitimacy) is provided by the *Korus Kholding* case, which was decided in 2006 by the Federal Arbitrazh Court for the Moscow District. That case involved tax evasion schemes remarkably similar to the ones used by Yukos, by a company named OAO Korus Kholding ("Korus Kholding") that, in 2001, purported to conduct activities in the low-tax region of Baikonur through a trading shell by the name of OOO Korus Baikonur. The court's decision in the *Korus Kholding* case, which had nothing to do with Yukos, but which like the Yukos case involved tax evasion schemes implemented long before January 2004 (though finally adjudicated thereafter), fatally undermines the argument that abuses of the tax regimes in the low-tax regions were legal until promulgation of the December 2003 law. *See* Resolution of Federal Arbitrazh Court of Moscow District, Case No. KA-A40/5876-06 (July 28, 2006) (Exhibit RME-1487).

by companies outside the energy sector (*see* ¶¶ 295-296 *supra*), in each instance under conditions where no political intervention has ever been alleged. In fact, in one of the attachments to his witness statement, Mr. Kasyanov concedes that, as Prime Minister, he had no knowledge of law enforcement efforts by the authorities -- "*such issues quite simply, somehow never reached me.*"[1657] Whether Mr. Kasyanov's recollection is accurate or not, the authorities' proven attempts to combat abuses of the low-tax region program by Yukos and other affiliates fatally undermine his suggestion that, if Yukos had only gone to the trouble of asking,[1658] the tax authorities would have reassured them that what they were doing was perfectly proper.

1059. In reality, it is unclear whether, even today, Mr. Kasyanov is aware of the existence or nature of the abuses that led to Yukos' downfall. Judging from his testimony, it would seem not. For example, he appears not to know that Yukos concealed its ownership of trading shells.[1659] Likewise, his testimony suggests that, while he vaguely appreciated that Yukos and other companies used "*transfer pricing,*" he did not realize that Yukos' trading entities were shams created solely for tax purposes,[1660] or that they made no significant local investments[1661] (even though even a "big picture man" such as himself must have realized that the sole justification for the low-tax region program was to generate such investments). Nor is there even a hint that Mr. Kasyanov realizes that the profits of the trading shells were transferred out of those companies via schemes that would make it extremely difficult, if not impossible, for the authorities to unravel Yukos' "tax optimization" structure.[1662]

1657 *See* Kasyanov Witness Statement, Transcript of Mikhail Kasyanov's testimony (May 24, 2010) before the Khamovnichesky Court of Moscow in the second criminal case brought against Mikhail Khodorkovsky and Platon Lebedev, 8.

1658 As discussed in ¶ 1033 *supra*, Yukos could have asked the authorities for a "clarification," but apparently never did.

1659 *See* ¶¶ 237-243 *supra.*

1660 *See* ¶¶ 244-248 *supra.*

1661 *See* ¶¶ 249-255 *supra.*

1662 *See* ¶¶ 256-277 *supra.*

1060. Insofar as Mr. Kasyanov evidently does not understand that Yukos abused the low-tax region program, or the ways in which it did so, his speculation that the authorities would have readily blessed those practices if only they had been asked to do so lacks any probative weight.

2. Dubov

1061. Mr. Dubov is one of the Oligarchs, and therefore, like Mr. Nevzlin, has a huge personal stake in the outcome of these proceedings. The gravamen of his witness statement is the allegation that some officials in the low-tax region of Mordovia were aware of the the Mordovian elements of Yukos' "tax optimization" scheme. A careful reading of that witness statement, however, simply confirms once again that Claimants are unable to provide evidence that Russian tax officials were aware of Yukos' abuses of the low-tax region program, let alone that they approved any of them.

1062. Mr. Dubov confirms that, as charged by the Russian authorities, Yukos' local investments were paltry, or nonexistent. His estimate of "*Rub 80 million per month to the Republic*" of Mordovia corroborates the findings of the Audit Chamber which determined that Yukos had contributed barely 2% of its tax savings to the economy of that region.[1663] Mordovia was widely viewed as a satrapy of the Oligarchs, whose local influence was so overwhelming that Mr. Nevzlin was able to have himself elected as one of the region's federal senators.[1664] Even so, Yukos' contributions to Mordovia were miserly. Tellingly, Mr. Dubov says nothing at all regarding Yukos' contributions to the economies of the numerous other low-tax regions that it abused over the years. They can safely be assumed to have been even smaller.

1063. Mr. Dubov himself was a Deputy to the State Duma where he says he took a special interest in tax matters.[1665] There can thus be no doubt that he understood the architecture and detailed mechanism of Yukos' "tax

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1663 *See*, *e.g.*, Audit Chamber Report on Yukos, Lukoil and Sibneft for 2003 and January-March 2004 18-19 (Exhibit RME-266). *See also* ¶¶ 249-255 *supra*.

1664 Nevzlin Witness Statement, ¶ 10. *See also* ¶ 254 *supra*.

1665 Dubov Witness Statement, ¶ 6.

optimization" scheme, as well as its vulnerabilities. Yet, Mr. Dubov effectively concedes, *sub silentio*, that the Duma never attempted to usurp the Russian courts' role in defining anti-abuse rules to draw lines between legitimate uses and abuses of the low-tax region program. Notwithstanding his enormous influence within that body, Yukos evidently chose not to seek legislative endorsement for its abuses of the low-tax region program, but rather to keep them secret from the Duma as well as from anyone else. In fact, apart from his above-cited discussion of Yukos' modest contribution to the local economy of Mordovia (which assumes the relevance of the tax authorities' complaints regarding the lack of "proportionality" of Yukos' local investment), and a few other comments regarding Yukos' Mordovian shells, Mr. Dubov eschews any discussion of the issues that are critical for use-versus-abuse purposes. Thus, for example, there is not a word in Mr. Dubov's statement regarding Yukos' role in the day-to-day management of the Mordovian shells (and all the other ones), even though he must realize that this issue was critical for the tax authorities (as it was for PwC, which listed Yukos' misrepresentation in this regard as one of the grounds for withdrawing its certification of Yukos' accounts). Nor does Mr. Dubov discuss the opaque Cyprus/British Virgin Islands holding structure for Fargoil, the most important of the Mordovian shells, a scheme with which he must have been intimately familiar.

1064. Instead, Mr. Dubov makes generalized claims that federal as distinguished from local officials were also familiar with Yukos' scheme, but evidence to which he refers in support of this claim—the "tables" comparing the per-ton tax burden of the major Russian oil companies—actually contradict him. This is readily apparent if one considers that it is evident from the face of the "tables" for 2002 that Mr. Dubov attaches to his witness statement that they did not include any information regarding the taxes actually paid by Yukos or any of the other companies, but rather assumed that all of them had paid profits taxes at a uniform hypothetical rate—in 2002, a rate of 24%.[1666] Since 24% was the full

[1666] Dubov Witness Statement, Exhibit B. In the English translation, the reference to profit tax ("Profit Tax (24%)") appears 14 lines from the end of the table, in the left-hand column as can be readily ascertained, the profit tax for Yukos and every other company is exactly 24% of its estimated "Taxable Profit."

rate applicable in 2002 for profits earned outside the low-tax regions, the "tables" to which Mr. Dubov draws the Tribunal's attention in fact assume that neither Yukos nor any other listed company was making any use at all of low-tax regions. Those "tables" therefore do not show, or even suggest, by the most indirect of inferences, that their compilers or readers know anything at all about Yukos' reliance on low-tax regions to reduce its taxes, let alone that they were aware of the abusive methods that had been used to achieve this result.

3. Other Witnesses

1065. Tellingly, several other individuals who have submitted witness statements in these proceedings and who are undoubtedly knowledgeable regarding Yukos' "tax optimization" scheme, the abuses that it involved, Yukos' attempts at concealment, and the tax authorities' knowledge (if any) of the same, have carefully steered clear of all of these sensitive topics. This is notably the case for the following:

(i) Mr. Leonid Nevzlin, who -- in Mr. Khodorkovsky's absence -- is the Oligarchs' leader and, as a major beneficial owner of Claimants, a highly interested participant in these proceedings. He avoids any discussion of tax issues except to say that "*the Russian Prosecutor General's Office brought charges against [him] for tax evasion and embezzlement*."[1667]

(ii) Mr. Bruce Misamore is another highly interested participant in these proceedings: he served as Yukos' Chief Financial Officer from April 2001 through December 2005,[1668] when he fled Russia. He is also currently a member of the management board of the Dutch Stichtings to which he and other former Yukos managers diverted Yukos' offshore assets,[1669] which he had previously (and secretely) controlled through such devices as his role as "protector" of

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1667 *See* Witness Statement of Leonid Nevzlin (Aug. 29, 2010) ("Nevzlin Witness Statement"), ¶ 14.

1668 *See* Misamore Witness Statement, ¶ 7.

1669 *See* ¶¶ 528-539 *supra*.

various trusts.[1670] Clearly, Mr. Misamore is intimately familiar with the operation of Yukos' "tax optimization" scheme, which he helped to design. Yet he limits himself to a prudently general and unsupported declaration that "*Yukos' tax structure*" was "*well known to the Russian tax authorities, who audited the company annually.*"[1671] In particular, he carefully avoids any discussion of the sensitive issues that are relevant here (*i.e.*, the attempts by Mr. Misamore and his colleagues to conceal their scheme, its non-arm's length components, its use of sham Russian trading companies, and secret foreign trusts and holding companies to conceal the true ownership of the same[1672] -- all matters that fell squarely within his responsibilities as Yukos' CFO, that he had dealt with personally, and that would for the most part have been obviously illegal in his native United States).

Tellingly, Mr. Misamore -- while speculating (again, without evidentiary support) that PWC's withdrawal of its certifications of Yukos' accounts[1673] resulted from Russian Government "pressure" -- carefully steers clear of any discussion of the four grounds that PwC had cited specifically as reasons for that withdrawal.[1674] Instead, again he makes a general -- and patently incorrect -- statement to the effect that PwC "*never*" brought any "*serious concerns*" to his attention, whereas it is indisputable, to cite only one example, that PwC had been deeply troubled about rumors that entities in the opaque Jurby Lake Structure (Behles, Baltic, and

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1670 *See* Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2008, 15:56), 14 (Exhibit RME-140): "*Question: What sort of trusts are these: who was behind them, who managed them and who was the trustee and the trust protector? Answer: I do not know specific details but our understanding was that an individual YUKOS executive was behind each trust. This could have been someone like Bruce Misamore, David Godfrey – someone from YUKOS' top management*".

1671 *See* Misamore Witness Statement, ¶ 39.

1672 *See* ¶¶ 237-277 *supra.*

1673 *See* Letter from ZAO PwC Audit to E.K. Rebgun (June 15, 2007) (Annex (Merits) C-611).

1674 *See* Misamore Witness Statement, ¶ 29.

South) were beneficially owned by Mr. Khodorkovsky and associates, rumors that Mr. Misamore and Mr. Khodorkovsky falsely denied at the time, in writing.[1675]

(iii) Mr. Steven Theede, another American, served as Yukos' Chief Operating Officer from August 2003 and thereafter as its Chief Executive Officer until August 2006.[1676] He, like Mr. Misamore, was actively involved in siphoning off the company's offshore assets.[1677] Mr. Theede arrived at Yukos before the collapse of Yukos' "tax optimization" scheme, and he too must have been aware of its details; yet he fails to discuss the scheme at¶ all, limiting his testimony to the comparatively safe area of Yukos' attempts to settle its tax liabilities starting in April 2004.[1678] Mr. Theede does not claim that the Russian tax authorities knew of Yukos' scheme.

(iv) Mr. Frank Rieger, a German who rose through the ranks in Yukos' finance department to the position of Financial Controller (in charge, *inter alia*, of financial reporting for Yukos' non-Russian affiliates), served as Yukos' acting Chief Financial Officer starting in December 2005, when Mr. Misamore fled Russia. Mr. Rieger was thus intimately familiar with the secret British Virgin Islands

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1675 *See* ¶¶ 81-95 *supra.* Thus, for instance, in a letter addressed to PwC on May 24, 2002, Mr. Khodorkovsky and Mr. Misamore stated that: "[A]*t December 31, 2001 and during the three-year period then ended, Behles Petroleum S.A., South Petroleum Limited, Baltic Petroleum Trading Limited* […] *were not related to [Yukos] under the provisions of Statement of Financial Accounting Standards No. 57, Related Party Disclosure*." (*See* Letter from Yukos Oil Company to ZAO PricewaterhouseCoopers Audit (May 24, 2002) signed by M.B. Khodorkovsky and B.K. Misamore attached to Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2007; 13:19) (Exhibit RME-17), ¶ 17). PwC had also on several occasions raised serious concerns about the obscure relationship between Yukos and the Yukos Universal Beneficiaries (*see* ¶ 36 *supra*, which seemingly resulted in the attribution to those Beneficiaries of Yukos stock worth approximately US$ 4.5 billion. *See also, e.g.*, Record of Interrogation of a Witness with the Participation of an Interpreter (Douglas Robert Miller, PwC Moscow, Russia) (May 8, 2008; 15:56), 19-23 (Exhibit RME-140).

1676 *See* Theede Witness Statement, ¶ 5, 7.

1677 *See* ¶ 532 *supra.*

1678 *See generally* Theede Witness Statement.

companies and trusts used to siphon trading shell profits out of Russia. Like his more senior colleagues, Mr. Rieger carefully refrains from saying anything about these or other sensitive topics, even as he lavishly praises Yukos' "transparency," stating that it was so extreme that "*many people were shocked*" by it.[1679] He does not, however, claim that the Russian tax authorities were aware of Yukos' scheme.

On the other hand, like his former boss Mr. Misamore, Mr. Rieger does challenge the *bona fides* of PwC's withdrawal of its certifications of Yukos' accounts, claiming that the very idea that Yukos might have withheld information from PwC, let alone lied to it, "*defies credibility,*" and saying that he cannot remember PWC ever "*rais*[ing] *concerns in this respect*."[1680] Also, like Mr. Misamore, Mr. Rieger ignores the evidence confirming that PwC was lied to, and carefully avoids addressing any of the four grounds cited by PWC in support of its withdrawal letter.[1681]

(v) Finally, Mr. Jacques Kosciusko-Morizet, is a Frenchman who was a longstanding member of Yukos' Board of Directors, and Chairman of its Audit Committee, from June 2000 to December 2004.[1682] Mr. Kosciusco-Morizet was thus in charge of the internal body which, as a matter of Yukos' governance, should have identified the colossal tax risks that the company was running as a result of its aggressive "tax optimization" program. Lamentably, he failed to do so. The most charitable interpretation of Mr. Kosciusko-Morizet's role in the Yukos debacle is that he, like PwC (for which his praise is fulsome) and the tax authorities, were kept in the dark as to what Yukos was really doing. In any event, there is no

1679 *See* Rieger Witness Statement, ¶ 14.

1680 *See* Rieger Witness Statement, ¶ 19.

1681 *See* Letter from ZAO PwC Audit to E.K. Rebgun (June 15, 2007) (Annex (Merits) C-611).

1682 *See* Kosciusko-Morizet Witness Statement, ¶ 10, 15.

indication in Mr. Kosciusko-Morizet's witness statement that, even now, he realizes that the relevant issue is not whether Yukos was "transparent" in some generic way, but whether the company acted lawfully when it created (and concealed) sham trading entities whose sole purpose was to evade taxes,[1683] when it caused inventory to be sold to those companies at artificially low prices,[1684] and when those companies' profits were extracted through such subterfuges as "loans," "donations," and dividends to opaque Cypriot and British Virgin Islands shell companies and trusts -- all of which would have been illegal or at least highly problematic in Mr. Kosciusko-Morizet's native France. His witness statement maintains a prudent distance from all of these issues.

Mr. Kosciusko-Morizet shies away from any claim that the Russian tax authorities knew of Yukos' "tax optimization" scheme. He does, however, join with Mr. Misamore in speculating that PWC's withdrawal of certifications must have been the result of Russian Government "*pressure,*" because, he says, that withdrawal was "*in blatant contradiction with* [his] *relationship with PwC*" as Chairman of Yukos' Audit Committee.[1685] Like his former colleagues, however, Mr. Kosciusko-Morizet does not attempt to "contradict" -- or even comment on -- any of the four instances of dissimulation of information from PWC by Yukos that PWC cited as grounds for decertification.[1686] Mr. Kosciusko-Morizet's silence is understandable: in order to "contradict" PwC, he would need to testify that he knew that, at the time when PwC was auditing Yukos, PwC already knew the truth about all four of these matters, *i.e.*, that PWC knew (i) that Mr. Khodorkovsky and his associates secretly controlled Behles, Baltic and South; (ii) that Yukos secretly

1683 *See* ¶¶ 237-243 *supra.*

1684 *See* ¶¶ 244-248 *supra.*

1685 Kosciusko-Morizet Witness Statement, ¶ 25.

1686 *See* Letter from ZAO PwC Audit to E.K. Rebgun (June 15, 2007) (Annex (Merits) C-611).

controlled the management of all of the trading shells; (iii) that the Oligarchs had paid huge amounts to four pre-privatization directors of Yukos (the Yukos Universal Beneficiaries);[1687] and (iv) that Mr. Khodorkovsky and his associates had looted Yukos by causing it to repay debts owed to them by their insolvent bank (Bank Menatep). But to testify that PwC knew the truth about these matters at the time, Mr. Kosciusko-Morizet would need to admit that he too knew about them -- an extremely awkward admission given his responsibilities as chairman of Yukos' Audit Committee. The safer course, which he has chosen, is to avoid discussing any of these issues.

d) The Scope Of The Tax Assessments, Including The Attribution To Yukos Of The Trading Shells' Revenues And Profits, The Assessments Of VAT On Exports, And The Levying Of Fines For Willful And Repeated Misconduct, Was Entirely Appropriate

1066. In considering the appropriateness of the contested assessments, it should be recalled that, at the time when they were made, the authorities were in possession of incontrovertible evidence that Yukos' managers were hard-boiled tax cheats, who had evaded a huge volume of taxes by techniques that they knew to be illegal (if only because of the features of their scheme whose evident purpose was its concealment)[1688] and which they nevertheless continued to use even after the courts had expressly condemned those practices and even after Lukoil, Yukos' direct competitor, had announced that it had abandoned them.[1689] The legitimate expectations of tax cheats are necessarily -- and fairly -- much more limited than those of law-abiding investors whose missteps are the result of honest error rather than bad faith. In Russia and elsewhere, egregious tax cheats can expect to be punished, to the full extent permitted by law. They cannot reasonably expect that the tax authorities, upon discovering their schemes, will

1687 *See* ¶ 36 *supra*

1688 *See* ¶¶ 271 *supra.*

1689 *See* ¶¶ 297-302 *supra.*

exercise their discretion in the direction of leniency. To the contrary, as explained by the House of Lords in a decision rejecting an argument along those lines:

> "For years a battle of manoeuvre has been waged between the legislature and those who are minded to throw the burden of taxation off their shoulders onto those of their fellow subjects. It would not shock us in the least to find that the legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain."[1690]

1067. Year after year, the managers of Yukos "*played with fire*" by pursuing a scheme that they knew to be unlawful, and whose purpose was to "*throw the burden of* [the] *taxation off* [the] *shoulders*" of Yukos and onto those of Russian companies whose managers were not necessarily less clever, but certainly more honest. Claimants -- who elected and reelected those Yukos managers -- cannot be heard to complain that, when their scheme was discovered, the Russian authorities ended up assessing and collecting higher taxes than if they had not "*played with fire*."

1068. Against this background, Respondent will address *seriatim* Claimants' principal complaints regarding the scope of the assessments, *i.e.*, their objections to (i) the attribution to OAO NK Yukos -- the parent company of the Yukos group -- of the revenues and profits of its trading shells, (ii) the assessment of VAT on exports, and (iii) the levying of "willful" and "repeat offender" fines. As will be seen, all of these objections are meritless.

(1) Attribution Of Shell Companies' Revenues And Profits To OAO Yukos

1069. According to Claimants, "the Tax Ministry came up with the unprecedented theory according to which the whole bulk of the [trading shells] revenues were to be attributed exclusively to Yukos and no longer to its trading companies,"[1691] which resulted in Yukos paying -- wrongly, in their view -- taxes

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1690 *Howard de Walden v.* IRC [1941] 25 TC 11 (Exhibit RME-2324A). [emphasis added]

1691 Claimants' Memorial on the Merits, ¶¶ 302-303.

on the revenue and profits nominally generated by the trading shells. This objection is specious.

1070. First, the imposition of the evaded taxes on Yukos was fully consistent with the fact that the trading shells were shams, and with compelling and largely uncontested evidence that Yukos was at all times and in every sense the real party in interest -- the master puppeteer that had orchestrated the fraud down to its smallest details, and also the scheme's ultimate beneficiary, because the taxes evaded ultimately benefited Yukos and its shareholders, including Claimants.[1692] The authorities' decision to assess the wrongfully evaded taxes on Yukos was thus logical and entirely appropriate.

1071. Claimants' suggestion that those taxes (and related penalties) should instead have been imposed on the trading shells themselves is a further example of the "too clever by half" aggressiveness that was a hallmark of Yukos' management. The reason is that, as Yukos' managers knew -- and as Claimants undoubtedly know -- the trading shells had either already been liquidated by the time the tax audits leading to the complained-of assessments began, or did not have any significant assets, and thus would have been unable to pay any assessment that might have been addressed to them, as opposed to Yukos. If the course advocated by Claimants had been followed, *i.e.*, if the assessments had been levied on the trading shells, Yukos would have been able to commit, on a much grander scale, the "perfect crime" that it had successfully perpetrated in 2001 with Business-Oil and the other Lesnoy trading shells: accruing the full benefit of the tax evasion scheme, yet avoiding any liability therefor thanks to the hasty liquidation of those shells, before any reassessments could actually be collected.[1693] Sensibly, the tax authorities managing the assessments in 2003-2004 that are contested in these proceedings avoided falling into this trap, and treated the revenues and profits of the trading shells as though they had been earned by Yukos (which, as a matter of business reality, they had been), and by reassessing Yukos itself rather than the trading shells.

1692 *See* Section II.H. *supra.*

1693 *See* ¶¶ 281-287, 998 *supra.*

1072. By so doing, the authorities did not offend any legitimate expectation that Yukos or Claimants might ever have entertained. Investors do not have a legitimate expectation that they can evade taxes by using judgment-proof shell companies as the front-line instrumentalities of their fraudulent schemes, and then objecting when the tax authorities seek to collect the overdue taxes from the parent company that has been orchestrating the schemes and reaping the resulting benefits. In appropriate cases such as this one, the Russian authorities are free to assess the parent company.[1694] In other countries,

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[1694] The Yukos case in not unique in this regard. *See* Konnov Report, ¶¶ 50-51. Other cases, in which the tax authorities assessed taxes on a real party in interest, which earned the revenues as a matter of business reality both before and after the Yukos case include, *e.g.*, the following:

(i) The *ANTEK* case, in which the Federal Arbitrazh Court of the North-Western District found that the company artificially reduced the number of its employees by relocating them to nominal third-party employers and using these employees under "management consulting agreements" and, consequently, upheld the assessment of taxes on the company and not on the nominal employers. *See* Resolution of the Federal Arbitrazh Court of the North-Western District, Case No. A66-6278-03 (Apr. 14, 2004) (Exhibit RME-1512).

(ii) The *Ufimsky, Novoufimsky* and *Ufaneftekhim* refineries cases (the "Refineries"), in which the Supreme Arbitrazh Court upheld the assessment of taxes issued by tax authorities (July 2003) with respect to the Refineries (as real parties conducting operations) disregarding a chain of fictitious transactions with sham entities registered in the City of Baikonur whose purpose was to create an appearance that these sham entities (and not the Refineries) were involved in oil refining. *See* Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation, Case No. 10767/04 (Jan. 25, 2005) (Exhibit RME-1488), Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2075/04-AK (May 25, 2004) (Exhibit RME-1472), Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation, Case No. 10755/04 (Jan. 25, 2005) (Exhibit RME-1489), Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2076/04-AK (May 25, 2004), (Exhibit RME-1471), Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation, Case No. 10750/04 (Jan. 25, 2005), (Exhibit RME-1490), Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-2074/04-AK (May 25, 2004) (Exhibit RME-1491).

(iii) The *Korus Kholding* case, involving tax evasion scheme similar to the one applied by Yukos, in which the Federal Arbitrazh Court of the Moscow District upheld a tax assessment with respect to Korus Kholding that, in 2001, purported to conduct activities in the low-tax region of Baikonur through a trading company Korus Baikonur. The court found, *inter alia*, that (i) Korus Baikonur was a trading shell with no economic substance in the Baikonur region; (ii) Korus Kholding had entered into sale and purchase agreements and commission agreements relating to oil and oil products through Korus Baikonur for the sole purpose of evading taxes; and (iii) neither Korus Kholding nor Korus Baikonur had contributed to the local economy of the Region of Baikonur. Accordingly, the court upheld the decision of the tax authorities to disregard Korus Baikonur, and to assess taxes directly on Korus Kholding as though Korus Baikonur had never existed. *See* Resolution of Federal Arbitrazh Court of Moscow District, Case No. KA-A40/5876-06 (July 28, 2006), 2-4

reallocating revenues and income, and consequently tax liability, to the real party in interest in a way that reflects economic realities is routine, and a "wrong taxpayer" argument such as the one being urged upon this Tribunal by Claimants would be dismissed as frivolous.[1695]

(2) Assessment Of VAT On Exports

1073. A related complaint by Claimants involves the authorities' assessments on Yukos of value-added taxes ("VAT") with respect to various export transactions.[1696] In reality, these assessments were a natural corollary of the authorities' decision to disregard the trading shells as shams, and to treat Yukos itself as the real party in interest -- which for VAT purposes, meant treating it as the real exporter. This approach simply reflected reality: it appears uncontested (and is in any event uncontestable) that the export transactions in question were negotiated by personnel at Yukos' Moscow headquarters, not by the strawmen who masqueraded as the staff of the trading shells.[1697]

(Exhibit RME-1487).

(iv) The *MIAN* case, in which the courts upheld the tax authorities' findings that MIAN applied a tax evasion scheme through the use of shell companies, which were *de facto* controlled by MIAN. MIAN exercised sales of real estate properties through these entities under so-called "investment agreements" with the use of promissory notes. Based on the analysis of actual activities which MIAN conducted, income of the shell companies was attributed to MIAN, which was assessed both profits tax and VAT. *See* Decision of Moscow Arbitrazh Court, Case No. A40-64068/06-115-389 (July 20, 2007) (Exhibit RME-1492), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09-AP-11923/07-AK (Oct. 19, 2007) (Exhibit RME-1493), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. A40-64068/06-115-389 (Feb. 1, 2008) (Exhibit RME-1494).

(v) The *Milk Factory Syktyvkar* case, in which the tax authorities established that Milk Factory Syktyvkar entered into an artificial service agreement with a dependent shell company, which used so called "simplified taxation system" and, thus, similarly to Yukos' shell companies, a claimed tax exemptions. The tax authorities disregarded the arrangements between Milk Factory Syktyvkar and its shell company as created solely for the purpose of tax evasion, attributed income derived by the shell company to Milk Factory Syktyvkar and assessed profits tax, VAT and unified social tax on Milk Factory Syktyvkar accordingly. *See also* Resolution of the Supreme Arbitrazh Court, Case No. 17152/09 (July 6, 2010) (Exhibit RME-1495) and Resolution of the Federal Arbitrazh Court of the Volga-Vyatka District, Case No. A29-5718/2008 (Oct. 14, 2009) (Exhibit RME-1496).

1695 *See* ¶¶ 1156-1165 *infra*.

1696 Claimants' Memorial on the Merits, ¶¶ 321-322.

1697 *See* ¶¶ 237-243 *supra*.

1074. Claimants suggest, however, that because the oil and the oil products in question were ultimately exported from Russia, no VAT should have been levied.[1698] The argument is disingenuous. In Russia, as in other countries, export transactions are not exempted from VAT *ipso facto*, nor as a matter of right.[1699] Exemption (or "zero-rating") is available only if certain other conditions have also been met, notably the timely filing of the requisite documentation in the correct manner by the true exporter. In Russia, these requirements were confirmed by the Constitutional Court in a decision handed down in 2003, before the Yukos assessments that are challenged by Claimants in these proceedings. In the *Far Eastern Shipping*[1700] section of that decision, the court upheld the tax

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1698 Claimants' Memorial on the Merits, ¶ 321.

1699 Pursuant to Article 164(1), paragraph 1, of the Russian Tax Code (Exhibit RME-1483), "[*t]he sale of the following is subject to a tax at a rate of 0 percent: 1) Goods [...] placed under the Export customs treatment, provided they are actually shipped outside the Russian Federation and the documents provided by article 165 of this Code are submitted.*" [emphasis added]

Pursuant to Article 165 of the Russian Tax Code (Exhibit RME-1484), "[i]*n case of sale of the goods provided by sub-clause 1 of clause 1 of Article 164 of this Code, the following documents shall be submitted to the tax authorities to prove eligibility to 0 percent tax rate [...] 1) Contract (copy of a contract) between the taxpayer and a foreign entity for supply of goods outside the customs territory of the Russian Federation.* [...] *2) Bank statement (copy of a statement) evidencing the actual credit of revenue from the foreign entity, the buyer of the goods, to the taxpayer's account with a Russian bank.* […] *3) customs [declaration] (its copy) with marks put by the Russian customs authority releasing the goods in the export treatment and* […] *the boarder customs authority* […] *4) Copies of shipping, transportation and/or other documents* […] *evidencing the shipment of goods outside the Russian Federation.*" [emphasis added]

Article 165(10) of the Russian Tax Code specifies that the above-mentioned documents "*shall be submitted by taxpayers for proving eligibility of the 0* [percent] *tax rate application concurrently with the submission of the returns*" (Exhibit RME-1484).

The tax authorities and courts always treat these requirements for filing VAT returns and supporting documents strictly, and unless they are duly fulfilled, the tax remains due. *See* Konnov Report, ¶¶ 56-57. *See*, in particular, Resolution of the Federal Arbitrazh Court of Urals District, Case No. F09-4252/05-S2 (Sept. 27, 2005) (Exhibit RME-1497) (where the court found: "*If* […] *the taxpayer presents to the tax authorities the documents, justifying the application of tax rate of 0 percent, the paid sums of tax are refundable to the taxpayer* […]. *Since this condition was not fulfilled by the Company and relevant tax return was not presented to the Inspectorate, the taxpayer did not acquire the right to application of tax deduction*"); Resolution of the Federal Arbitrazh Court of Urals District, Case No. F09-1159/03-AK (Apr. 28, 2003) (Exhibit RME-1498); Resolution of the Federal Arbitrazh Court of the North-Western District, Case No. A56-31805/04 (May 3, 2005) (Exhibit RME-1499); Resolution of the Federal Arbitrazh Court of Urals District, Case No. F09-563/05-AK (Mar. 9, 2005) (Exhibit RME-1500).

See also ¶¶ 1205-1214 *infra.*

1700 *See* Constitutional Court's Ruling No. 12-P (July 14, 2003) (Exhibit RME-1501) The Constitutional Court in this case considered jointly applications of three taxpayers – Far Eastern Shipping Company being one of them. With respect to the other taxpayers, the Constitutional Court applied an *ejusdem generis* interpretation to a statutory list of acceptable

authorities' denial of a VAT exemption even though the reality of the export was not denied.[1701] In that case, moreover, unlike the present one, the taxpayer had not been accused of fraud or any other wrongdoing.

1075. Other countries have similarly denied VAT exemption to export transactions notwithstanding the absence of any dispute that the export had been effected, and notwithstanding the absence of any misconduct on the part of the exporter.[1702]

1076. *A fortiori*, the denial of a VAT exemption is appropriate when the exporter, like Yukos, has been involved in flagrantly illicit conduct. The reasoning underlying a recent decision of the European Court of Justice is compelling in this regard. In that case, *R. v. Germany*, the German tax authorities had levied VAT on exports that involved a scheme to evade taxes, not in Germany, but in another country (Portugal). The court held that Germany was entitled to charge VAT on the transactions in question, even though everyone agreed that, in the absence of fraud, the relevant transactions would have been entitled to exemption, so that the effect of the court's decision was to allow Germany to levy a tax that it would normally not have been able to collect. In effect, the court held that exemptions from VAT for exports are a privilege, not an unconditional right, and that the taxpayer's fraud provides ample justification for taxing authorities to deny that privilege.[1703] The *R. v. Germany* decision is applicable throughout the European Union, including in Cyprus and the United Kingdom, whose flags the Claimants are flying in these proceedings. Claimants

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supporting documentation for application of a "0" VAT rate. The Constitutional Court in this ruling drew a distinction between "public" and "contractual" documents and explained that in respect of "contractual documents" (such as a bill of lading) a taxpayer may provide other documents confirming the same information, whereas in respect of "public" documents (such as a customs cargo declaration), alternative documents may not be submitted. A tax return is undoubtedly a "public" document and may not be substituted.

1701 The case involved services rather than goods. The services included maritime transport by a Russian ship. It was undisputed that the ship in question had effectively left Russian waters and thus that services related to exports had been provided. Constitutional Court's Ruling No. 12-P (July 14, 2003) (Exhibit RME-1501).

1702 *See* ¶¶ 1205-1214 *infra.*

1703 European Court of Justice, *R. v. Germany* case *c-285/09 (Dec. 7, 2010)* (Exhibit RME-1401*)*. The *R. v Germany* case is discussed in greater detail in ¶¶ 1208 *infra.*

have not suggested any reason why the ECT should be deemed to prevent Russia from assessing a tax that any European Union member state is permitted to levy under analogous circumstances.[1704]

1077. A broader point needs to be made here. When a taxpayer elects to cheat his country's treasury, one of the risks he runs -- over and above the payment of normal penalties -- is that the tax authorities will recalculate and assess taxes on a basis that is more costly for the taxpayer than the most tax-efficient strategy that he could have adopted if he had employed lawful tax-minimization techniques. Taxpayers who implement complex frauds such as the one perpetrated by Yukos do not enjoy a guarantee that, if their scheme is discovered, the authorities will deconstruct it and reconstruct it in a tax-optimal fashion. Tax fraud, in other words, is not an offense that can be safely perpetrated with the expectation that "there is no harm in trying" -- *i.e.*, that the very worst that can happen is the assessment of the evaded taxes (and normal fines), computed in the otherwise most tax efficient manner. To the contrary, a risk that is inherent to any fraudulent scheme is that -- over and above penalties -- the ultimate tax bill will be higher than if the taxpayer had adopted a lawful strategy. That is what happened to Yukos in regard to the VAT assessments, which Yukos could have avoided through lawful tax planning, but which were properly charged to Yukos when its scheme was unraveled. Nothing in Russian law or international practice protects Yukos, or other perpetrators of fraudulent schemes, from this kind of risk.[1705]

1078. Finally, it should be noted that, when the authorities first assessed VAT on Yukos (in December 2003), Yukos' management responded in a particularly self-destructive way, by persisting in using trading shells to carry out export transactions even though Yukos' entire trading shell scheme had by then been challenged by the authorities as a sham. By then, it should have been

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1704 *See* ¶ 1208 *infra.*

1705 *Biwater Gauff* is to no avail to Claimants' contrary position (Claimants' Memorial on the Merits, ¶ 649). That case involved the Tanzanian government's denial of an input VAT refund to which the foreign investor was entitled pursuant to the relevant investment agreement. No such agreement, of course, is present here. Nor was the investor in *Biwater Gauff* charged with fraud or any other misconduct.

obvious to Yukos' management that continued use of trading shells would simply guarantee further VAT assessments on Yukos -- assessments that Yukos could have avoided, easily and at no cost, simply by having Yukos itself (or one of the other genuine companies of the Yukos group) acknowledge its status as the real exporter and file the requisite documentation itself. The stubborn insistence by Yukos' management in continuing to use trading shells to carry out export transactions throughout the year 2004, *i.e.*, after their receipt of the tax assessment for the year 2000, resulted in further, very significant (but easily avoidable) assessments of VAT on Yukos.

1079. Around that same time, in August 2004, Yukos' management also belatedly filed amended VAT returns for some prior periods, acknowledging Yukos as the true exporter.[1706] Here too, however, Yukos acted self-destructively -- most notably, it submitted those returns in a format that was incapable of being processed by the authorities' computer, with the result that, as any tax expert would have predicted, they were rejected.[1707] Neither Claimants nor any of the witnesses whose testimony they have so far adduced in these proceedings has offered an explanation for this further self-destructive course of action.

1706 *See* VAT return for the Year 2000 (Aug. 31, 2004) (Exhibit RME-1508), VAT Return for the Year 2001 with cover letter from D.V. Gololobov (Aug. 31, 2004) (Exhibit RME-1509), VAT Return for the Year 2002 (Aug. 31, 2004) (Exhibit RME-1510), VAT Return for the Year 2003 (Aug. 31, 2004) (Exhibit RME-1511).

1707 For an unexplained reason, Yukos belatedly filed yearly VAT returns, whereas quarterly or monthly returns were required. *See* Konnov Report, ¶ 58. *See* Article 163 of the Tax Code, providing with respect to VAT that "*1. Tax period shall be established as a calendar month, unless otherwise provided by paragraph 2 of this Article (this applies to taxpayers performing the obligations of tax agents, hereinafter referred to as tax agents). 2. For taxpayers (tax agents) whose monthly revenues from the sale of goods (works, services) within a quarter, excluding the tax and sales tax, do not exceed one million rubles, the tax period shall be established as a quarter.*" With effect from Jan. 1, 2004, Article 163 was amended to read: "*1. Tax period shall be established as a calendar month, unless otherwise provided by paragraph 2 of this Article (this applies to taxpayers performing the obligations of tax agents, hereinafter referred to as tax agents). 2. For taxpayers (tax agents) whose monthly revenues from the sale of goods (works, services) within a quarter, excluding the tax, do not exceed one million rubles, the tax period shall be established as a quarter.*" (Exhibit RME-1502). Not surprisingly, the courts have rejected such returns. *See, e.g.*, Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9/A40-7780/05-98-90 (Apr. 28, 2005), 59 (Annex (Merits) C-196) ("*The tax return submitted by OAO Yukos Oil Company for value added tax for 2003 cannot be considered, since it does not meet the requirements of tax legislation regarding submission of a VAT tax return for each tax period, which is a month or quarter*" [emphasis added]).

(3) Fines

1080. Claimants also complain of the statutory penalties that were added to Yukos' tax assessments. As shown below, these objections too are meritless. The fines in question were fully justified by Yukos' misconduct, and their rates were, if anything, fairly low by international standards. Moreover, Russian law afforded Yukos an opportunity to avoid the bulk of these fines even after its fraudulent scheme had been detected. In a further colossal misjudgment, Yukos' management squandered this opportunity by failing to take timely advantage of it.

(a) "Willful Offender" Fines

1081. Under Russian law, the authorities are authorized to impose a fine of 40%, whenever they determine that the taxpayer is a "willful offender." (In cases not involving willfulness, the "standard" fine is 20%.) Such a willful offender fine was levied against Yukos in each of the tax years at issue.[1708] "Willful offender" fines are a natural byproduct of Russia's reliance on a system of self-assessment, in which taxpayers themselves (unless audited) determine the amount due. Such a system requires strong disincentives against the temptation to which taxpayers would otherwise be subject to underreport their tax liabilities.

1082. For this purpose, "willfulness" does not require criminal *mens rea*: it is sufficient that the taxpayer's underassessment indicate a degree of awareness

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1708 On other occasions, defenders of Yukos have contested the assessment of a "willful offender" fine for tax year 2000 on statute of limitations grounds. (For that tax year, no "repeat offender" fine was levied.) The argument, in a nutshell, was that it was improper for the authorities to levy any kind of fine with respect to tax year 2000, because their assessment was not made until April 14, 2004, *i.e.* a few months after the alleged expiration of the statute of limitations for fines. Yukos' argument was considered by Russia's highest courts, which ultimately rejected it on the ground that the statute of limitations had been tolled by Yukos' interference with the authorities' December 2003 tax audit. The argument is in any event meritless, and tellingly, Claimants have not made it in these proceedings. In reality, the statute of limitations provided a windfall to Yukos, insofar as the tax authorities never disturbed Yukos' abuses of the low-tax region regime prior to 2000. Yukos thus obtained a "free ride" for the frauds it perpetrated in 1999, which involved significant amounts. *See* Yukos Oil Company U.S. GAAP Financial Statements (Dec. 31, 2000), 18 (Annex (Merits) C-27). In any other country, these would have been reassessed, because outside Russia, fraudulent conduct tolls the statute of limitations, usually indefinitely. *See* ¶¶ 1229-1230 *infra*.

of the potential unlawfulness of its conduct.[1709] Claimants' argument that Yukos' elaborate fraud should not have been regarded as "willful" is frivolous. Equally devoid of support in Russian law is Claimants' argument that, in order for a violation to be deemed "willful," the taxpayer must already have been found liable.[1710] Even if Yukos, *quod non*, had been transparent and subjectively in good faith with respect to its "tax optimization" scheme, the very complexity of its scheme made it unavoidable that it would, at a minimum, be deemed "willful": one does not create a network of trading companies carelessly or as a result of honest mistake. In any event, as shown in paragraphs 1003 to 1029 above, Yukos' managers knew perfectly well that their scheme was illegal when they first implemented it -- an aggravated form of "willfulness."

(b) Repeat Offender Fines

1083. In Russia, repetition of a tax offence is considered an "aggravating circumstance" and doubles the fine. Thus, if a repeat offender evades the tax willfully, he may be subject to fine at the rate of 80% of the tax evaded. The authorities levied 80% fines on Yukos with respect to most (but not all) tax violations for years starting in 2001. It is not disputed that Yukos' misconduct in the years 2001 and thereafter was in all material respects identical to what it had done in tax year 2000 (the only year for which a repeat offender fine was not levied).

1084. Claimants contest the levying of repeat offender fines against Yukos on the grounds that "the previous similar offense must not only be committed, but also be detected and sanctioned."[1711] Claimants allege that the assessment of such fines against Yukos in tax years 2001 and thereafter is evidence of the tax authorities' "ulterior motives of destroying Yukos."[1712] In support of their position, Claimants rely on a Resolution of the Presidium of the Russian Arbitrazh Court that was adopted only in 2008, years after Yukos'

1709 *See* Konnov Report, ¶ 72.

1710 *See* Konnov Report, ¶ 72, note 131.

1711 Claimants Memorial on the Merits, ¶ 332.

1712 Claimants Memorial on the Merits, ¶ 323.

appeals against the assessments at issue had run their course. Prior to the issuance of the 2008 Resolution, there had been a number of cases, unrelated to Yukos, in which the courts had upheld the assessment of repeat offender fines in the same manner as was done in the Yukos cases.[1713] Thus, when the tax authorities levied repeat offender fines against Yukos -- an egregious repeat offender if there ever was one -- they were not deviating from established practice but rather, applying one of the interpretations of the relevant statute[1714] that was in current use at the time. As much was effectively conceded by Yukos' own lawyer who, while urging that Yukos not be assessed a repeat offender fine, noted the "unclarity" of the law.[1715]

1085. In any event, as explained by Mr. Konnov, Yukos would have been vulnerable to repeat offender fines even if the taxpayer-favorable 2008 jurisprudence mentioned above had been in effect at the time of the assessments.[1716]

1086. In sum, Yukos and its management had no grounds for entertaining a legitimate expectation at the time when they were implementing its "tax optimization" scheme that, if they were ever found out, they would be able to avoid the imposition of repeat offender fines as well as other fines.

(c) Steps Yukos Could Have Taken To Avoid The Fines For Tax Years Starting with 2001

1087. An unusually taxpayer-friendly provision of Russian law, Article 81(4) of the Tax Code, allows taxpayers to avoid all penalties for past misdeeds -- even egregious ones such as Yukos' -- provided only that they file amended tax returns before being formally notified of the onset of the audit relating to the relevant tax years. If the taxpayer takes advantage of Article 81(4) in, a timely fashion, it needs to pay only the tax previously evaded (and interest), but no fine. This provision, combined with the Russian practice (followed in the Yukos case)

1713 *See* Konnov Report ¶¶ 77-82.

1714 *See* Article 112(2) of the Tax Core (Exhibit RME-2248).

1715 *See* Konnov Report ¶ 78.

1716 *See* Konnov Report, ¶ 81-82.

of auditing "open" tax years (*i.e.,* tax years not time-barred by the statute of limitations) one after the other, rather than simultaneously (as in most countries), gives even the most flagrant tax offenders a unique opportunity, not afforded by most other countries, to eliminate their exposure to fines by filing last-minute amended returns.[1717]

1088. In Yukos' case, the authorities had made clear their complete condemnation of Yukos' scheme when they delivered their audit report for 2000 to Yukos, *i.e.*, on December 29, 2003.[1718] They did not, however, announce commencement of their audit of the next year (2001) until March 23, 2004, *i.e.*, 84 days later.[1719] As a result, Yukos had a window of opportunity of nearly three months duration in which it could have legally avoided any penalty whatsoever for tax year 2001 (including a willful offender fine and a repeat offender fine), simply by filing amended returns and paying the respective taxes and interest. The authorities' audit for 2002 and 2003 did not start until August 9, 2004 [1720] and October 28, 2004,[1721] respectively, and Yukos could likewise have avoided all penalties simply by filing amended returns for 2002 and 2003 before those dates and paying the overdue taxes and interest. Instead, Yukos' managers recklessly squandered this opportunity.

1089. As for tax year 2003, Yukos has only itself to blame for filing a fraudulent annual return for that year, which ended on or around March 28, 2004, the filing deadline. In the annual profits tax return that it filed in 2003, Yukos continued to pretend that its scheme was lawful, even though by then, three months had elapsed since Yukos' receipt on December 29, 2003 of the audit report for 2000 condemning its scheme. Indeed, Yukos continued to file monthly VAT returns on the basis that it was right, and the authorities (and clearly everyone else) were wrong even in 2004.

1717 *See* Konnov Report, ¶¶ 83-85.

1718 *See* ¶¶ 353-365 *supra.*

1719 Field Tax Audit Report No. 30-3-14/1 (June 30, 2004), 3 (Exhibit RME-345).

1720 Field Tax Audit Report No. 52/852 (Oct. 29, 2004), 3 (Exhibit RME-346).

1721 Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 2 (Exhibit RME-260).

1090. Had Yukos filed lawful tax returns beginning as of January 1, 2004 (*i.e.*, after its receipt of the December 29, 2003 tax audit report) and exercised in timely fashion its right to file amended returns for years 2001 and 2002, and paid the respective taxes and default interest, it would have reduced its overall tax liabilities in an amount that would have ensured that Yukos would have not faced bankruptcy proceedings, and that would in all likelihood also have avoided the need for the YNG auction. The reason is that, as explained in paragraphs 369 to 372 above, Yukos' total tax assessments could have been reduced by more than half, to around RUB 288.3 billion (US$ 10.1 billion). Sufficient resources to pay this amount were available at the time to Yukos both inside and outside Russia.[1722]

(d) Comparison With Practices In Other Countries

1091. Claimants repeatedly complain that the tax assessments at issue represented high percentages of Yukos' net income. These complaints are absurd. For one, VAT is assessed even on money-losing businesses, and there is of course no rule or custom anywhere in the world that limits exposure to taxes (let alone to fines) to the amount of the taxpayer's profits. Indeed, Yukos recognized as much when it was envisaging a listing on the New York Stock Exchange -- it proposed disclosures included a warning to investors that, if its tax scheme were challenged, the resulting assessments could lead to "losses."

1092. Assessments in excess of profits could have been expected in other countries as well, in particular in jurisdictions levying more severe fines than Russia's on taxpayers caught having committed elaborate, multi-year, high-volume evasive schemes such as Yukos' scheme. For a more complete discussion of international practices, *see* Section VI.C.3.c *infra.*

1093. In addition, virtually all other countries would also have assessed taxes and levied fines with respect to Yukos' pre-2000 abuses, to which they --

1722 *See* ¶¶ 528-539 *supra* and 1388-1389 *infra.* To date, Claimants have never alleged the contrary.

unlike Russia -- would not have accorded statute of limitations protection, *inter alia*, because of the manifest indicia of fraud in Yukos' behavior.[1723]

1094. Finally, no other country surveyed would have afforded Yukos an eleventh-hour opportunity to avoid fines for later years, because in most countries, once the authorities have uncovered a fraudulent scheme, it is usually too late for the taxpayer to avoid liability for penalties.

1095. To conclude: Claimants' defense of Yukos' "tax optimization" practices fails, utterly. Claimants' suggestions that Yukos' scheme was legal is flatly contradicted by the overwhelming weight of the evidence, and in particular by pre-Yukos Russian court decisions condemning precisely the kinds of abuses that lay at the heart of Yukos' system. It is obvious, moreover, that Yukos' managers -- some of them witnesses in these proceedings -- were well aware of the risks from the very beginning, which is why they went to such great lengths to keep their scheme secret. Finally, Claimants have failed to show that even Russian authorities had relevant information regarding the scheme -- the information about its abusive features.

B. Claimants Have Failed To Establish That The Measures Complained Of Resulted In A Total Or Substantial Deprivation Of Their Investment

1. Claimants Have The Burden Of Establishing That The Measures Complained Of Caused A Total Or Substantial Deprivation Of Their Rights As Yukos Shareholders

1096. Article 13(1) ECT protects investors from nationalization, expropriation and "*measures having effect equivalent to nationalization or expropriation*." A total or substantial deprivation of ownership rights or their economic use is a necessary factual predicate for a determination of liability under Article 13 ECT. As stated in *Glamis v. United States*:

> "There is for all expropriations, however, the foundational threshold inquiry of whether the property or property right was in fact taken. This threshold question is relatively straightforward in the case of a direct taking, for example, by nationalization. In the case of an indirect taking or an act tantamount to expropriation

[1723] *See* ¶¶ 1229-1230 *infra.*

such as by a regulatory taking, however, the threshold examination is an inquiry as to the degree of the interference with the property right. This often dispositive inquiry involves two questions: the severity of the economic impact and the duration of that impact.

Several NAFTA tribunals agree on the extent of interference that must occur for the finding of an expropriation, phrasing the test in one instance as, 'the *affected property* must be impaired to such an extent that it must be seen as 'taken'; and in another instance as, 'the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner.' Therefore, a panel's analysis should begin with determining whether the economic impact of the complained of measures is sufficient to potentially constitute a taking at all: '[I]t must first be determined if the Claimant was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto … had ceased to exist'."[1724]

[1724] *Glamis Gold, Ltd. v. United States of America*, UNCITRAL, Award (June 8, 2009), ¶¶ 356-357 (Exhibit RME-1107) [italics in original]. *See also Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. The United Mexican States*, ICSID ARB(AF)/04/05, Award (Nov. 21, 2007), ¶ 240 (Exhibit RME-1108): "An expropriation occurs if the interference is substantial and deprives the investor of all or most of the benefits of the investment."; *Telenor Mobile Communications A.S. v. The Republic of Hungary*, ICSID ARB/04/15, Award (Sept. 13, 2006), 21 ICSID Rev. 603 (2006), 627 ¶ 65 (Exhibit RME-1109): "There has been a substantial volume of case law, both under the Washington Convention and in general public international law, as to the magnitude of the interference with the investor's property or economic rights necessary to constitute expropriation. Though different tribunals have formulated the test in different ways, they are all agreed that the interference with the investor's rights must be such as substantially to deprive the investor of the economic value, use or enjoyment of its investment."; *AIG Capital Partners Inc. and CJSC Tema Real Estate Company v. Republic of Kazakhstan*, ICSID ARB/01/6, Award (Oct. 7, 2003), 11 ICSID Rep. 3 (2008), 55 (Exhibit RME-1110): "Article III incorporates into the BIT international law standards for 'expropriation' and 'nationalization'. Paragraph 1 describes the general rights of investors and the obligation of the parties with respect to expropriation and nationalization: they apply to direct and indirect measures (of the State) tantamount to expropriation or nationalization – *i.e.*, to what are known as 'creeping expropriations' which result in substantial deprivation of the benefit of an investment without taking away of the title to the investment."; *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Interim Award (June 26, 2000), ¶ 102 (Annex (Merits) C-953): "While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner. [. . .] Indeed, at the hearing, the Investor's Counsel conceded, correctly, that under international law, expropriation requires a 'substantial deprivation.'"; *CMS Gas Transmission Company v. The Argentine Republic*, ICSID ARB/01/8, Award (May 12, 2005), ¶¶ 261-262 (Annex (Merits) C-973): "The Tribunal in the *Lauder* case rightly explained that 'The concept of indirect (or *'de facto'*, or *'creeping'*) expropriation is not clearly defined. Indirect expropriation or nationalization is a measure that does not involve an overt taking, but that effectively neutralized the enjoyment of the property.' The essential question is therefore to establish whether the enjoyment of the property has been effectively neutralized." [italics in original]; *Waste Management, Inc. v. United Mexican States*, ICSID ARB(AF)/00/3, Award (Apr. 30, 2004), ¶ 155 (Annex (Merits) C-

1097. Claimants thus have the burden of showing that the measures complained of effectuated a total or substantial deprivation of their rights as Yukos shareholders. As stated in *Tokios Tokelès v. Ukraine*:

> "A critical factor in the analysis of an expropriation claim is the extent of harm caused by the government's actions. For any expropriation – direct or indirect – to occur, the state must deprive the investor of a 'substantial' part of the value of its investment.[…]
>
> Moreover, the burden of demonstrating the impact of the state action indisputably rests on the Claimant. The principle of onus[*sic*] *probandi actori incumbit* – that a claimant bears the burden of proving its claims – is widely recognized in practice before international tribunals."[1725]

1098. Or as stated in *Tecmed v. Mexico*:

> "To establish whether the Resolution is a measure equivalent to an expropriation under the terms of section 5(1) of the Agreement, it must be first determined if the Claimant, due to the Resolution, was radically deprived of the economical use and enjoyment of its investments, as if the rights related thereto [...] had ceased to exist. In other words, if due to the actions of the Respondent, the assets involved have lost their value or economic use for their holder and the extent of the loss."[1726]

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968); *Suez and others v. The Argentine Republic*, ICSID ARB/03/17, Decision on Liability (July 30, 2010), ¶ 129 (Exhibit RME-1111): "In analyzing the measures taken by Argentina to cope with the crisis, the Tribunal finds that they did not constitute a permanent and substantial deprivation of the Claimants' investments. Although they may have negatively affected the profitability of the APSF Concession, they did not take or reduce the property rights of APSF or its investors and did not affect the ability of APSF to hold the Concession and to direct its operations and activities. The Tribunal therefore concludes that such measures did not violate the above quoted BIT articles with respect to direct or indirect expropriation;"; *Merrill & Ring Forestry L.P. v. The Government of Canada*, UNCITRAL, Award (Mar. 31, 2010), ¶ 145 (Exhibit RME-1112): "The standard of substantial deprivation identified in *Pope & Talbot*, and followed by many other decisions, both in the context of NAFTA and other investment protection agreements, is the appropriate measurement of the requisite degree of interference."; *Walter Bau AG (in liquidation) v. Thailand, Ad hoc*—UNCITRAL, Award (July 1, 2009), ¶ 10.8 (Annex (Merits) C-1000): "Professor Crawford for the Claimant in oral submissions acknowledged that an indirect expropriation requires a substantial deprivation to have taken place, although such deprivation does not need to be complete."

1725 *Tokios Tokelès v. Ukraine*, ICSID ARB/02/18, Award (July 26, 2007), ¶¶ 120-121 (Annex (Merits) C-985). [emphases added]

1726 *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID ARB(AF)/00/2, Award (May 29, 2003), ¶ 115 (Annex (Merits) C-965) [emphases added]. *See also Otis Elevator Company v. Iran*, Iran-U.S. Claims Tribunal, Case No. 284, Award (Apr. 29, 1987), 14 Iran-U.S.C.T.R. 283 (1987), 299 ¶ 47 (Exhibit RME-1113): "In order to find that a deprivation or taking had occurred, the Tribunal would have to be satisfied that there was governmental

1099. Similarly, in *Tradex v. Albania*, the tribunal confirmed that the claimant bears the burden of establishing the substantive elements of its expropriation claim, including total or substantial deprivation caused by the measures complained of.[1727] The *Tradex* tribunal dismissed the expropriation claim because of claimant's failure to establish that acts attributable to Albania caused the substantial deprivation of the investment:

> "[W]hat is relevant in the context of this Award is only whether expropriation measures were the cause of these difficulties, which Tradex has not proved."[1728]

1100. Accordingly, to constitute "*measures having effect equivalent to nationalization or expropriation*," Claimants must establish that the measures complained of proximately caused a total or substantial deprivation of their rights as Yukos shareholders. The Iran-U.S. Claims Tribunal confirmed this requirement in dismissing a claim based on the even broader standard of Article II(1) of the Algiers Declaration, which covers claims based on "*expropriations or other measures affecting property rights*"[1729]:

> "In order to state a justiciable claim, Hoffland would have to allege facts indicating that its property was lost through conduct attributable to NIOC and wrongful as a matter of law. Hoffland, however, has alleged only that NIOC sold substantial quantities of crude oil to United States companies engaged in the manufacture of agrichemicals; more about NIOC Hoffland does not say. It does not allege that the sales of oil by NIOC to American companies were unlawful. Moreover, NIOC's sales of oil were "measures affecting [Hoffland's] property rights" within the meaning of Article II(1) of the Claims Settlement Declaration only if those sales were the proximate cause of the injuries to its bees. If not, there

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interference with the Claimant's shareholding interest in Iran Elevator which substantially deprived the Claimant of the use and benefit of its investment."

1727 *Tradex Hellas S.A. v. Republic of Albania*, ICSID ARB/94/2, Award (Apr. 29, 1999), 14 ICSID Rev. 197 (1999), 219 ¶ 74 (Annex C-1317) (Exhibit RME-1114): "[It] can be considered as a general principle of international procedure–and probably also of virtually all national civil procedural laws– [...] that it is the claimant who has the burden of proof for the conditions required in the applicable substantive rules of law to establish the claim."

1728 *Ibid.*, 247 ¶ 200.

1729 Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (Claims Settlement Declaration) (Jan. 19, 1981), 1 Iran-U.S.C.T.R. 9 (1983), 9, Art. II(1) (Exhibit RME-1115).

was no conduct attributable to NIOC over which we would have jurisdiction, even if the sales were unlawful."[1730]

1101. Likewise, the Iran-U.S. Claims Tribunal dismissed Otis Elevators' expropriation claim in *Otis Elevator v. Iran* on the ground that claimant had failed to establish a causal link between conduct attributable to the Government of Iran and claimant's enjoyment of its shareholder rights in Iran Elevator:

> "In order to find that a deprivation or taking had occurred, the Tribunal would have to be satisfied that there was governmental interference with the Claimant's shareholding interest in Iran Elevator which substantially deprived the Claimant of the use and benefit of its investment. On the balance of the evidence before it, the Tribunal holds that a multiplicity of factors affected the Claimant's enjoyment of its property rights in Iran Elevator, among them its position as a minority shareholder in an inactive company and the changed circumstances of the Iranian elevator market. However, the Tribunal is not convinced that the Claimant has established that the infringement of these rights was caused by conduct attributable to the Government of Iran. The acts of interference determined by the Tribunal as being attributable to Iran are not sufficient in the circumstances of this Case, either individually or collectively, to warrant a finding that a deprivation or taking of the Claimant's participation in Iran Elevator had occurred. The Claim is therefore dismissed."[1731]

1102. The jurisprudence of the International Court of Justice is in accord. In the *ELSI* case, the Court confirmed that for any expropriation to occur, the claimant must establish that the State deprived the investor of a substantial part of its investment. The Court dismissed the United States claim that the Italian authorities' conduct amounted to an expropriation of Machlett's and Raytheon's shareholdings in ELSI contrary to Article V of the Treaty of Friendship, Commerce and Navigation between the United States and Italy:

> "In the view of the Chamber, […] the questions raised as to the possibilities of disguised expropriation or of a 'taking' amounting ultimately to expropriation, [do not] have to be resolved in the present case, because it is simply not possible to say that the ultimate result was the consequence of the acts or omissions of the

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1730 *Hoffland Honey Co. v. National Iranian Oil Co.*, Iran-U.S. Claims Tribunal, Case No. 495, Award (Jan. 26, 1983), 2 Iran-U.S.C.T.R. 41 (1984), 42 (Exhibit RME-1116). [emphases added]

1731 *Otis Elevator Company v. Iran*, Iran-U.S. Claims Tribunal, Case No. 284, Award (Apr. 29, 1987), 14 Iran-U.S.C.T.R. 283 (1987), 299-300 ¶ 47 (Exhibit RME-1113). [emphases added]

> Italian authorities, yet at the same time to ignore the most important factor, namely ELSI's financial situation, and the consequent decision of its shareholders to close the plant and put an end to the company's activities."[1732]

1103. It is clear that an expropriation claim cannot be based on damages incurred by an investor caused by its own conduct or the conduct of its investment. For example, the French-German Mixed Arbitral Tribunal dismissed several compensation claims based on Article 297(e) of the Versailles Treaty where the claimant was deprived of his property as a result of his violation of applicable German law. For example, in *Costimex v. Germany*, the Tribunal held:

> "Attendu que le requérant, qui en 1919 avait une succursale à Cologne, a dû connaître les dispositions légales alors en vigueur en Allemagne, concernant l'importation et le commerce de différentes denrées alimentaires;
>
> Att. qu'en vertu d'un décret daté du 11 novembre 1919 et émanant du général en chef anglais, commandant l'armée anglaise du Rhin, les ordonnance allemandes contenant les dispositions susmentionnées restaient applicables aux marchandises importées par les ressortissants des Puissances alliées, à l'exception des personnes faisant parties des armées;
>
> Att. que si dans ces conditions le requérant a importé le saindoux sans l'autorisation requise de la Reichsfettcentrale et que ce saindoux a été saisi et confisqué, le dommage qui en résulte pour le requérant est dû à sa propre faute;
>
> […]
>
> Att. que le défendeur ne répond pas d'un dommage causé par la faute même du requérant.
>
> Par ces motifs :
>
> Vu l'art. 297 *e* du Traité de paix;
>
> Déboute le requérant de sa demande;"[1733]

1732 *Case Concerning Elettronica Sicula S.P.A. (ELSI) (United States of America v. Italy),* Judgment (July 20, 1989), 1989 I.C.J. Rep. 15, 71 ¶ 119 (Annex (Merits) C-942). [emphasis added]

1733 "Whereas the claimant, who in 1919 had a branch in Cologne, had to know the legal provisions applicable at that time in Germany, regarding the import and the trade of different foodstuffs; Whereas pursuant to a decree dated November 11, 1919 and adopted by the English general-in-chief, commander of the English Rhine army, the German ordinances containing the aforementioned provisions remained applicable to merchandise imported by

Biedermann v. Germany is another example:

> "Att., quant aux autres chefs de réclamation, que les parties sont d'accord que la confiscation de l'orge et la fermeture de la brasserie du requérant ont été la suite de ses contraventions aux lois et ordonnances concernant le ravitaillement civil;
>
> Att. que dans ces conditions c'est par la faute même du requérant que le dommage a été causé;
>
> Att. qu'en conséquence le Tribunal, suivant sa jurisprudence antérieure, estime que la demande est mal fondée;"[1734]

1104. As set forth below, loss of Claimants' rights as Yukos shareholders resulting from Yukos' bankruptcy was the result Claimants' own conduct, the conduct of the controlling Oligarchs, and the conduct of Yukos management.[1735]

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nationals of the allied Powers, to the exception of persons being part of the armies; Whereas if under these circumstances the claimant has imported lard without the required authorization from the Reichsfettcentrale and this lard has been seized and confiscated, the damage resulting therefrom for the claimant is due to his own fault; [...] Whereas the defendant does not answer for damage caused by the very fault of the claimant. On these motives: Having considered Art. 297 *e* of the peace Treaty; Dismisses the claimant's claim;" [unofficial translation]. *Costimex v. Germany*, French-German Mixed Arbitral Tribunal, Decision (July 30, 1926), 6 Rec. des Dec. des Trib. Arb. Mixtes 876 (1927), 878 (Exhibit RME-1117) [emphases added]

1734 "Whereas, as regards the other heads of claim, that the parties are in agreement that the confiscation of the barley and the closing of the claimant's brewery have been the consequence of his infringement of the laws and ordinances concerning civil supplies; Whereas under these circumstances it is due to the very fault of the claimant that the damage has been caused; Whereas as a consequence, the Tribunal, following its previous jurisprudence, finds that the claim is ill-founded;" [unofficial translation]. *Biedermann v. Germany*, French-German Mixed Arbitral Tribunal, Decision (June 8, 1925), 6 Rec. des Dec. des Trib. Arb. Mixtes 168 (1927), 170 (Exhibit RME-1118); *Frischmann v. Germany*, French-German Mixed Arbitral Tribunal, Decision (Aug. 27, 1926), 6 Rec. des Dec. des Trib. Arb. Mixtes 891 (1927), 893 (Exhibit RME-1119): "Att. qu'il résulte des faits apparus au procès que la fermeture du moulin du requérant a été ordonnée parce que le requérant a contrevenu aux ordonnances concernant la distribution des blés; Att. que dans ces conditions, le préjudice résultant d'un acte du requérant lui-même, le défendeur n'est pas tenu de lui payer une indemnité; […] Déboute le requérant de sa demande;" "Whereas it results from the facts revealed at trial that the closing of the claimant's mill has been ordered because the claimant has infringed the ordinances concerning the distribution of wheat; Whereas under these circumstances, the damage being the result of the claimant's own action, the defendant is not required to pay him an indemnification; [...] Dismisses the claimant's claim;" [unofficial translation]. *See also Tradex Hellas S.A. v. Republic of Albania*, ICSID ARB/94/2, Award (Apr. 29, 1999), 14 ICSID Rev. 197 (1999), 219 ¶¶ 146-175 (Annex C-1317) (Exhibit RME-1114) (discarding the invasion of the claimant's land by villagers as the basis for an expropriation claim because their acts were not attributable to the State of Albania).

1735 Claimants have not demonstrated that they have as a practical matter lost their investment insofar as Yukos' foreign assets consisting of multiple corporate entities remain within their

2. The Substantial Deprivation Of Claimants' Yukos Shares Was Caused By Claimants Themselves, Their Controlling Oligarchs, And Yukos Management.

1105. The detailed facts presented above demonstrate beyond any serious question that the substantial deprivation of Claimants' Yukos shares about which they now complain was caused by Claimants themselves, their controlling Oligarchs, and the Yukos directors and officers they installed and repeatedly reappointed to manage their investment in Yukos, and not by the Russian Federation. Claimants and the Oligarchs doomed Yukos to a self-inflicted demise with their consistent and repeated imprudent and illegal actions, as well as their repeated and consistent failures to take remedial or mitigating steps that were plainly available to them -- as noted above, never failing to miss an opportunity to miss an opportunity -- to avoid the consequences they now apparently regret. The litany of these wrongful actions and unconscionable failures to act is at this point fully familiar to the Tribunal, and may be summarized as follows:

(i) Yukos' illegal "tax optimization" scheme, an abuse of the low-tax region program employing sham trading companies that the Oligarchs and Yukos' management cloaked in secrecy, subterfuge, and obfuscation, having no business purpose other than tax evasion, and which never made any significant contributions to the local economies of the relevant regions, the only lawful purpose of the low-tax region program, an abuse that Yukos' managers and its controlling shareholders could not have plausibly believed was lawful in light of the disavowal of such practices by Yukos' competitors and Yukos' acknowledgements in internal memoranda and draft disclosure documents, which confirm that Yukos and the Oligarchs either knew this scheme was illegal, or at least they knew

effective control within the *Stichtings*. Claimants' Memorial fails to take account of or present evidence concerning the contents of the *Stichtings* and their values. The Russian Federation reserves all rights in respect of these and all other beneficial rights Claimants have obtained for presentation following the discovery period and Claimants' Reply submissions.

it was highly vulnerable to the tax authorities' successful challenge, in which event Yukos would suffer significant losses;

(ii) Yukos' failure to avail itself of multiple opportunities to pay its 2000 tax year assessment, stemming from its illegal "tax optimization" scheme, despite having ample time and ample resources with which to make that payment, and knowing that its failure to pay would result in the accrual of substantial amounts in interest, fines, and enforcement fees, and eventually despite the Russian courts' repeated affirmance of that assessment, after multiple appeals, and, finally, as could be expected, resulting in the accrual of substantial interest, fines, and fees and leading Russian tax authorities to pursue further enforcement proceedings and measures;

(iii) Yukos' failure even to make any provision for these tax liabilities in its financial statements, despite its legal obligation to do so;

(iv) Yukos' payment instead of an unprecedented US$ 2 billion "giga-dividend, primarily to Claimants, representing approximately 65% of the tax bill Yukos refused to pay, and which Claimants now argue Yukos was prevented from paying;

(v) Yukos's pre-payment to the Oligarchs' company a substantial loan obligation, likewise at the same time it was refusing to pay its outstanding tax obligations and insisting that it was being prevented from discharging those obligations;

(vi) Yukos' failure either to amend its tax returns, or pay subsequent assessments, for tax years 2001, 2002 and 2003, also stemming from its illegal "tax optimization" scheme, and in the face of repeated and consistent Russian court rulings that Yukos' substantially similar practices during tax year 2000 were illegal and warranted the assessments made for that year, also resulting in the accrual of substantial interest, fines and fees on those further assessments;

(vii) Yukos' repeated and consistent attempts to mislead Russian tax authorities by making spurious and insincere settlement offers, based on tainted assets and premised upon unreasonably extended payment periods;

(viii) Yukos' decision to file amended VAT returns on a basis its managers or anyone with passing familiarity with Russian tax law would have known would not be accepted;

(ix) Yukos' failure during this entire period to file a voluntary bankruptcy petition in Russia, despite its admitted insolvency, and which would have suspended further tax enforcement measures against it;

(x) Yukos' sabotaging of the YNG auction by threatening to cause "*a lifetime of litigation*" for anyone purchasing assets in that auction, and filing a spurious bankruptcy petition in Texas predicated on a jurisdictional sham (which in itself was based on backdated documents), pursuant to which Yukos obtained the TRO against potential bidders for YNG assets and their bank financiers, a campaign of intimidating terror that, as Yukos and the Oligarchs intended, diminished competitive bidding for YNG and the Russian Federation's ability to maximize the auction proceeds and thereby reduce Yukos' outstanding tax liabilities to the greatest possible extent;

(xi) Yukos' stripping of valuable assets from the company and its segregation of those assets in Dutch Stichtings, controlled by Yukos' former senior managers, explicitly for the purpose of placing those assets beyond the reach of Yukos' creditors, including in particular its bank lenders in the SocGen syndicate and Russian tax authorities;

(xii) Yukos' default on its obligations to the SocGen syndicate, leading the syndicate to commence bankruptcy proceedings against Yukos,

in which the Oligarchs then refused to cooperate with Yukos' creditors to preserve some value in the company and for its controlling shareholders, including Claimants, attempting instead to further pillage Yukos' estate by filing sham claims and proposing a purported rehabilitation plan that would have given two-thirds of the company to the Oligarchs and promised payments to other creditors based on highly contingent scenarios and over a period that exceeded what was permissible under Russian law;

(xiii) And certainly not least, during this entire period, Yukos' and the Oligarchs' repeated and consistent lies to PwC, and through PwC to Yukos' creditors and the investing public, fraudulently inducing PwC to issue "clean" audit opinions and to certify the company's financial statements, importantly for these proceedings concerning such key subjects as the Oligarchs' secret kickback payments to Yukos' former managers to facilitate the Oligarchs' illegal acquisition of control over Yukos, Yukos' "tax optimization" scheme that led to its demise, and the Jurby Lake Structure by which the Oligarchs looted Yukos and lined their own pockets.

C. The Russian Court Decisions That Confirmed The Tax Assessments Did Not Constitute Or Contribute To "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1106. For the reasons amply stated above, not only did Claimants have no basis for expecting that the Russian tax laws that their "tax optimization" scheme was violating would not be enforced, but also the enforcement of these laws, and the Russian tax authorities' assessments against Yukos based on their enforcement of these laws, was repeatedly confirmed by the Russian courts, at multiple levels.[1736] The assessments and their enforcement fall well within the wide margin of appreciation afforded states as to taxation measures.

1736 *See* ¶¶ 987-1095 *supra*, 1290-1305, 1315-1317 *infra*.

1. This Tribunal Cannot Act As An Appellate Court To Review Russian Court Decisions

1107. This Tribunal cannot sit as an appellate court reviewing Russian court decisions upholding Yukos' tax assessments. In the context of an expropriation case, Claimants' claims face exacting hurdles. First, Claimants need to allege and establish a basis for a wholesale attack on the Russian court system. Second, Claimants would have to allege and establish that the court decisions not only should be disregarded, but that they also constitute "*measures having effect equivalent to nationalization or expropriation*," *i.e.*, that they caused a total or substantial deprivation of a protected investment.

1108. Governmental conduct upheld by domestic courts cannot be deemed to be improper unless the courts themselves are established to be in breach of international law. As stated in the award in *Azinian and others v. Mexico*:

> "It is therefore necessary to examine whether the annulment of the Concession Contract may be considered to be an act of expropriation violating NAFTA Article 1110."[1737]
>
> "How can it be said that Mexico breached NAFTA when the Ayuntamiento of Naucalpan purported to declare the invalidity of a Concession Contract which by its terms was subject to Mexican law, and to the jurisdiction of the Mexican courts, and the courts of Mexico then agreed with the Ayuntamiento's determination?"[1738]
>
> "With the question thus framed, it becomes evident that for the Claimants to prevail it is not enough that the Arbitral Tribunal disagree with the determination of the Ayuntamiento. A governmental authority surely cannot be faulted for acting in a manner validated by its courts *unless the courts themselves are disavowed at the international level*. As the Mexican courts found that the Ayuntamiento's decision to nullify the Concession Contract was consistent with the Mexican law governing the validity of public service concessions, the question is whether the Mexican

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1737 *Robert Azinian et al. v. The United Mexican States*, ICSID ARB(AF)/97/2, Award (Nov. 1, 1999), ¶ 91 (Annex (Merits) C-951).

1738 *Ibid.*, ¶ 96.

court decisions themselves breached Mexico's obligations under Chapter Eleven."[1739]

1109. There is a long line of authority establishing the rule that international courts and tribunals, including investment treaty tribunals, cannot sit as an appellate court to review domestic court decisions. What must be shown is that there is a violation of a treaty -- in this case a violation of Article 13(1) ECT. It is thus not sufficient to establish an expropriation that Russian courts could be shown to have violated the fair and equitable treatment standard or due process requirements, even if it were the case, which the Russian Federation vigorously contests. As stated in the award in *Azinian and others v. Mexico*:

> "The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA. *What must be shown is that the court decision itself constitutes a violation of the treaty*. Even if the Claimants were to convince this Arbitral Tribunal that the Mexican courts were wrong with respect to the invalidity of the Concession Contract, this would not per se be conclusive as to a violation of NAFTA. More is required; the Claimants must show either a denial of justice, or a pretence of form to achieve an internationally unlawful end."[1740]

1110. The *Waste Management, Inc v. Mexico* award restated the rule as follows:

> "Turning to the actual reasons given by the federal courts, the Tribunal would observe that it is not a further court of appeal, nor is Chapter 11 of NAFTA a novel form of *amparo* in respect of the decisions of the federal courts of NAFTA parties."[1741]
>
> "In any event, and however these cases might have been decided in different legal systems, the Tribunal does not discern in the decisions of the federal courts any denial of justice as that concept has been explained by NAFTA tribunals, notably in the *Azinian*, *Mondev*, *ADF* and *Loewen* cases. The Mexican court decisions were

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1739 *Ibid.*, ¶ 97. [italics in original]

1740 *Ibid.*, ¶ 99. [italics in original]

1741 *Waste Management, Inc. v. United Mexican States*, ICSID ARB(AF)/00/3, Award (Apr. 30, 2004) ¶ 129 (Annex (Merits) C-968).

> not, either *ex facie* or on closer examination, evidently arbitrary, unjust or idiosyncratic. There is no trace of discrimination on account of the foreign ownership of Acaverde, and no evident failure of due process."[1742]

1111. Claimants' own authorities support this rule. The award in *Mondev International Ltd v. United States* emphasized:

> "It is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State. Under NAFTA, parties have the option to seek local remedies. If they do so and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal."[1743]

1112. As stated in *Jan de Nul NV and Dredging International NV v. Egypt*, also relied upon by Claimants:

> "It is not the role of a tribunal constituted on the basis of a BIT to act as a court of appeal for national courts."[1744]

1113. These investment treaty cases rearticulate and apply a rule laid down by the Permanent Court of International Justice in 1927:

> "The fact that the judicial authorities may have committed an error in their choice of the legal provision applicable to the particular case and compatible with international law only concerns municipal law and can only affect international law in so far as a treaty provision enters into account, or the possibility of a denial of justice arises."[1745]

1114. It is thus simply not appropriate for this Tribunal to address alleged errors of Russian courts, even if, as asserted, but not substantiated by Claimants, and denied by the Russian Federation, the alleged errors underpin some of the decisions upholding Yukos' tax assessments. The tribunal's statement in *EnCana v. Ecuador* is directly on point:

1742 *Ibid.*, ¶ 130.

1743 *Mondev International Ltd v. United States of America*, ICSID ARB(AF)/99/2, Final Award (Oct. 11, 2002), ¶ 126 (Annex (Merits) C-963).

1744 *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt*, ICSID ARB/04/13, Award (Nov. 6, 2008), ¶ 209 (Annex (Merits) C-997).

1745 *The Case of the S.S. 'Lotus' (France v. Turkey)*, Judgment (Sept. 7, 1927), 1927 P.C.I.J. (Ser. A) No. 10, 24 (Exhibit RME-1120).

> "Consistent with well-established international principle and doctrine, Article VIII of the BIT [expropriation guarantee] does not convert this tribunal into an Ecuadorian tax court, in particular having regard to its Article XII [tax exemption]. The Tribunal cannot pick and choose between different and conflicting national court rulings in order to arrive at a view as to what the local law should be."[1746]

2. Claimants Must Establish That The Russian Court Decisions That Confirmed The Tax Assessments Constitute A Radical Departure From Russian Law And Have Failed To Do So

1115. Claimants have failed to show that the tax assessments and the court decisions upholding them were based on "*novel*" theories[1747] in the application of Russian tax law.

1116. Quite to the contrary, as discussed in greater detail at paragraphs 278 to 304 above and at paragraphs 968 to 1002 above, and as shown in the expert report of Mr. Konnov,[1748] the anti-avoidance doctrines relied upon by Russian tax authorities and courts in the Yukos case had been applied by Russian courts literally in hundreds of prior cases, including several involving abuses of the low-tax region program and even two cases involving trading shells which were later found to be related to Yukos (*i.e.*, the 1999-2001 *Business-Oil* (Lesnoy trading shell case)[1749] and the 2001-2002 *Sibirskaya* case).[1750]

1117. Yukos' management was aware from the start of the illegality of its "tax optimization" scheme, and for this reason took great pains to conceal it,[1751] including by: (i) lying to its own auditors at PwC,[1752] (ii) structuring the trading shells network to make it virtually impossible for the tax authorities to uncover it

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1746 *EnCana Corp. v. Republic of Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 200 note 138 (Annex (Merits) C-976).

1747 Claimants' Memorial on the Merits, ¶¶ 289 and 321.

1748 Konnov Report, ¶¶ 39-52.

1749 *See* ¶¶ 281-287 *supra*.

1750 *See* ¶¶ 291-294 *supra*.

1751 *See*, *e.g.*, ¶¶ 226-275 *supra*.

1752 *See*, *e.g.*, ¶¶ 705-738 *supra*.

upon audit (*e.g.*, through the use of "call-options"[1753] and the interposition of layers of opaque Cypriot and British Virgin Islands companies and trusts[1754]); (iii) obstructing the audits ultimately leading to the tax assessments;[1755] and (iv) denying in the face of overwhelming evidence that the trading shells were Yukos' affiliates.[1756] This conduct cannot be reconciled with Claimants' contention that the tax assessments and their judicial upholding were based on "*novel*" legal theories.

1118. Also fatal to Claimants' contention are the acknowledgments by Yukos' management in 2002 that the company's "*tax optimization mechanisms* […] *may be challenged by the tax authorities*," which would "*result in substantial tax claims against the Company*," including "*related interest and penalties*."[1757] These and other similar acknowledgments make it impossible for Claimants to deny that, at least by 2002, Yukos' managers -- whom they had appointed -- fully understood the illegality of Yukos' "tax optimization" scheme.

1119. In sum, there is abundant evidence in the record confirming that the legal basis for the tax assessments and their affirmation by Russian courts were consistent with Russian law as applied by the Russian courts before and after the Yukos matter.

3. The Tax Assessments Confirmed By The Courts Are Not Expropriatory Under The Applicable Standard, Which Gives States A Wide Margin Of Discretion

a) Imposition And Enforcement Of Taxes Does Not Generally Constitute Expropriation

1120. Taxation measures, even if resulting in substantial deprivation, are intrinsically lawful from a public international law perspective, and benefit from

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1753 *See*, *e.g.*, ¶ 271.

1754 *Ibid.*

1755 *See*, *e.g.*, ¶ 355 *supra*.

1756 *See*, *e.g.*, ¶ 361 *supra*.

1757 *See*, *e.g.*, ¶¶ 303-304 *supra*.

a presumption of lawfulness because they are necessary to the functioning of a State.

1121. A very considered articulation of this standard is found in the interpretative note to Article VIII(2), on taxation, of the Multilateral Agreement on Investment:

> "When considering the issue of whether a taxation measure effects an expropriation, the following elements should be borne in mind:
>
> a) The imposition of taxes does not generally constitute expropriation. The introduction of a new taxation measure, taxation by more than one jurisdiction in respect to an investment, or a claim of excessive burden imposed by a taxation measure are not in themselves indicative of an expropriation.
>
> b) A taxation measure will not be considered to constitute expropriation where it is generally within the bounds of internationally recognised tax policies and practices. When considering whether a taxation measure satisfies this principle, an analysis should include whether and to what extent taxation measures of a similar type and level are used around the world. Further, taxation measures aimed at preventing the avoidance or evasion of taxes should not generally be considered to be expropriatory.
>
> c) While expropriation may be constituted even by measures applying generally (e.g., to all taxpayers), such a general application is in practice less likely to suggest an expropriation than more specific measures aimed at particular nationalities or individual taxpayers. A taxation measure would not be expropriatory if it was in force and was transparent when the investment was undertaken.
>
> d) Taxation measures may constitute an outright expropriation, or while not directly expropriatory they may have the equivalent effect of an expropriation (so-called 'creeping expropriation'). Where a taxation measure by itself does not constitute expropriation it would be extremely unlikely to be an element of a creeping expropriation."[1758]

[1758] OECD, The Multilateral Agreement on Investment, Draft Consolidated Text (Apr. 22, 1998), 86 (Exhibit RME-1121) [emphases added]. *See also EnCana Corp. v. Republic of Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶¶ 173, 177 and 200 note 138 (Annex (Merits) C-976).

1122. Leading commentary is fully in accord. As stated by Professor Brownlie:

> "In the present context particular significance attaches to the distinction between taxation and expropriation. The significance attaches to the fact that in many legal systems expropriation without compensation is prima facie unlawful whereas taxation is prima facie lawful. The presumption relating to taxation may apply also in international law."[1759]

1123. Commentators routinely emphasize that States may justify severe appropriations of property, in many instances indistinguishable from confiscation, without incurring international responsibility. Alexander Fachiri's article *International Law and the Property of Aliens* is illustrative:

> "[T]he power of taxation is referred to as a means of arriving at results indistinguishable from confiscation without the possibility of legal international objection."[1760]

1124. Another example is Professor G. C. Christie's article *What Constitutes a Taking of Property under International Law?*:

> "[T]he operation of a State's tax laws, changes in the value of a State's currency, [...] will all serve to justify actions which because of their severity would not otherwise be justifiable;"[1761]

1125. Arbitral tribunals are in accord. In *Kügele v. Polish State*, the Upper Silesian Arbitral Tribunal dismissed the expropriation claim of a brewery owner complaining about an increase of tax in the form of license fees that made operation of the brewery unremunerative, forcing its closure:

> "The increase of the licence fee was not in itself capable of taking away or impairing the rights of the plaintiff … The increase of the tax cannot be regarded as a taking away or impairment of the right to engage in a trade, for such taxation presupposes the engaging in

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1759 Ian Brownlie, *International Law at the Fiftieth Anniversary of the United Nations: General Course on Public International Law*, 255 Rec. des Cours 9 (1995), 143 (Exhibit RME-1122); KAJ HOBÉR, INVESTMENT ARBITRATION IN EASTERN EUROPE: IN SEARCH OF A DEFINITION OF EXPROPRIATION (2007), 153-154 (Exhibit RME-1123).

1760 Alexander P. Fachiri, *International Law and the Property of Aliens*, 10 B.Y.I.L. 32 (1929), 54 (Exhibit RME-1124).

1761 G. C. Christie, *What Constitutes a Taking of Property under International Law?* 38 B.Y.I.L. 307 (1962), 331-332 (Annex (Merits) C-1021).

> the trade. It is true that taxation may render the trade less remunerative or altogether unremunerative. However, there is an essential difference between the maintenance of a certain rate of profit in an undertaking and the legal and factual possibility of continuing the undertaking. The trader may feel compelled to close his business because of the new tax. … But this does not mean that he has lost the right to engage in the trade. For had he paid the tax, he would be entitled to go on with his business."[1762]

1126. The tribunal in *EnCana Corporation v. Ecuador* articulated the standard as follows:

> "Of its nature all taxation reduces the economic benefits an enterprise would otherwise derive from the investment; it will only be in an extreme case that a tax which is general in its incidence could be judged as equivalent in its effect to an expropriation of the enterprise which is taxed."[1763]

The tribunal dismissed EnCana's expropriation claim, which relied on general standards applied by investment treaty tribunals in cases that did not turn on issues of taxation:

> "From the perspective of expropriation, taxation is in a special category. In principle a tax law creates a new legal liability on a class of persons to pay money to the State in respect of some defined class of transactions, the money to be used for public purposes. In itself such a law is not a taking of property; if it were, a universal State prerogative would be denied by a guarantee against expropriation, which cannot be the case. Only if a tax law is extraordinary, punitive in amount or arbitrary in its incidence would issues of indirect expropriation be raised."[1764]

That a State retains a wide margin of discretion in imposing new or modified taxation measures is emphasized in *Feldman v. Mexico*:

> "[G]overnments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning

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1762 *Kügele v. Polish State*, Upper Silesian Arbitral Tribunal (Feb. 5, 1932), *in* ANNUAL DIGEST OF PUBLIC INTERNATIONAL LAW CASES, YEARS 1931 AND 1932 (H. Lauterpacht, ed. 1938) 69, 69 (Exhibit RME-1125).

1763 *EnCana Corp. v. Republic of Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 173 (Annex (Merits) C-976). *See also ibid.*, ¶ 177.

1764 *Ibid.* [emphasis added]

> restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this."[1765]

1127. The burden is thus on Claimants to establish that there has been an abusive exercise of the taxing power, and that this abuse produced consequences having an effect equivalent to expropriation. This burden is "*very high*."[1766]

1128. States have a particularly wide margin of discretion in exercising their powers to enforce taxes. For example, the European Convention on Human Rights expressly qualifies the right to property in the following terms:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to [...] secure the payment of taxes or other contributions or penalties."[1767]
>
> "The Commission is of the opinion, however, that it is for the national authorities to make the initial assessment, in the field of taxation, of the aims to be pursued and the means by which they are pursued: accordingly, a margin of appreciation is left to them. The Commission is also of the view that the margin of appreciation must be wider in this area than it is in many others."[1768]

1765 *Marvin Feldman v. The Government of Mexico*, ICSID ARB(AF)/99/1, Award (Dec. 16, 2002), ¶ 103 (Annex C-1319) (Annex (Merits) C-964).

1766 K. Yannaca-Small, *Indirect Expropriation and the Right to Regulate: How to Draw the Line?*, *in* ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS – A GUIDE TO THE KEY ISSUES (K. Yannaca-Small, ed. 2010), 476 (Exhibit RME-1126). *See also* JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES (2010), 302 (Exhibit RME-1127): "[S]ince taxation falls within a state's normal police power, for a tax measure to constitute indirect expropriation it would need to be extraordinarily excessive and arbitrary and to violate an existing agreement with the investor."

1767 Protocol No. 1 of Mar. 20, 1952 to the European Convention for the Protection of Human Rights and Fundamental Freedoms (Nov. 4, 1950), 213 U.N.T.S. 221 (1955), 264, Art. 1 (Exhibit RME-1128).

1768 *Lindsay v. United Kingdom*, ECHR Application No. 11089/84, Decision on Admissibility (Nov. 11, 1986), 49 European Commission of Human Rights, Decisions and Reports 181 (1986), 190 (Exhibit RME-1129). [emphasis added]

b) Taxation Measures Generally Within Bounds Of Internationally Recognized Tax Policies And Practices Are Not Expropriatory

1129. As stated in the interpretative note to Article VIII(2), on taxation, of the Multilateral Agreement on Investment:

> "b) A taxation measure will not be considered to constitute expropriation where it is generally within the bounds of internationally recognised tax policies and practices. When considering whether a taxation measure satisfies this principle, an analysis should include whether and to what extent taxation measures of a similar type and level are used around the world. Further, taxation measures aimed at preventing the avoidance or evasion of taxes should not generally be considered to be expropriatory."[1769]

1130. A State cannot be deemed to have abused its wide margin of discretion in exercising sovereign powers of taxation, including enforcement measures, where the State has acted within the bounds of internationally recognized tax policies. Accordingly, a State's power to impose mandatory confiscation plus fines and penalties, wiping out a person financially, has been upheld as a legitimate measure to enforce customs duties.[1770]

1769 OECD, The Multilateral Agreement on Investment, Draft Consolidated Text (Apr. 22, 1998), 86 (Exhibit RME-1121) [emphases added]. *See also Gasus Dosier- und Fördertechnik GmbH v. Netherlands*, ECHR, Application No. 15375/89, Judgment (Feb. 23, 1995), ¶ 59 (Exhibit RME-1130): "Conferring upon a particular creditor the power to recover against goods which, although in fact in the debtor's possession, are legally owned by third parties is, in several legal systems, an accepted method of strengthening that creditor's position in enforcement proceedings. Under Netherlands law as it stood at the material time, landlords had a comparable power with respect to unpaid rent, as they did also under French and Belgian law; the Government have also cited several provisions in the tax laws of other member States that give similar powers to the tax authorities in special cases. Consequently, the fact that the Netherlands legislature has seen fit to strengthen the tax authorities' position in enforcement proceedings against tax debtors does not justify the conclusion that the 1845 Act, or section 16(3) of it, is not aimed at 'securing the payment of taxes', or that using the power conferred by that section constitutes a 'confiscation', whether 'arbitrary' or not, rather than a method or recovering a tax debt."

1770 *X. v. Austria*, European Commission on Human Rights, Application No. 7287/75, Decision on Admissibility (Mar. 3, 1978), 13 European Commission of Human Rights, Decisions and Reports 27 (1979) (Exhibit RME-1131).

c) The Tax Assessments Against Yukos Are Generally Within The Bounds Of Internationally Recognized Tax Policies And Practices

1131. Even a cursory examination of the tax practices of other countries confirms that -- notwithstanding Claimants' scathing criticisms -- the tax measures taken by the Russian authorities with respect to Yukos were not unusual by international standards, nor more severe than those of most other countries, and that indeed, in some significant respects, they were if anything more lenient, because in many countries Yukos' egregious conduct, which included repeated and consistent attempts to conceal its scheme, its interference with the authorities' audits, serial dissipations of assets, misleading and insincere settlement proposals more than sufficient to foster mistrust, unlawful refusals to pay, and extraordinary interference with enforcement measures intended to maximize the proceeds available to discharge Yukos' tax obligations, would have prompted the authorities to react more quickly and forcefully.

1132. In the following review of precedents from other jurisdictions, we have of necessity surveyed only a small number of countries. We have focused on the European and American members of G-8, along with some other members of the OECD. To reduce translation burdens, we have emphasized materials from countries whose legal documents are available in English.

1133. For the avoidance of doubt, the position of Respondent is not that its laws and practices as applied to Yukos were in every instance more taxpayer-favorable than those of other countries. Rather, its position is that, as amply demonstrated in the discussion below, Russia's laws and practices, in this case and more generally, have been consistent with those of many, or even most, of the other countries surveyed.

1134. For purposes of the following analysis of other countries' laws, we will consider separately the major criticisms that Claimants have raised, starting with their preposterous suggestion that Yukos' "tax optimization" scheme was legal.

(1) Tax Evasion Schemes Similar To The One Carried Out By Yukos Would Have Been Condemned In Other Countries Under Anti-Avoidance Doctrines Such As "Substance Over Form" Or "Sham Transactions / Sham Companies"

1135. The treatment by the Russian tax authorities of Yukos' tax evasion scheme is entirely consistent with the positions that would have been taken by the tax authorities of virtually every other country. The rationale underlying this consensus among tax authorities is simple and obvious: the fairness and credibility of any tax system would be seriously undermined if taxpayers engaging in artifices such as those employed by Yukos were thereby able to avoid significant tax liabilities. Although details vary from country to country, it is readily demonstrable that tax administrations around the world would have been at least as firm as the Russian Federation in dealing with abuses of the kind perpetrated by Yukos.

1136. More than a half-century ago, the U.S. tax authorities and courts began to develop a series of interrelated jurisprudentially-validated doctrines to assist tax authorities in combating abuses. The stated purpose of these doctrines is to deny to taxpayers the benefits of tax-motivated transactions, notwithstanding the fact that such transactions may satisfy the literal requirements of specific statutory provisions.[1771] One such body of case law

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[1771] *See,* Expert Report of Dale Hart ("Hart Report") ¶ 2(d). In the United States, courts have fashioned and applied various overlapping forms of the "substance over form" doctrine since the Supreme Court's seminal decision in *Gregory v. Helvering*, 293 U.S. 465 (1935) (Exhibit RME-1215). The prevailing common law doctrines deny tax benefits for tax-motivated transactions that do not reflect a meaningful change in a taxpayer's economic position. *See, e.g., Killingsworth v. Comm'r*, 864 F.2d 1214, 1216: "[A]*lthough a transaction may, on its face, satisfy applicable Internal Revenue Code criteria, it will nevertheless remain unrecognized for tax purposes if it is lacking in economic substance.*" (Exhibit RME-1216) [emphasis added]; *Karr v. Comm'r*, 924 F.2d 1018, 1023: "[E]*xpenses incurred in connection with a sham transaction are not deductible.*" (Exhibit RME-1217); *Horn v.Comm'r*, 968 F.2d 1229, 1236 (D.C. Cir. 1992): "*The economic sham doctrine generally works to prevent taxpayers from claiming the tax benefits of transactions, which, although they may be within the language of the Code, are not the type of transaction Congress intended to favor.*" (Exhibit RME-1218); *Yosha v. Comm'r*, 861 F.2d 494, 497 (7th Cir. 1988): "[T]*here is a doctrine that a transaction utterly devoid of economic substance will not be allowed to confer such an,* [a tax] *advantage.*" (Exhibit RME-1219); *Ferguson v. Comm'r*, 29 F.3d 98, 101 (2d Cir. 1994) (*per curiam*): "*An activity will not provide the basis for deductions if it lacks economic substance.*" (Exhibit RME-1220); Department of The Problem of Corporate Tax Shelters. Discussion, Analysis and Legislative Proposals, Corporate Tax Shelters (July 1999), 56: "[T]*he third, and final, way the IRS can use non-statutory standards to challenge the tax benefits of a particular tax-advantaged transaction is through the application of the economic substance doctrine. This doctrine allows the IRS to deny tax benefits if the economic substance of a transaction is*

involves the so-called "economic substance doctrine," which denies tax benefits arising from transactions -- such as the ones employed by Yukos -- that do not result in any meaningful change in the taxpayer's economic position, other than a reduction in tax liabilities. As explained by the U.S. courts, tax law requires that the relevant transactions have economic substance separate and distinct from the economic benefits achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is warranted, where a taxpayer seeks to claim tax benefits, unintended by the legislature, by means of transactions that serve no economic purpose other than tax savings.[1772]

1137. A closely related line of U.S. jurisprudence involves the so-called "step-transaction" doctrine, pursuant to which the various interdependent "steps" in a complex scheme (such as, in the case of Yukos, the purchase and resale of oil and oil products by the trading shells prior to their final sale to the ultimate customer) are simply collapsed and treated for tax purposes as a single transaction (in Yukos' case, as a direct sale by Yukos to the ultimate customer).[1773]

1138. Still another doctrine that is regularly invoked by U.S. tax authorities is the so-called "sham entity" doctrine, pursuant to which those authorities entirely disregard the existence of legal entities -- such as, in the Yukos case, the trading shells -- that lack a legitimate, non-tax-related business

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insignificant relative to the tax benefits obtained" (Exhibit RME-1221) [emphasis added]. These doctrines were recently codified in Sections 7701(o) of the U.S. Internal Revenue Code (Exhibit RME-1222).

1772 *See*, Hart Report, ¶ 2(d)(i). *ACM Partnership, Southampton-Hamilton Company v. Commissioner of Internal Revenue*, 73 T.C. Memo 1997-115 (CCH) 2189, 2215 (1997), *aff'd in relevant part* 157 F.3d 231 (3d Cir. 1998), cert. denied 526 U.S. 1017 (1999) (Exhibit RME-1223). *See also Klamath Strategic Investment Fund, LLC v. United States of America*, 472 F. Supp. 2d 885 (E.D. Texas 2007), *aff'd*, 568 F.3d 537 (5th Cir. 2009) (Exhibit RME-1224); Joseph Bankman, Articles and Essays: *The Economic Substance Doctrine*, 74 S. Cal. L. Rev. 5, 12 (Nov. 2000) (Exhibit RME-1225); Jeffrey C. Glickman, Clark R. Calhoun, *The "States" of the Federal Common Law Tax Doctrines*, 61, Tax Law. 1181 (Summer 2008) (Exhibit RME-1226); Donald L Korb, *The Economic Substance Doctrine in the Current Tax Shelter Enviroment*, Tax AnalystsTM. (Exhibit RME-1227).

1773 *See*, *e.g.*, *Esmark, Inc. and Affiliated Companies v. Commissioner of Internal Revenue*, 90 T.C. 171 (1988) (Exhibit RME-1228). *See also Commissioner of Internal Revenue v. Gordon*, 391 U.S. 83 (1968) (Exhibit RME-1229); *King Enterprises, Inc. v. United States*, 418 F.2d 511 (Ct. Cl. 1969) (Exhibit RME-1230); *American Bantam Car Company v. Commissioner of Internal Revenue*, 11 T.C. 397 (1948), *aff'd per curiam,* 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950) (Exhibit RME-1231).

purpose or that do not conduct any genuine business activities (as distinguished from purely formal execution of documents done solely to support a tax-reduction scheme, as was the case for the trading shells).[1774] As discussed below, the taxes evaded by the sham entities are instead assessed on the real party in interest.

1139. Most other countries have developed similar rules, by statute and/or case law, which permit their tax authorities to ignore the legal forms chosen by taxpayers, and to assess taxes on the basis of economic realities.

1140. For instance, in the United Kingdom, the tax authorities are not bound by the legal form of transactions, but may impose taxes on the basis of a purpose-based reading of the statute and the reality of the transactions intended by the parties.[1775] It is also possible, where the use of a corporate structure has been designed for the purposes of tax evasion, to completely disregard the existence of legally separate corporate entities.[1776] Where such entities are merely

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1774 Hart Report, ¶ 2(d)(ii). *See, e.g. ASA Investerings Partnership v. Commissioner of Internal Revenue*, 201 F.3d 505 (D.C Cir. 2000) (Exhibit RME-1232); *Northern Indiana Public Service Co. v. Commissioner of Internal Revenue*, 115 F.3d 506 (7th Cir. 1997), *aff'd*, 105 T.C. 341 (1995) (Exhibit RME-1233).

1775 Expert Report of Felicity Cullen ("Cullen Report") ¶¶ 140-169. The seminal case law in this area is contained in a succession of decisions of the House of Lords commencing with *W T Ramsay v. Inland Revenue Commissioners*; *Eilbeck (Inspector of Taxes) v. Rawling* [1981] STC 174 (Exhibit RME-1235), until, most recently, *Barclays Mercantile Business Finance Ltd v. Mawson (Inspector of Taxes)* [2005] 1 AC 684 (Exhibit RME-1236). As enunciated in *Barclays Mercantile* by the House of Lords, the doctrine states that the provisions of a statute (including a tax statute) should be interpreted purposively "[i]*n order to determine the nature of the transaction to which* [the statute] *was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description*." *Ibid*. [emphasis added]. Another decision in the *Ramsay* line of authorities is *Collector of Stamp Revenue v.Arrowtown Assets Ltd* [2003] HKCFA 46, delivered by the Hong Kong Final Court of Appeal, where the law was described as follows: "[T]*he driving principle in the Ramsay line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically*" (Exhibit RME-1237) [emphasis added]. The House of Lords cited this description in *Barclays Mercantile, supra. A fortiori*, this is true when dealing with "shams." The classic definition of "sham" in English law was articulated by Lord Diplock in *Snook v. London & West Riding Investments Ltd* [1967] 1 All ER 518, 529: "*I apprehend that, if it has any meaning in law,* ["sham"] *means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.*" (Exhibit RME-1234).

1776 *See, e.g., Re H and others* [1996] 2 All ER 391 (Exhibit RME-1238).

a device or "sham" set up for the purpose of tax evasion, criminal prosecution is possible, based on the common law crime of "cheating the public revenue." A good example of this is *R v. Charlton and others*,[1777] which bears a striking resemblance to the Yukos case since it involved the interposition by a U.K. company (the tax evader) of a subsidiary organized in a low-tax jurisdiction (Jersey), for the purpose of reducing -- through "on paper" back-to-back purchase and sale transactions at artificial prices -- the profits that would otherwise have been earned by the U.K. company, and that would therefore have been fully taxable in the United Kingdom.

1141. In Cyprus, pursuant to Article 33 of the Assessment and Collection of Taxes Law, tax authorities may "*disregard*" transactions which they consider to be "*artificial or fictitious*" and assess taxes on the real party in interest.[1778]

1142. Likewise, in Austria, Article 21 of the General Tax Code (*Bundesabgabenordnung*) gives priority in tax assessments to economic realities rather than to outward appearances, and Article 22 denies tax benefits in cases when there is an abuse of the law (*Mißbrauch*), which is defined to include any legal structure that is unusual or inappropriate and that can only be explained by the intent to reduce taxes.[1779]

1777 *R v. Charlton and others* [1996] STC 1418 (Exhibit RME-1239). Cullen Report, ¶¶ 161-169.

1778 Article 33 of the Assessment and Collection of Taxes Law (Exhibit RME-1240).

1779 Pursuant to Article 21 of the Austrian General Tax Code, "[i]*n the evaluation of questions in tax law, the true economic substance is decisive in an economic approach and not the external appearance of the facts,*" whereas Article 22 provides that "*(1) Tax liabilities cannot be circumvented or reduced by misuse of the forms and the organisational options of civil law. (2) If the abuse (paragraph 1) is present, taxes shall be levied to the same extent as they would have been, if the legal organisation had properly reflected the economic activities, facts, and relationships.*" (Exhibit RME-1241). Administrative court, Decision No. 2002/14/0074 (Dec. 9, 2004) (Exhibit RME-1242); "*According to current case law, abuse in the sense of this law is seen as a legal structure, which is unusual and inappropriate with regard to the economic goal and which only becomes comprehensible in the light of the tax saving connected with it. Generally speaking, it is not a single legal action but a chain of legal acts which forms the circumstances with which the consequence of Section 22 Para. 2 BAO […] is bound up*." *See also,* Administrative Court, Decision No. 2001/13/0018 (Aug. 10, 2005) (Exhibit RME-1243).

1143. In Belgium, the tax authorities are entitled to challenge tax-driven schemes on the basis of their sham nature[1780] or on the basis of the general anti-avoidance provision of the Income Tax Code (*Code des Impôts*).[1781]

1144. In France, the main statutory anti-abuse provision, which is based on the *abus de droit* principle, grants broad authority to the French tax administration to disregard tax-driven legal structures or transactions,[1782] including the right to attribute income (and attendant tax liabilities) to the real party in interest.

1145. Similarly, in Germany, the general "substance over form" rule contained in Section 42 of the Tax Code (*Abgabenordnung*) allows tax authorities

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1780 J. Autenne and M. Dupont, *L'Evitement de l'impôt et sa licéité* in Liber Amicorum Jacques Malherbe, Brussels, Bruylant, 2006, page 61 *et seq.* 956 (Exhibit RME-1244); T. Afschrift, D. Garabedian, P. Glineur, et al., *L'Evolution des principes généraux du droit fiscal*: *20è anniversaire de la maîtrise en gestion fiscale*, Brussels, Larcier, 71 (Exhibit RME-1245).

1781 Specifically, pursuant to Article 344, ¶ 1, of the Code des Impôts sur les Revenue, "[n]*'est pas opposable à l'administration des contributions directes, la qualification juridique donnée par les parties à un acte ainsi qu'à des actes distincts réalisant une même opération lorsque l'administration constate, par présomptions ou par d'autres moyens de preuve visés à l'article 340, que cette qualification a pour but d'éviter l'impôt, à moins que le contribuable ne prouve que cette qualification réponde à des besoins légitimes de caractère financier ou économique.*" ("[t]*he legal characterization of a legal act or a series of legal acts executing one and the same transaction is not opposable to the tax authorities when the latter establish – by presumption or by the other means provided for in article 340 - that the purpose of that legal characterization is merely tax avoidance unless the taxpayer demonstrates that the characterization reflects legitimate financial or economic needs.*") (Exhibit RME-1246).

1782 Pursuant to Article L.64 Livre des procédures fiscales, "[a]*fin d'en restituer le véritable caractère, l'administration est en droit d'écarter, comme ne lui étant pas opposables, les actes constitutifs d'un abus de droit, soit que ces actes ont un caractère fictif, soit que, recherchant le bénéfice d'une application littérale des textes ou décisions à l'encontre des objectifs poursuivis par leurs auteurs, ils n'ont pu etre inspirés par aucun autre motif que celui d'éluder ou d'atténuer les charges fiscales que l'intéressé, si ces actes n'avaient pas été passés ou réalisés, aurait normalement supportées eu égard à sa situation ou à ses activités réelles.*" ("*The administration has the right to ignore any legal documents constituting an abus de droit, treating them as not binding, for the purpose of evidencing their true nature, if such documents are of a fictitious nature, or have been motivated by no reason other than the avoidance or reduction by the taxpayer, through the attempted literal application of laws or court precedents in a manner contrary to the intent of the authors thereof, of tax burdens that the taxpayer would normally have had to bear if such documents had not been adopted or executed, taking into account the taxpayer's real situation and activities*" (Exhibit RME-1247). *See, e.g., Bazar de l'Hotel de Ville*, Cour administrative d'appel de Paris (Apr. 17, 2008) No. 06PA04006 (Exhibit RME-1248); *Ministre de l'Economie, des Finances et de l'Industrie v. Société Sagal*, Conseil d'Etat (May 18, 2005) No. 267087 (Exhibit RME-1249); *Ministre de l'Economie, des Finances et de l'Industrie v. Société Pléiade*, Conseil d'Etat (February 18, 2004) No. 247729 (Exhibit RME-1250). *See generally*, Vincent Daumas, *Abus de droit: derniers développements jurisprudentiels*, Ed. Francis Lefevre, RJF 1/11 (Exhibit RME-1251).

to disregard schemes whose purpose is simply to circumvent the payment of taxes.[1783]

1146. In Italy, the Supreme Court has held that "*the use of tax minimization schemes whose purpose is predominantly aimed at allowing to the taxpayer the benefit of a tax saving constitutes an abuse of right and entitles the tax authorities to disregard the same and assess taxes according to the true nature of the transaction.*"[1784]

1147. In The Netherlands, tax authorities can invoke the "abuse of law" (*fraus legis*) doctrine to defeat complex structures (such as those implemented by Yukos) where the complete or partial avoidance of taxes is the main motive, and where the use (*rectius*: abuse) of the special regimes invoked by the taxpayer is at odds with the legislative intent[1785] (*i.e.*, in the present case, to promote the economic development of the low-tax regions).

1148. In Spain, the General Tax Law (*Ley General Tributaria*) contains two anti-abuse provisions: (i) Article 15 ("*conflict in the application of the tax law*"), which denies tax benefits in cases where the relevant transactions are "*artificial or inappropriate*," and without significant legal or economic effect other than tax

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1783 Specifically, Section 42 of the German Tax Code provides that ("[i]*t shall not be possible to circumvent tax legislation by abusing legal options for tax planning schemes. Where the element of an individual tax law provision to prevent circumventions of tax has been fulfilled, the legal consequences shall be determined pursuant to that provision. Otherwise, in the event of an abuse within the meaning of subsection (2), the tax claim shall arise in the same manner as it arises through the use of legal options appropriate to the economic transactions concerned. (2) An abuse shall be deemed to exist where an inappropriate legal option is selected which, in comparison with an appropriate option, leads to tax advantages unintended by law for the taxpayer or a third party. This shall not apply where the taxpayer provides evidence of nontax reasons for the selected option which are significant when viewed from an overall perspective.*") (Exhibit RME-1252).

1784 Decision of the Italian Supreme Court, Grand Chamber, No. 30055 (Dec. 23, 2008), (Exhibit RME-1253). *See also*, *e.g.*, Decision of the Italian Supreme Court, Grand Chamber, No. 30057 (Dec. 23, 2008), (Exhibit RME-1254) and Decision of the Italian Supreme Court, No. 10257 (Apr. 21, 2008) (Exhibit RME-1255). *See* also Article 37-*bis* of Presidential Decree No. 600 (Sept. 29, 1973) (Exhibit RME-1259), and the more recent case law of the Italian Supreme Court: Decision No. 8772 (Apr. 4, 2008) (Exhibit RME-1256), Decision No. 688 (Jan. 13, 2011) (Exhibit RME-1257).

1785 O.C.R. Marres, *The Abuse of Law Doctrine, a Powerful Weapon Against Base Erosion*, Weekly Journal for Tax Law 2008/1431 (Dec. 18, 2008), Section 7 (Exhibit RME-1260). *See also* Decision of the Dutch Supreme Court (July 11, 1990) No. 26306, BNB 1990/293 (Exhibit RME-1261) and Decision of the Dutch Supreme Court (July 11, 2008) No. 43 376, BNB 2008/266c (Exhibit RME-1262), which was confirmed by Decision No. BNB 2010/215* (Mar. 19, 2010) (Exhibit RME-1263).

savings; and (ii) Article 16 ("*simulation*"), which allows the tax authorities to disregard the legal form of transactions and impose taxes on the basis of the true intent of the parties.[1786]

1149. In Sweden, the general anti-avoidance provision contained in the 1995 Tax Avoidance Act allows Swedish tax authorities to disregard the form of any transaction whose "*predominant reason*" is obtaining a tax benefit,[1787] and to re-assess the relevant taxes in accordance with the true nature of the transaction (*rättshandlingens verkliga innebörd*).[1788]

1150. Similarly, tax authorities in Switzerland are entitled to assess taxes on the basis of economic reality, disregarding legal form, where the latter is "*unusual*" and primarily or exclusively dictated by tax-avoidance considerations.[1789]

1151. A number of non-European countries have developed similar anti-avoidance provisions.

1152. For instance, in Australia, with respect to both the income tax[1790] and the Goods and Services Tax ("GST") (the country's VAT equivalent),[1791] tax authorities "*closely review complex tax-driven structures and arrangements that objectively make little sense other than for the dominant purpose of obtaining a tax benefit*

1786 Articles 15 and 16 of the Spanish General Tax Law, No. 58 (Dec. 17, 2003) (Exhibit RME-1264).

1787 Section 2 of the Tax Avoidance Act (1995: 575) (Exhibit RME-1266).

1788 In Sweden, it is well settled that "*taxation shall be carried out on the basis of the transactions' real meaning irrespective of the name they have been given.*" Ruling of the Swedish Supreme Administrative Court, Decision No. 132-1998, RÅ 1998 ref. 19 (Exhibit RME-1267).

1789 *Société anonyme F. c. la Commission genevoise de recours de l'impôt pour la défense nationale*, Swiss Federal Tribunal (June 3, 1960) cited in ASA 29 (1960/61), 437 (Exhibit RME-1268). *See also, X AG v. Zurich, Canton and Administrative Court*, Swiss Federal Tribunal, Decision No. 90 I 217 (July 8, 1964) (Exhibit RME-1269).

1790 Pursuant to Sections 177A(5), 177C(1), 177(D)(d), and 177(F) of the Income Tax Assessment Act TAA 1936, tax authorities may disregard any "*scheme*" whose "*dominant purpose*" is to "*enabl*[e] *the relevant taxpayer* [...] *or other taxpayers each to obtain a tax benefit in connection with the scheme,*" where "*tax benefit*" is very broadly defined (Exhibit RME-1270).

1791 Pursuant to Paragraph 165-55, Division 165 of the "*A New Tax System (Goods and Services Tax) Act 1999*" (Exhibit RME-1271), Australian tax authorities have full powers to disregard the formal configuration of any tax-driven scheme. *See, e.g.*, VCE and Commissioner of Taxation [2006] AATA 821; (2006) 63 ATR 1249 (Exhibit RME-1272).

[...] *tak*[ing] *particular interest in apparent differences between a business's economic and commercial performance and its tax outcomes.*"[1792]

1153. In Canada, anti-avoidance rules have been codified and the tax authorities, whenever confronted with an "*avoidance transaction,*" are required to deny the tax benefits that would normally be applicable to the transaction.[1793] The definition of "*avoidance transaction*" is broad and encompasses any transaction generating a tax benefit unless the taxpayer -- who has the burden of proof -- shows that "*the transaction may reasonably be considered to have been undertaken or arranged primarily for* bona fide *purposes other than to obtain the tax benefit*."[1794]

1154. In New Zealand, tax authorities are free to disregard all "shams."[1795] The authorities also have broad anti-abuse powers in the absence of "shams," provided only that the taxpayer has made an "*arrangement*" of which "*tax avoidance*" is one of the "*purposes or effects*" and "*the tax avoidance purpose or effect is not merely incidental.*"[1796]

1792 Australian Taxation Office, Compliance Program 2009-10, 25 (Exhibit RME-1273).

1793 Pursuant to Subsection 245(2) of the Canadian Income Tax Act, R.S.C. 1985 c.1 (5th suppl.) as amended "*Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction*". (Exhibit RME-1276).

1794 Subsection 245(3) of the Canadian Income Tax Act R.S.C. 1985 c.1 (5th suppl.) as amended [emphasis added]. Pursuant to Section 245(1), a "*tax benefit*" includes any "*reduction, avoidance or deferral*" of any amount payable under the Income Tax Act (Exhibit RME-1276). The manner in which parties to transactions choose to label them does not necessarily govern their characterization for tax purposes; rather, it is necessary to identify the substance or true character of the transaction. *Merchant v. The Queen,* 2009 TCC 31; 2009 DTC 1054; [2009] 2 CTC 2174 (Exhibit RME-1279), citing *Christie, A.C.J.T.C.C. in Purdy v. M.N.R.*, 85 DTC 254, 256: "*It must be borne in mind that in deciding questions pertaining to liability for income tax the manner in which parties to transactions choose to label them does not necessarily govern. What must be done is to determine what on the evidence is the substance or true character of the transaction and render judgment accordingly.*"

1795 *Case X10* (2005) 22 NZTC 12,155 (income tax-minimizing transaction found to be sham lacking any commercial sense or reality) (Exhibit RME-1280); *Erris Promotions Limited & Ors v. Commissioner of Inland Revenue* (2003) 21 NZTC 18,330 (various income tax shelters disregarded as shams) (Exhibit RME-1281).

1796 Subpart YA1 of the Income Tax Act 2007 (No. 97/00 at Oct. 1, 2009) Public Act (Exhibit RME-1283). "*Tax avoidance*" is in turn very broadly defined to include "*directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future*

1155. In sum, it is clear that the "bad-faith taxpayer" and other anti-abuse doctrines relied upon by the Russian courts in upholding the Yukos tax assessments were well "*within the bounds of internationally recognized tax policies and practices*"[1797] and that, in fact, Russia's approach would have been anomalous by international standards if the Russian tax authorities had treated Yukos' scheme as lawful.

1156. Claimants nevertheless argue that Russia somehow violated international law by attributing to Yukos revenues and profits purportedly earned by its trading shells. Such an argument would be dismissed summarily in other countries. This is because, in applying "substance over form" or other anti-avoidance doctrines, tax authorities the world over routinely impose on companies found to be the real party in interest the taxes that would ordinarily have been levied on others. Indeed, the most typical case is very much like Yukos': the taxes evaded thanks to subsidiaries are assessed on the parent company.

1157. For instance, in Australia, the Commissioner possesses a statutory power to issue assessments to a parent or affiliated company where he considers that the corporate group of companies has entered into a "scheme" with the dominant purpose of obtaining a tax benefit.[1798]

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income tax." BG1 of the Income Tax Act 2007 (No. 97/00 at Oct. 1, 2009) Public Act, Subpart BG – Avoidance (Exhibit RME-1282). S*ee also, Ben Nevis Forestry Ventures Ltd & Ors v. Commissioner of Inland Revenue* and *Accent Management Ltd & Ors v. Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 §§ 105-106 (Exhibit RME-1284). *BNZ Investments Limited & Ors v. Commissioner of Inland Revenue* (2009) 24 NZTC 23,582 (Exhibit RME-1285).

1797 OECD, The Multilateral Agreement on Investment. Draft Consolidated Text (Apr. 22, 1998), 86 (Exhibit RME-1286).

1798 That is, the Commissioner may issue an assessment to a parent or affiliated company where he believes that a scheme has been executed for the purpose of transferring a tax liability to a company which (i) lacks substance, or (ii) is insolvent. Section 177F of the Income Tax Assessment Act 1936. (Exhibit RME-1270).

1158. Likewise, the Austrian tax authorities are entitled to treat mere holding companies as transparent entities and to attribute income (and therefore also taxes) to the company actually generating the business.[1799]

1159. In Canada too, in appropriate circumstances, the authorities reassess parent companies for taxes that would otherwise be due by their subsidiaries, notably in cases such as the present one, where the parent company has dominated the subsidiaries. [1800]

1160. In Cyprus, whenever the terms of dealings between related parties "*differ from those which would be made between independent businesses*," the tax authorities are allowed to reallocate profits to the party which would normally have realized the same, and to assess taxes accordingly.[1801]

1161. New Zealand is another country where the tax authorities are allowed to "follow the money," *i.e.*, assess the parent for taxes evaded by subsidiaries where the latter have diverted assets to the parent.[1802] Some of the relevant cases involve, as here, companies whose assets have been stripped by the controlling shareholders. [1803] More broadly, under their general anti-abuse statute, the New Zealand authorities are allowed, when dealing with multiparty abuses, to reallocate tax burdens to the party whom they view as the correct taxpayer. [1804]

1162. In Spain, the authorities can assess parent companies for taxes that would normally have been due from their affiliates, if the latter have been used to

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1799 *See e.g.,* Administrative Court, Decision No. 2002/14/0074 (Dec. 9, 2004) (Exhibit RME-1242) and Administrative Court, Decision No. 2001/13/0018 (Aug. 10, 2005) (Exhibit RME-1243).

1800 *See Appleby v. MNR,* 74 DTC 6514, [1974] CTC 693, where the court held that the company was so completely dominated by its shareholder that the company's acts could be viewed as the shareholder's own (Exhibit RME-1277). *See also*, *Dominion Bridge Company Ltd. v. The Queen,* 75 DTC 5150; [1975] CTC 263 (Exhibit RME-1278).

1801 Article 33 of the Cypriot Income Tax Act (Exhibit RME-1287).

1802 *Wire Supplies Ltd. & Ors v. CIR* (2007) 23 NZTC 21,404 (Exhibit RME-1288).

1803 *Ibid. See also*, HD 15(1) of the Income Tax Act 2007, HD 15 Asset Stripping of Companies (Exhibit RME-1290).

1804 *O'Neil & Ors v Commissioner of Inland Revenue* (2001) 20 NTTC 17, 051 (Exhibit RME-1289).

evade taxes.[1805] More generally, the Spanish tax authorities can attribute to the real party in interest income that has been formally earned by a third party pursuant to a tax-avoidance scheme.[1806]

1163. Similarly, the Swiss tax authorities are entitled to reallocate to a Swiss company income that was formally earned by a low-tax-jurisdiction affiliate that lacked any independent existence or economic *raison d'être*.[1807]

1164. The anti-avoidance arsenal of U.S. tax authorities also includes various means of forcing a parent company to pay taxes nominally due from affiliates. [1808]

1165. In sum, the Russian anti-avoidance doctrines underpinning the contested assessments of Yukos -- including the reallocation to Yukos of the revenues and income nominally generated by the trading shells -- would be regarded as normal, and even obvious, in virtually every other country.

(2) Claimants' Arguments Regarding The Authorities' Alleged Change Of Position and Retroactive Application Of The Law Would Be Summarily Dismissed In Other Countries

1166. Throughout the world, tax authorities have successfully resisted attempts to restrict their ability to change their position -- either generally or with regard to a specific tax avoidance technique -- with full "retroactivity" insofar as "open" years are concerned, meaning tax years for which reassessments are not barred by the statute of limitations.

1805 *See* Article 43(1)(g) of the Spanish General Tax Code Law 58/2003 (Exhibit RME-1291). *See also*, Central Tax Appeal Board, Committee 11, R.G. 1039/2006, Resolution of (Apr. 2, 2008), NFJ029188 (Exhibit RME-1292) and Central Tax Appeal Board, Committee 11, R.G. 1586/2007, Resolution of (Dec. 3, 2008), NFJO31624 (Exhibit RME-1293).

1806 Central Economic-Administrative Court, Investigation Board 3a, R.G. 2461/2007, Resolution of (Nov. 6, 2008), Section 4, NFJO31218 (Exhibit RME-1265).

1807 *Masse en faillite de A. SA v. Administration fiscale cantonal du canton de Genève*, Swiss Federal Tribunal, Decision No. 2P.92/2005 (Jan. 30, 2006), 11 (Exhibit RME-1294).

1808 For example, under the *alter ego* doctrine, the IRS may treat property, or rights to property, legally owned by a corporation as though owned by shareholders. *See* IRM, § 5.12.2.6.7 (Exhibit RME-1295). *See also*, *Towe Antique Ford Found. v. IRS* 999 F.2d 1387 (9th Cir. 1993) (Exhibit RME-1296). *See*, *generally*, Hart Report, ¶¶ 2, 13-14.

1167. The authorities' position in this regard -- both in Russia and elsewhere -- makes eminent sense as a practical matter: the enforcement of tax laws would be crippled if, in order to assess a tax, the authorities were required to demonstrate that they had invariably taken the same position at all times in connection with all previous audits of the same taxpayer, let alone all other taxpayers.

1168. Thus, in the United States, retroactivity in the area of tax law, notably in connection with efforts to combat abuses, is not unusual.[1809] Thus, the Secretary of the Treasury has broad discretion to adopt concededly "retroactive" regulations to combat abusive practices. In accordance with Section 7805(b)(3) of the Internal Revenue Code, "*the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse.*"[1810] Moreover, the Internal Revenue Code presumes that most rulings (other than so-called "regulations") issued by the IRS will be retroactive, and that the IRS will exercise its discretion to provide for prospective application only if and when appropriate.[1811] *A fortiori*, tax authorities in the United States are also empowered to begin enforcing preexisting rules that had previously not been enforced.[1812]

1169. In Canada, retroactive taxing statutes have been recognized as valid.[1813]

1809 *See* Hart Report, ¶¶ 2(b) and (c).

1810 Section 7805(b)(3) of the Internal Revenue Code (Exhibit RME-1297). [emphasis added]

1811 Hart Report, ¶ 2 (c).

1812 *See, e.g., Sam Young and Lee A. Sheppard, Korb Slams Textron Ruling, Wall Street Rule*, 117 Tax Notes 204 (Oct. 15, 2007) (then Internal Revenue Service ("IRS") Chief Counsel unequivocally stating that the government is not estopped by prior inaction from enforcing law even with respect to large, long-standing, and well-publicized transactions (Exhibit RME-1298); Heather Bennett, Parker Debunks *'Wall Street Rule,' Pushes LTR Preconferences*, 100 Tax Notes, 1634 (Sept. 29, 2003) (then IRS Chief Counsel stating that "[t]*he failure of the IRS to issue published guidance on a transaction, and even the failure of the IRS to raise issues regarding a transaction in audits for many years, does not prevent the IRS from questioning the tax treatment of the transaction*") (Exhibit RME-1299). *See* Section 7805(b)(3) of the Internal Revenue Code (providing that regulations may apply on a retroactive basis in order to prevent abuse) (Exhibit RME-1297). For an example of a regulatory change applied retroactively, *see* Treasury regulation Section 1.301-1(g) (applying retroactively to certain tax shelter transactions previously identified in an IRS notice) (Exhibit RME-1300).

1813 *Hokhold v. The Queen*, 93 DTC 5339 [1993] (Exhibit RME-1301).

1170. In the United Kingdom too, tax legislation has on occasion included features that were openly retroactive.[1814]

1171. More generally, in the United Kingdom, there is a principle at common law that neither a Minister nor a subordinate officer of the Crown, of which HM Revenue and Customs is an organ, can by any conduct or representation bar (or "estop") the Crown from enforcing a statutory prohibition or from prosecuting for its breach.[1815] Although a taxpayer can invoke "*legitimate expectations*," those expectations are protected only if the taxpayer has been fully open with the tax authorities ("*put all his cards face upwards on the table*") and if the tax authorities have agreed that no tax was due by means of a prior "*representation*" to the taxpayer which was "*clear, unambiguous and devoid of* [relevant] *qualification*."[1816] Yukos, of course, kept its cards very much up its sleeve.

1172. In France, tax authorities are not prevented from assessing taxes on the basis that they have refrained from exercising their powers in the past. According to Articles L80A and L80B of the *Livre de Procédures Fiscales*, tax

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1814 Cullen Report, ¶¶ 170-176. There have been instances in the United Kingdom of tax laws with indisputably retroactive features. *See*, *e.g.* Section 122 of the Finance Act 2009 (which extended the territorial qualifying condition for agricultural property relief in relation to transfers of value where inheritance tax was paid or due on or after Apr. 23, 2003) (Exhibit RME-1302), Section 58 of the Finance Act 2008 (which amended certain provisions of the UK tax legislation relating to UK residents who were members of foreign partnerships and, per Section 58(4), the amendments are "*treated as always having had effect*") (Exhibit RME-1303), and Schedule 15 to the Finance Act 2004 (which introduced an income tax charge on pre-owned assets; whilst the charge could not arise until 2005/06, relevant arrangements could have been put in place many years previously, as the charge applied to arrangements in the period since March 18, 1986). (Exhibit RME-1304).

1815 *See Howell v. Falmouth Boat Construction Co. Ld.* [1951] AC 837 (Exhibit RME-1305); *see also Southend on Sea Corpn v. Hodgson (Wickford) Ltd* [1962] 1 QB 416 (Exhibit RME-1306), where it was held that there is no distinction between a case where estoppel is sought to be raised to prevent the performance of a statutory duty and one where it is sought to be raised to hinder the exercise of statutory discretion. In the tax context, it has been held that no estoppel could arise in relation to a statutory provision for the charging of VAT, which is mandatory, nor hinder HM Revenue and Customs' exercise of its statutory discretion to make an assessment (*see Animal Virus Institute v. Customs and Excise Comrs* [1988] VATTR 56 (Exhibit RME-1307) *and R v. IRC, ex p MFK Underwriting Agencies Ltd* [1989] STC 873) (Exhibit RME-1308)).

1816 *Regina v. Commissioners of Inland Revenue* (ex parte Mattessons Wall's Ltd) (1996) 68 TC 205 (Exhibit RME-1309); *see also R v. Inland Revenue Commissioners* (ex parte MFK Underwriting Agencies Ltd and related applications) (1989) STC 873 (Exhibit RME-1310).

authorities are precluded from changing their previous positions only in two narrowly defined circumstances:

(i) in cases when the taxpayer has been previously assessed, a reassessment of the same tax year is precluded (a) if the reassessment is based on an interpretation by the authorities of the law (i) that is different from their interpretation upon which the earlier assessment was based and (ii) if the taxpayer challenges the new interpretation in good faith, and (b) the prior interpretation was "formally accepted" by the tax authorities; or

(ii) in cases when the taxpayer has relied on an interpretation by the tax administration through formal, published "*instructions*" or circulars which had not been withdrawn at the time of the transaction at issue.[1817]

In all other cases, French tax authorities enjoy discretion to change their positions as they see fit and to reassess taxes accordingly.

1173. In Germany, the tax authorities are actually under an obligation to change their previous assessments if they become aware of previously unknown facts justifying a higher tax burden.[1818] The general rule under German tax law is that the tax authorities are prevented from changing their previous positions only when there has been "*reliance in good faith*" on the part of the taxpayer.[1819]

1174. In the Italian tax system, it is undisputed that tax authorities may legitimately enforce all tax legislation even if previously unenforced, may change their interpretation of tax laws, and may amend positions taken in the past. Taxpayers are only protected (i) from assessments, as well as from fines and interest, if they have obtained a positive tax ruling, and have implemented the

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1817 *See* Articles L.80A *and* L.80B (Exhibit RME-1311) and (Exhibit RME-1312), respectively.

1818 *See* Article 173(1) No. 1 of the German Tax Code (Exhibit RME-1313).

1819 *See* Article 176 subsections 1 and 2 of the German Tax Code (Exhibit RME-1314). General Federal Fiscal Court, Decision No. IR 3/86 (Oct. 31, 1990) (Exhibit RME-1315) *and* Prof. Dr. Johanna Hey, Protection of Confidence in German Federal Tax Court (Bundesfinanzahaf: BFH / Ruling and Administrative Practice), Section 4.2.2 (Exhibit RME-1316).

transaction as disclosed to the administration in the ruling request, and (ii) from fines and interest if they have followed indications coming from the tax administration itself.[1820]

1175. In still other countries, the right of tax authorities to change their position is virtually unlimited.

1176. In Australia, for instance, the tax authorities are bound by their prior position only if they have issued a written "private" ruling to the taxpayer, and only to the extent that such taxpayer fully disclosed all relevant information and thereafter complied with all of the provisions of the ruling. Even in such cases, the tax authorities reserve the right to apply their country's general anti-abuse provisions to assess taxes notwithstanding any such prior "private" rulings.[1821] Such "U-turns" -- as they are locally known -- have for many years been a part of the Australian legal landscape. [1822] The rationale, as recently explained by the Australian Authorities ("ATO"), is that:

> "[t]he ATO's ability to apply views retrospectively promotes a desirable deterrent effect on those seeking to take inappropriate advantage of uncertainty or ATO errors in non-binding material. It may also encourage taxpayers to seek clarity and to raise the ATO's awareness of all issues where the law was unclear."[1823]

1177. In Canada, "[i]*t is trite law that estoppel cannot apply so as to prevent the Minister* [in charge of taxation] *from performing the duties imposed on him by the Income Tax Act, namely the proper assessment of returns in accordance with the law*."[1824]

1820 *See*, respectively, Articles 11 (Exhibit RME-1318) and 10 (Exhibit RME-1317) of Law No. 212 (July 27, 2000).

1821 In the case of public pronouncements of the authorities (as distinguished from individualized private rulings), taxpayer reliance on the authorities' stated position is relevant only for purposes of assessment of penalties and interest. If the authorities change their mind, the tax itself is nevertheless due.

1822 For a critical overview of the practice of "U-turns," *see* Inspector-General of Taxation, *Review into the delayed or changed Australian Taxation Office views on significant issues* (March 25, 2010) (Exhibit RME-1319). *See also e.g.,* J. Kehoe, *Offshore Swaps Probe*, Australian Financial Review (Oct. 19, 2009) (Exhibit RME-1320).

1823 *See* Clause 5.2, Inspector-General of Taxation, *Review into delayed or changed Australian Taxation Office views on significant issues* (Mar. 2010) (Exhibit RME-1319).

1824 *Hawkes et al v. The Queen*, 97 DTC 5060 (FCA) ¶13 (Exhibit RME-1321). *See also, Humphrey v. The Queen,* 2006 TCC 168; 2006 DTC 2730 [2006] 3 CTC 2136 (Exhibit RME-1322).

In particular, the tax authorities are not bound to adhere in later years to a position taken with regard to a taxpayer's return for an earlier year.[1825] Indeed, even in cases where tax authorities have in the past expressly approved the taxpayer's scheme, "common sense" dictates that the taxpayer not be allowed to invoke "the misstatement, the negligence or the simple misrepresentation of a government worker" as grounds for avoiding payment of taxes otherwise due.[1826]

1178. In New Zealand, tax authorities are free to "change their mind" regarding the tax treatment of particular types of transactions and to assess taxes even if they have taken a diametrically opposite approach in the past. The courts uphold such changes in position on the grounds, *inter alia*, that within a large bureaucracy, "*it is inevitable that there will be inconsistencies of interpretation and application*" of the tax laws, and that the tax administration "*cannot estop* [itself] *from enforcing the law*."[1827]

1179. In the instant case, the Russian authorities did not "change their minds"; instead, they relied on anti-abuse doctrines of long-standing application, which had previously been used to challenge abuses by Yukos' own subsidiaries, as well as by other taxpayers. In any event, even if, *quod non,* Russia were deemed to have "changed its mind" on this occasion, this would have been entirely consistent with the practices of most other countries -- all the more so as Claimants have been unable to identify anything even remotely resembling an

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1825 *Cohen v. The Queen*, 80 DTC 6250 [1980] (Exhibit RME-1324); *Waxman Estate v. The Queen*, 94 DTC 1216 [1994] (Exhibit RME-1325); *Carr v. MNR*, 94 DTC 1067 [1993] (Exhibit RME-1326) (the authorities "*can take one position in one year's assessment and then take another position in subsequent years.*"); *Brad-Lee Meadows Ltd v. MNR*, 90 DTC 1269 [1990] (Exhibit RME-1327).

1826 *Ludmer v. The Queen*, 95 DTC 5311, 5314 [1994] (Exhibit RME-1328), citing *Canada v. Lidder*, 2 F.C. 621, 625.

1827 *Westpac Banking Corporation v. Commissioner of Inland Revenue* (2008) 23 NZTC 21,694, affirmed (2009) 24 NZTC 23,340 (taxpayer had obtained a "binding" ruling from tax administration's "Rulings" department approving first of a series of similar "structured finance" transactions, but had not sought rulings for subsequent deals, which tax administration's "Corporate" department challenged on tax avoidance grounds; the courts upheld the reassessments, holding that the tax administration is entitled to "change [its] mind," that within a large bureaucracy, "*it is inevitable that there will be inconsistencies of interpretation and application*" of the tax laws, and that the tax administration "*cannot estop* [itself] *from enforcing the law*") (Exhibit RME-1329) and (Exhibit RME-1455). *See O'Neil & Ors v. Commissioner of Inland Revenue* (2001) 20 NZTC 17,051 (inconsistent assessments permissible) (Exhibit RME-1289).

official "clarification" or even an informal statement of position by any Russian authority upon which Yukos might have relied in devising or implementing its unlawful scheme.

(3) The Claimants' Arguments Based On The Authorities' Alleged Prior Knowledge Of Yukos' Abuses Would Be Considered Frivolous In Other Countries

1180. The suggestion that tax authorities are somehow estopped from collecting taxes that are otherwise due simply because they had prior knowledge of the taxpayer's activities would be rejected as frivolous in nearly every country, including, to provide a small sampling, Austria,[1828] Germany,[1829] Italy,[1830] the United States,[1831] and the United Kingdom.[1832]

1181. In particular, in most countries, the tax authorities are not precluded from conducting repeat audits of previously audited taxpayers. This is true, *inter alia*, in Cyprus,[1833] the United Kingdom,[1834] Canada,[1835] New Zealand,[1836] the United States,[1837] and other countries.[1838]

1828 In Austria, it is clear that previous inaction or silence by the tax authorities would not preclude subsequent enforcement of tax law (*see* Articles 148 and 303 of the Austrian General Tax Code) (Exhibit RME-1330) (Exhibit RME-1331).

1829 In Germany, pursuant to Section 7(3), sentence 1, of the German Corporate Income Tax Act (*Körperschaftsteuergesetz: KStG*) (Exhibit RME-1332) and Section 16(1), sentence 2, of the German VAT Act (*Umsatzsteuergesetz: UStG*) (Exhibit RME-1333), tax authorities are normally not prevented from assessing taxable transactions with respect to one tax year even if the same or similar transactions have not been assessed in previous years.

1830 It is also well-settled in Italy that a taxpayer may not invoke the previous silence of the authorities to escape his tax liabilities (*see* Article 10, Law No. 212, (July 27, 2000) ("*Statuto dei diritti del Contribuente*")) (Exhibit RME-1334).

1831 With rare exceptions, the IRS is bound only by its written advice, and even in the case of writings, the IRS is not precluded from subsequently correcting its position. Hart Report, ¶ 2(c).

1832 The Crown cannot be estopped, except by a "representation." *See* ¶ 1171 *supra*.

1833 In Cyprus, Article 23 of the Assessment and Collection of Taxes Law does not prevent tax authorities from conducting a further audit prior to expiration of the statute of limitations (Exhibit RME-1335).

1834 In the United Kingdom, the authorities are free to make a "discovery" assessment whenever "*they could not have been reasonably expected, on the basis of the information made available to them* [by the taxpayer] *before that time, to be aware* [of an insufficiency in a prior assessment]." ¶ 44 Schedule 18 to the Finance Act 1998 (Exhibit RME-1336). This is especially true if there is new evidence available and, particularly, evidence of deliberate misconduct; *see* Section 73(6) (Exhibit RME-1337) *and* Section 77(6) Value Added Tax Act 1994 (Exhibit RME-1338) in

(4) In Other Countries, Claimants' Charges Of Discrimination Would Be Summarily Dismissed

1182. The claim that Yukos was the victim of discrimination by the tax authorities would have been given short shrift had it been presented in most other countries. There is a compelling practical reason why tax authorities the world over share an antipathy for taxpayers' claims of discrimination: no system of taxation can function if a taxpayer can avoid payment of taxes otherwise due simply by showing that not all similarly situated taxpayers have been assessed in the same way, since it would be a practical impossibility for the authorities to prove that they had treated all taxpayers equally at all times. As pointed out by a Canadian court that considered the issue:

> "No matter how similar the activities of two businesses, if one company can frame its dispute [with the tax authorities] in such a

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relation to VAT, and ¶¶ 41-45 of Schedule 18 Finance Act 1998 in relation to corporation tax ((Exhibit RME-1339).

1835 *See Hawkes et al v. The Queen,* 97 DTC 5060 (FCA) at Section 12 ("*Again the authorities are clear that it is only the final assessment which can be attacked and that interim opinions, or even previous assessments, cannot be relied upon to establish the invalidity of the last assessment or reassessment provided the latter is made within the time allowed by the statute* [of limitations]"). (Exhibit RME-1321).

1836 In New Zealand, subject only to the statute of limitations, "*assessments are capable of continual amendment until the Commissioner is satisfied that the correct amount of tax has been assessed.*" *Dandelion Investments Limited v. Commissioner of Inland Revenue* (2000) 19 NZTC 15,585 at § 10 (a case involving a series of four reassessments over a period of four years) (Exhibit RME-1340). *See also Vinelight Nominees Limited v. Commissioner of Inland Revenue* (2005) 22 NZTC 19,298 (Exhibit RME-1341) and *Foxley and Anor v. Commissioner of Inland Revenue* (2008) 23 NZTC 21,813 (Commissioner may attempt to increase assessment even after commencement of litigation challenging the assessment) (Exhibit RME-1342). Pursuant to Section 108 of the New Zealand Tax Administration Act, the Commissioner may amend the assessment at any time so as to increase its amount if the taxpayer has submitted a tax return that is fraudulent or willfully misleading. (Exhibit RME-1450).

1837 Hart Report, ¶ 16; *see* Section 7605 of the U.S. Internal Revenue Code allowing repeat audit when necessary (Exhibit RME-1344) and Tax Analyst Document Service, Examination of Returns and Claims for Refund Credit or Abatement, Determination of Correct Tax Liability, Rev. Proc. 2005-32 (2005) (reserving the right to reopen closed cases in the event of fraud) (Exhibit RME-1345).

1838 In France, *see* Article L51 (Exhibit RME-1346) and Article L187 (Exhibit RME-1347) of the French Tax Procedure Code; in Germany, *see* BFH, II R 102/85 (Nov. 4, 1987) (Exhibit RME-1348); R. Eckhoff, in W. Hübschmann, E. Hepp, A. Spitaler, AO, Section 193 No. 45, 476 *et seq.* (Exhibit RME-1349); in Italy, *see* Article 43 of Presidential Decree (Sept. 29, 1973) No. 600 (Exhibit RME-1350).

> way as to make another company's affairs relevant, the result would be chaos."[1839]

1183. Indeed, the vital public interest in revenue collection would be irremediably compromised if tax authorities were obligated to demonstrate that they had treated all other taxpayers similarly, every time that they sought to enforce tax laws against a particular taxpayer.

1184. Moreover, no such comparison among different taxpayers could be made without jeopardizing the tax secrecy that in virtually all countries protects taxpayer data.[1840] As explained by another Canadian court:

> "If by chance the appellants were allowed to call as witnesses taxpayers whom they knew or thought they knew had benefited from preferential treatment by the Minister [in charge of taxes] it can be seen what an unfavorable position the latter would be placed in, as he could in no case present opposing evidence since he is firmly bound by the prohibition imposed on him against directly or indirectly disclosing the secret information he has in this connection."[1841]

1185. As a result, in most countries, tax authorities enjoy a wide measure of discretion in enforcing the tax laws, give short shrift to allegations of "discrimination" or "selective enforcement" (both in assessing and settling overdue taxes), and do not consider these to be valid defenses to the payment of taxes otherwise due.[1842]

1186. As recently held by a U.S. Court of Appeals:

> "Despite the goal of consistency in treatment, the IRS is not prohibited from treating [...] taxpayers disparately. Rather than being a strict, definitive requirement, the principle of achieving

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1839 *Hokhold v. The Queen*, 93 DTC 5339 [1993], *citing Ford Motor Company of Canada Limited v. MNR* (Court file No. T-3700-82) (Exhibit RME-1301).

1840 *Ludmer v. The Queen,* 95 DTC 5311, 5316 [1994] (Exhibit RME-1328). *See also* note 1939 *infra*.

1841 *Ludmer v. The Queen,* 95 DTC 5311 [1994] (Exhibit RME-1328).

1842 For settlement discretion, *see* Hart Report, ¶ 21.

> parity in taxing similarly situated taxpayers is merely aspirational."[1843]

1187. The Court went on to conclude, bluntly, that "*the I.R.S* [has the] *prerogative to tax*" the taxpayer in question, "*but not its competitors.*"[1844]

1188. Other U.S. decisions are to the same effect, because a "*taxpayer cannot premise its right to an exemption by showing that others have been treated more generously, leniently or even erroneously by the IRS.*"[1845] Put even more starkly, a "[f]*ailure by the IRS to assess deficiencies against some taxpayers does not preclude assessment against other taxpayers.*"[1846]

1189. Indeed, in the United States and several other countries, the tax authorities have a recognized right not only to treat similarly situated taxpayers differently, but to single out offenders for exemplary sanctioning. Thus, for instance, in the United States, the authorities are quite open regarding the benefits of "enforcement by example," which they consider an essential -- and entirely legitimate -- device to maximize compliance with the tax laws and at the same time to minimize the investment of prosecutorial time and resources.[1847] The avowed intent of this policy of targeted enforcement is to create high-profile

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1843 *Hostar Marine Transp. Sys. v. United States*, 592 F.3d 202, 210 (1st Cir. Mass. 2010). (Exhibit RME-1352) *See also Sirbo Holdings, Inc. v. Comm'r*, 509 F.2d 1220 (2d Cir. 1975) (Exhibit RME-1353); *Davis v. Comm'r*, 65 T.C. 1014 (1976) (Exhibit RME-1354).

1844 *Hostar Marine Transp. Sys. v. United States*, 592 F.3d 202, 210 (1st Cir. Mass. 2010). (Exhibit RME-1352).

1845 *City of Galveston, Texas v. United States,* 33 Fed. Cl. 685, 708 (1995) (Exhibit RME-1356).

1846 *Ray v. United States*, 25 Cl. Cr. 535, 541 (1992) (Exhibit RME-1355).

1847 For instance, it is the enforcement practice in the United States to deter the use of tax shelters and aggressive tax schemes. As the IRS Chief Counsel explained to a Practising Law Institute conference in December 2008, the IRS has adopted a "*three-and-out strategy*" for combating abusive tax shelters, by which the Office of Chief Counsel "*targets three promising cases involving* [a] *disputed tax scheme, wins the cases, and then uses the victories to compel settlements from the remaining defendants*." *See*, Michael Bologna, *Tax Shelters*: *IRS to Use 'Three-and-Out Strategy in Foreign Tax Credit Litigation' Korb Says*, 27 Tax Mgmt. Weekly Report, No. 48 (Dec. 1, 2008) (Exhibit RME-1357). Similar statements about the IRS' use of selective litigation were made by the IRS Chief Counsel in a speech to the Chicago Bar Association Federal Taxation Committee (Feb. 25, 2005) and by another IRS official in an October 23, 2003 Senate Finance Committee hearing. *See,* United States General Accounting Office, Internal Revenue Service, *Challenges Remain in Combatting Abusive Tax Shelters,* Statement of Michael Brostek, Director, Tax Issues, TNT (Oct. 21, 2003), 204-231 (Exhibit RME-1358).

examples that will have a deterrent effect on other taxpayers who might be tempted to evade taxes.

1190. Likewise, considerable discretion is afforded to the tax authorities in Australia.[1848] Not surprisingly, evasive schemes such as the one employed by Yukos are high on the authorities' list of priorities for exemplary enforcement measures. Indeed, "*maintaining a highly-visible deterrent to abuse of the tax system, including the abusive use of tax havens*" is one of the Australian authorities' proclaimed "*strategic areas of focus.*"[1849] In this respect, "[c]*ross-border tax avoidance schemes, particularly those involving tax havens and transfer pricing*," are a continuing enforcement "*priority.*"[1850] The Australian government strives "*to send the message that such arrangements carry substantial risks and consequences*," and has mobilized resources "*to continue the fight against this form of blatant abuse and to make the deterrence message abundantly clear.*"[1851] In both exemplary and routine cases, tax authorities enjoy broad discretion to treat taxpayers differently, both with respect to assessments and settlements.[1852]

1191. The United Kingdom is still another country where the tax authorities enjoy considerable latitude in treating taxpayers differently.[1853] In the UK, the tax authorities make no secret of their policy of using criminal prosecution powers in tax cases "*to send a strong deterrent message.*" Yukos' scheme, had it been implemented in the UK, would have been a clear candidate

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1848 *See*, *e.g.*, Australian Government, Australian Taxation Office, Compliance Program 2009-10 (Exhibit RME-1362). *Industrial Equity Limited and Another v. Deputy Commissioner of Taxation and Others* (1990) 170 CLR 649, 660-662 (Exhibit RME-1359).

1849 Australian Government, Australian Taxation Office, Corporate Plan 2009-10 (Exhibit RME-1360).

1850 Australian Government, Australian Taxation Office: Tax Office focus for 2009-2010, 1 (Exhibit RME-1361).

1851 Australian Taxation Office, Compliance Program 2009-10, 31 (Exhibit RME-1362).

1852 *See* Australian Taxation Office, Code of Settlement Practice, Re-released February 21, 2007 (Exhibit RME-1363).

1853 In the United Kingdom, the courts have held that HM Revenue and Customs is entitled to selectively enforce tax laws against certain evaders because the primary objective of the tax authorities is the collection of taxes, as opposed to punishment of offenders, because the tax authorities have inadequate resources to prosecute all tax evaders, and because selective enforcement has a deterrent effect on the generality of taxpayers (*see R v. IRC, ex p Mead and Cook* [1992] STC 482) (Exhibit RME-1365).

for transmission of this message. Cases thought to warrant exemplary treatment include "*systematic frauds where losses represents* [sic] *a serious threat to the tax base*" and cases involving "*deliberate concealment, deception, conspiracy or corruption.*"[1854]

1192. In Canada, as pointed out by an appellate court that considered the issue:

> "In our view, it is not open to the Tax Court to set aside a tax reassessment on the ground that the taxpayer ought to have been given the same favorable treatment as others who are similarly situated."[1855]

1193. Even in cases where:

> "it is understandable that the plaintiff [taxpayer] considers it unfair that Revenue Canada appears to have treated [other] taxpayers in similar circumstances differently, that cannot be the basis for the plaintiff's appeal."[1856]

1194. Whether or not egregious misconduct is present, tax authorities in these and many additional countries have policies or practices allowing them to treat taxpayers that are willing to make amends, and settle their disputes amicably more leniently than "die-hards" who insist on fighting tooth and nail to the bitter end, as Yukos did. Such a policy does not discriminate improperly, but rather encourages taxpayer compliance, promotes speedy settlement of disputes, facilitates the collection of State revenues, and permits more efficient deployment of enforcement resources.

1195. In New Zealand, the tax authorities have broad discretion to deal with tax evaders on a differentiated basis and, in particular, they are entitled to grant more lenient treatment to taxpayers who are willing to settle their liabilities on a negotiated basis before their court challenges are decided.[1857]

1854 *See* HMRC, Criminal Investigation Policy (Exhibit RME-1367).

1855 *Sinclair v. the Queen,* 2003 FCA 348, ¶ 7 (Exhibit RME-1366).

1856 *Hokhold v. the Queen*, 93 DTC 5339 [1993] (Exhibit RME-1301). *See also Ludmer v. The Queen*, 95 DTC 5311 [1994] (Exhibit RME-1328).

1857 Even in disputes involving a common scheme but different taxpayers, "*the Commissioner may settle on a different basis with those taxpayers he considers are in different circumstances. Different*

1196. In France as well, tax authorities have a discretionary right to abate the totality of penalties, either in the context of settlements or otherwise.[1858]

1197. In Germany, the courts have reapeatedly rejected claims of discrimination by holding that "*there is no equal treatment in wrongdoing.*"[1859]

1198. A policy of favoring cooperative taxpayers over obstreperous ones is appropriate even when the resisting taxpayers limit their opposition -- as is typically the case -- to the exercise of their legal rights. It is all the more legitimate in cases such as Yukos', where resistance was not limited to the exercise of legal rights, but included the use of illegal or otherwise manifestly improper means, such as the dissipation of assets, concealment of corporate books, fraudulent settlement proposals, and the spurious U.S. bankruptcy proceedings. The world over, misconduct of this kind -- predictably and entirely properly -- begets sanctions.

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circumstances might include, for example, the taxpayer's willingness to settle, the timing of the settlement offers in relation to the progress of the litigation proceedings […]." IS 10/07 "Care and Management of the Taxes covered by the Inland Revenue Acts"—Section 6A(2) and (3) of the Tax Administration Act 1994, Interpretation Statement—IS 10/07 (IS 10/07) (Oct. 22, 2010) ¶ 159 (Exhibit RME-1368). *See also Accent Management Ltd & Ors v. Commissioner of Inland Revenue* (No 2) (2007) 23 NZTC 21, 366, ¶ 21 (Exhibit RME-1456). More generally, Section 109 of the New Zealand Tax Administration Act establishes a strong presumption of correctness of assessments, providing, with limited exceptions, that "[e]*very disputable decision* [*of the tax authorities*] *and, where relevant, all of its particulars are deemed to be, and are to be taken as being, correct in all respects.*" (Exhibit RME-1369). Accordingly, judicial review is appropriate only in "exceptional circumstances." *See Westpac Banking Corporation v. Commissioner of Inland Revenue* (2009) 24 NZTC 23,340, 59 (Exhibit RME-1455). Section 114 states that an assessment may not be invalidated even if the authorities have violated other provisions of the tax laws. (an "*assessment made by the Commissioner* [of Inland Revenue] *is not invalidated: (a) Through a failure to comply with a provision of this Act or another Inland Revenue Act* [...]") (Exhibit RME-1369). For example, if the authorities make a correct assessment, but use an incorrect provision of the tax laws, or take procedural "shortcuts," the assessment is valid all the same. *See Commissioner of Inland Revenue v. Allen & Ors* (2003) 21 NZTC 18,137, ¶ 25 (Exhibit RME-1370) and *Westpac Banking Corporation v. Commissioner of Inland Revenue* (2009) 24 NZTC 23,340, ¶ 94. (Exhibit RME-1455) *See also*, *J D Hardie v. Commissioner of Inland Revenue* (2010) CIV 2010-404-1453 (Dec. 23, 2010). (Exhibit RME-1371).

1858 Article L.247 of the French Tax Procedure Code (*Livre des Procédures Fiscales*). (Exhibit RME-1372).

1859 The German Federal Constitutional Court (BverfG) has repeatedly stated that no criminal offender may avoid punishment on the ground that others have not been prosecuted. Decision of January 17, 1979, 1 BvL 25/77) (Exhibit RME-1351).

1199. Finally, we address Claimants' contention that the alleged discrimination against Yukos (and allegedly, in favor of its competitors) was politically motivated. It too would have been dismissed in other jurisdictions.

1200. First, to state the obvious, the fact that some of Yukos' core shareholders claimed to be the victims of political persecution or discriminatory treatment does not constitute an excuse -- legally or otherwise -- for Yukos not to pay the taxes that it had evaded and that would otherwise have been due. Second, there is a compelling practical reason why Russian and Western tax authorities share an antipathy towards taxpayers' claims of political persecution: no system of taxation can function if a taxpayer can avoid payment of taxes otherwise due simply by alleging that the tax authorities are pursuing a political agenda. The critical question is whether or not the taxes are due under the applicable tax laws. If they are due, even a proven political motivation would not constitute valid grounds for non-payment; the wronged taxpayer is not entitled to a dispensation from taxes (and interest and penalties) that are otherwise assessable.

1201. Thus, courts in the United States have required that the taxpayer overcome a very high burden of proof to allege an improper political purpose.[1860] It is well settled that the Anti-Injunction Act[1861] bars any "*suit for the purpose of restraining the assessment or collection of any tax*," even in cases where the tax assessment or collection method is alleged to violate the taxpayer's constitutionally-protected rights.[1862] The act prevents judicial interference with the assessment or collection of taxes even where the taxpayer claims to be a target of retaliatory audits by the Government in the context of a campaign of political persecution.[1863] There is no authority, moreover, for the proposition that, if a

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1860 *Teague v. Alexander*, 662 F.2d 79, 83 (D.C. Cir. 1981) (finding no improper political discrimination in audit of Vietnam War protester despite the IRS's "*less than careful concern for the First Amendment interests required of the government.*") (Exhibit RME-1374).

1861 *See,* § 7421(a) of the U.S. Internal Revenue Code (Exhibit RME-1375)

1862 *Bob Jones University v. Simon*, 416 U.S. 725, 736-740 (1974). (Exhibit RME-1376)

1863 *Judicial Watch, Inc. v. Rossotti*, 317 F.3d 401 (4th Cir. 2003). (Exhibit RME-1377) Suits are precluded if the tax authorities can show that, regardless of any political motivations, they are also genuinely seeking to enforce the technical requirements of the tax laws. *Ibid.*, 407. The

taxpayer's rights have been violated, the taxpayer acquires a right not to pay taxes otherwise due.

1202. Likewise, it is well-settled in New Zealand that, even if the tax authorities have assessed a taxpayer for improper reasons, such as pursuing an alleged "*vendetta*" against him, in the end, if the assessment is correct as a matter of tax law, it remains valid and must be paid. [1864]

1203. In Canada, courts have dismissed as "*frivolous*" a taxpayer's argument that it should be exempted from tax on the grounds that other more "*politically influential*" persons had enjoyed more favorable tax treatment.[1865]

(5) International Practice Does Not Support Claimants' Complaints About the Amount And Scope Of Assessments

(a) VAT

1204. The assessments of VAT against Yukos were consistent with the rules and practices of a number of other countries that levy VAT, or similar taxes. In almost all such countries, assessment and collection methods for VAT tend to be mechanistic, because one of the main attractions of this method of taxation from the standpoint of national treasuries is that it does not lend itself easily to taxpayer arguments regarding liability. Once the Russian authorities had determined -- on the basis of ample evidence -- that Yukos rather than the shells was the real seller/exporter and hence the proper taxpayer, the associated VAT assessments flowed automatically. Also virtually automatic was the rejection of Yukos' belated, untimely, and deficient attempts to file amended returns seeking exemption from VAT for export transactions.

1205. Strict, mechanistic enforcement of the prerequisites for VAT exemption (or "0%-rating") of exports is typical in most countries. For instance,

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only exceptions are cases in which "*under no circumstances could the Government ultimately prevail*," or where the plaintiff lacks any other route for judicial review. *Ibid.*, 407-08. [emphasis added]

1864 *Case Z19* TRA No. 03/03, Decision No. 15/2009, ¶¶74, 83, 95-96 (Exhibit RME-1378).

1865 *Sinclair v. The Queen*, 2003 DTC 5624 [2004] (Exhibit RME-1366).

Dutch courts have consistently denied a 0% VAT rate if the interested party is unable to substantiate with sufficient documentation its entitlement to the exemption, even in the absence of any fraud or wrongdoing.[1866] Likewise, in New Zealand, the courts have levied GST (the local equivalent of VAT) on an export transaction where the export was undisputed but the relevant documentation had originally been issued in the name of the wrong party, refusing corrected documentation submitted *ex post facto*.[1867] Examples of strict enforcement of exemption requirements can also be provided for countries as varied as the United Kingdom,[1868] Belgium,[1869] France,[1870] Germany,[1871] Italy,[1872] New Zealand,[1873] and Sweden.[1874]

1866 Article 12 of the Dutch Implementing Decree Turnover Tax 1968. (Exhibit RME-1379) *See e.g.*, Rate Commission, Decision No. 11 788 O '68 (June 14, 1977) (Exhibit RME-1380) and Court of Appeals of Amsterdam, Decision No. 918/79, BNB 1981/201 (Mar. 25, 1980) (Exhibit RME-1381) (both holding that copies of invoices were insufficient documentation to substantiate the application of a 0% VAT rate). Decision of the Court of Appeals of The Hague, Decision No. 94/3394, VN 1997/974 (May 21, 1996) (Exhibit RME-1382). *See also*, Court of Appeals of Amsterdam, Decision No. P06/00194, VN 2008/16.15 (Dec. 17, 2007) and Dutch Supreme Court, Decision No. BNB 2010/102 (Jan. 29, 2010) (Exhibit RME-1383) (both holding that the taxpayers were not able to substantiate their entitlement to a 0% VAT rate because they could not provide the tax authorities with the proper documentation) (Exhibit RME-1384).

1867 *Case P55* (1992) 14 NZTC 4,382 (Exhibit RME-1385).

1868 In the United Kingdom, exports are not exempt from VAT, although there is a system for the zero-rating of certain exports, such as exports to places outside the European Community ("EC"). Under that system, an export made by a taxable person (*e.g.* someone who is VAT-registered or liable to be VAT-registered in the UK) will only be zero-rated (*e.g.*, subject to 0% VAT) if the following conditions and procedural formalities are satisfied: (i) the goods must be physically exported from the EC within three or six months depending on the type of export; and (ii) evidence of export must be provided within three or six months depending on the nature of the goods, *see* Section 30(6) Value Added Tax Act 1994 (Exhibit RME-1386); Regulation 129 of the VAT Regulations 1995 (SI 1995/2518) (Exhibit RME-1387), and ¶ 3.5 of HMRC Notice 703: Export of Goods from the United Kingdom (Aug. 2006) ("Notice 703"). (Exhibit RME-1388) Such evidence (either official or commercial) includes a Goods Departed Message (GDM) generated by the New Export System (NES), a Single Administrative Document (SAD) endorsed by Customs at the point of exit from the EC, or commercial transport evidence such as an authenticated sea-way bill (¶¶ 6.2-6.3 of Notice 703). If the exporter fails to satisfy these conditions and formalities, the supply will be standard-rated for VAT purposes (*e.g.*, subject to 15% VAT), and normal rules relating to fines and interest would apply. If the period within which the conditions and formalities must be satisfied has passed, it is not generally possible for the exporter or another taxpayer to claim the zero-rating.

1869 *See* Articles 39, 45, 53 and 70 of the Belgian VAT Code. (Exhibit RME-1389) In addition to these legislative provisions, *see* Belgian Cassation Court (No. F05.0009.N (Feb. 14, 2008), which denied a 0% VAT rate in a case where the export had been carried out via an agent. (Exhibit RME-1390).

1206. Many countries go even further, denying the benefit of exemption or 0% rating, even where documentary requirements have been punctually satisfied, if the relevant export transaction is tainted by illegality (as was the case with Yukos) or even simply by impropriety.

1207. Thus, the French *Conseil d'Etat* has held that a fraudulent scheme entailing the disclosure of incorrect data properly resulted in the assessment of VAT, even though the relevant goods had actually been exported, the taxpayer's intention had not been to avoid VAT, and the French Treasury had suffered no revenue loss.[1875]

1208. More recently, the European Court of Justice, in the case of *R. v. Germany,*[1876] upheld the imposition of VAT by the German tax authorities on export transactions that had been carried out by a individual[1877] who had made fraudulent misrepresentations in his applications for exemption from German VAT, notwithstanding the fact that the fraud had not deprived Germany of any tax revenues, since the goods in question had effectively been exported out of Germany and therefore -- but for the fraud in the attendant documentation -- would have been unquestionably entitled to full exemption from German

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1870 *See* Article 74 of the French Tax Code, *Code général des impôts, Annexe III* (2009 Version). (Exhibit RME-1391).

1871 Germany exempts export deliveries only if certain conditions are met (*see* Section 4 No. 1 lit. a in conjunction with section 6(1) sentence 1 No. 1 and 2 of the VAT Act, section 6(4) of the VAT Act (Exhibit RME-1392), and Sections 8 and 13 of the VAT Implementation Regulation. (Exhibit RME-1393)

1872 *See* Articles 8 and 21 (Exhibit RME-1394) of Presidential Decree, No. 633 (Oct. 26, 1972) and Article 13, Law 413 (Dec. 30, 1991). (Exhibit RME-1396).

1873 *See* Sections 11 and 11A of the Goods and Services Tax Act 1985 for export of goods and Sections 11A for export of services (Exhibit RME-1397). *See also*, *e.g.*, *Case P 55* (1992) 14 NZTC 4,382. (Exhibit RME-1385).

1874 In Sweden, the entitlement to a 0% VAT rate on exports is subject to the taxpayer's complying with the procedure set forth, *e.g.*, in Sections 9.9.2 – 9.9.3 of the Tax Agency Manual on the VAT) (Exhibit RME-1398).

1875 SA Chatenoud, Conseil d'État, Decision No. 3134 (May 11, 1977) (Exhibit RME-1399) and Société Viviers de Porsguen, Conseil d'État, Decision No. 58969 (June 22, 1988) (Exhibit RME-1400).

1876 ECJ, Case C-285/09, *R. v. Germany,* Judgment (Dec. 7, 2010) (Exhibit RME-1401).

1877 The exporter in question had also been convicted criminally and sentenced to jail. *Ibid.* at ¶ 22.

VAT.[1878] The ECJ rejected the argument that imposition of VAT on the exporter would violate "*principles of fiscal neutrality or legal certainty, or* [...] *legitimate expectations*," holding that none of those principles can "*legitimately be invoked by a taxable person who has intentionally participated in tax evasion* [...]." This was true, the court held, even though the tax evaded was not one that the taxpayer himself would normally have had to pay, and even though the result was that Germany ended up with a windfall, collecting a tax that, in the absence of fraud, it would never have been able to assess.[1879]

1209. In two earlier cases involving credits for input VAT, the German Federal Tax Court (*Bundesfinanzhof* or BFH) had held that this tax benefit could be denied in transactions where the supplier was a sham company.[1880]

1210. Likewise, Canadian courts have denied refunds under that country's GST system in cases where the underlying transactions were shams.[1881]

1211. In Belgium, an assessment of VAT on export transactions (and a 100% penalty over and above the tax) was upheld by the Brussels Court of

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1878 In fact, as made clear by the ECJ, the German taxpayer had not himself evaded any tax for which he might have been liable, because the sole purpose and effect of his fraudulent conduct had been to assist unrelated third parties -- his foreign customers -- to evade taxes in their home country of Portugal.

1879 The ECJ stated that "[t]*hose principles cannot legitimately be invoked by a taxable person who has intentionally participated in tax evasion and who has jeopardized the operation of the common system on VAT*". *Ibid*. ¶54. The ECJ also summarily dismissed the argument that imposition of VAT on an exporter (who, as had been pointed out by the Advocate General, would probably never be able to recover it from his customer) would violate the general EU principle of proportionality. The court held that the exporter's involvement in the third party's tax evasion scheme was "*decisive*" in this regard. Specifically the court stated that "[a]*s regards the principle of proportionality, it must be observed that this does not preclude a supplier who participates in tax evasion from being obliged to pay VAT subsequently on this intra-community supply, inasmuch as his involvement in the evasion is a decisive factor to be taken into account in an assessment of the proportionality of a national measure.*" I*bid.* ¶53 (Exhibit RME-1401).

1880 *See* BFH, Decision No. XIR97/92 (July 13, 1994) (Exhibit RME-1402) and BFH, Decision No. VB108/01 (Jan. 31, 2002) (Exhibit RME-1403).

1881 *See, e.g., Les Voitures Orly Inc/Orly Automobiles Inc v. The Queen*, 2005 FCA 425 at ¶ 26 (Exhibit RME-1404). *See also, Camions DM Inc. v. The Queen*, 2009 TCC 63 (Exhibit RME-1405).

Appeal in a case where the taxpayer's good faith was questioned because the relevant transactions were found not to be normal commercial transactions.[1882]

1212. Another French example is the *Génicom* case, in which VAT was levied in a three-country transaction where the French taxpayer's mistake was essentially to have made an improvident bookkeeping choice, even though it was conceded by the authorities that not only had the goods been delivered outside France, but that they had never entered French territory.[1883]

1213. Sweden too has imposed VAT on export transactions that were found to be shams.[1884]

1214. In sum, notwithstanding Claimants' protestations to the contrary, neither the Russian authorities' assessments of VAT on Yukos' exports, nor the decisions of the Russian courts upholding them, offended anything that could even remotely be viewed as an international norm in this respect.

(b) Fines

1215. Russia's fines of up to 80% of the evaded taxes are entirely consistent with international practices. Fines are routinely levied at similar rates, for instance, in the United Kingdom,[1885] France,[1886] and the United States.[1887]

1882 *See*, *e.g.*, Brussels, Court of Appeal, Decision No. 2003/AR/1086 (Dec. 11, 2008) (Exhibit RME-1406).

1883 *Ministre de l'Economie, des Finances et de l'Industrie c/ SA Génicom*, Administrative Court of Appeals of Versailles, Decision No. 04VE00347 (Sept. 29, 2006) (Exhibit RME-1407).

1884 *See, e.g.*, *RSL COM Sweden AB v. Skattevert*, Stockholm Administrative Court of Appeal, Cases 2116-08, 2117-08, 2118-08 (Oct. 28, 2009) (Exhibit RME-1408).

1885 *See* Cullen Report, ¶¶ 81-105. Fines vary according to culpability: (i) a "*careless*" inaccuracy is subject to a fine of 30% of the potential lost revenue; (ii) a "*deliberate but not concealed*" inaccuracy is subject to a fine of 70% of the potential lost revenue; and (iii) a "*deliberate and concealed*" inaccuracy is subject to a fine of 100% of the potential lost revenue (*see* Sections 97 and ¶ 4 Schedule 24, Finance Act 2007 (Exhibit RME-1409), Articles 2 and 3, Finance Act 2007 Schedule 24 (Commencement and Transitional Provisions) Order, SI 2008/568 (Exhibit RME-1410). Legislation is pending to double these fines (to 60%, 140%, and 200% respectively) Cullen Report ¶90. (Exhibit RME-1411).

1886 In France, a base penalty of 80% is assessed in cases of "*abus de droit*" (which would include shams and other tax-motivated schemes), or of "dissimulation" or "fraudulent maneuvers." If the taxpayer impedes the authorities' attempts to perform their auditing responsibilities,

1216. There is no reason to believe that any of those countries would have imposed substantially lower fines on taxpayers within their jurisdictions whose conduct included the sort of wrongdoing engaged in by Yukos.

1217. In Australia, the so-called "base penalty" in cases where any part of an underpayment of tax ("shortfall") "*resulted from intentional disregard of a taxation law*" is 75% of the entire shortfall.[1888] This "base penalty" can be increased by a further 20% (to 90%) whenever aggravating circumstances are present (as they undoubtedly were for Yukos).[1889] Audited taxpayers are strongly encouraged to cooperate, and discouraged from adopting "cat and mouse" techniques like the ones used by Yukos. The statute governing penalties draws a sharp distinction between (i) those who "*took steps to prevent* [the authorities] *from finding out about*" their schemes (who are subject to a 20% increase in penalties), and (ii) those who, before or after learning that they were an audit target, voluntarily disclosed their underpayment of taxes, and thereby saved the authorities "*a significant amount of time or significant resources*," whose penalties may be reduced by up to 80%[1890] or even waived altogether.[1891]

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the penalty can be as high as 100% (*see* Articles 1729 and 1732 of the French Tax Code (Exhibit RME-1412) and (Exhibit RME-1413).

1887 *See* Hart Report, ¶18. The U.S. Internal Revenue Code subjects underpayments attributable to fraud (which has been interpreted to include willful evasion of taxes) to a fine of 75% of the unpaid tax, plus default interest. *See* Sections 6663 of U.S. Internal Revenue Code (Exhibit RME-1414). In cases of failure to pay a tax, the penalty -- over and above interest charges -- is 5% of the unpaid amount, per month, to a maximum of 25%, s*ee* Section 6651(a)(2) of the U.S. Internal Revenue Code (Exhibit RME-1416). The Unites States courts consider repetitive violations to be persuasive evidence of fraud. *See Baisden v. Comm'r,* TC Memo 2008-215 (Sept. 16, 2008) ("*Consistent, substantial understatements of income over several years are highly persuasive evidence of intent to defraud the Government*") (Exhibit RME-1417); *Estate of Ernest Clarke*, 54 T.C. 1149, 1162 (1970). ("[R]*epeated understatements of income in successive years, coupled with other circumstances–so-called badges of fraud–showing intent to conceal or misstate taxable income, present a basis from which fraud may be inferred.*") (Exhibit RME-1418); *Furnish v. Comm'r*, 262 F.2d 727 (9th Cir. 1958) (finding fraud where taxpayer understated income over ten-year period) (Exhibit RME-1419).

1888 Division 280, Subparagraph 284-90(1) of the Taxation Administration Act 1953 (Exhibit RME-1420).

1889 *Ibid.*, Division 280, Subparagraph 284-220 of the Taxation Administration Act 1953 (Exhibit RME-1421).

1890 Division 280, Subparagraphs 284-220 and 284-225 of the Taxation Administration Act 1953 (Exhibit RME-1421). One of the authorities' declared priorities is "[e]*ncouraging participants of dodgy* [tax avoidance] *schemes to make voluntary disclosures and take advantage of possible reduced*

1218. In Austria, penalties may be as high as 300% of the evaded tax.[1892]

1219. In Belgium, the base penalty applicable for willful violations of income tax law is 50% of the unpaid taxes and, in certain circumstances, may be increased up to 200%.[1893] In the VAT area, Belgian tax law provides for a penalty of up to 200%.[1894]

1220. In Italy, penalties can vary from 120% to 200%.[1895]

1221. In the Netherlands, the tax authorities may impose maximum penalties of up to 300%. [1896]

1222. In New Zealand, the maximum penalty is 100% in cases of "abusive tax position," and 150% for tax evasion or similar acts.[1897]

1223. In Switzerland, the maximum penalty is 300%.[1898]

1224. It is clear from the foregoing that the fines levied on Yukos were not excessive by international standards. Moreover, only a very few countries[1899]

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penalties." Australian Taxation Office, Tax Office focus for 2009-2010, 3 (Exhibit RME-1361). *See also*, *Kocic and Commissioner* of the Taxation [2011] AATA 47 (Feb. 1, 2010) (Exhibit RME-1422).

1891 Division 298, Subparagraph 298-20 of the Taxation Administration Act 1953 of the Taxation Administration Act (Exhibit RME-1423).

1892 *See* Sections 33, 34 and 38 of the Austrian Criminal Tax Code (Exhibit RME-1424).

1893 S*ee* Article 225 of the Royal Decree Implementing the Belgian Income Tax Code (Exhibit RME-1425).

1894 *See* Article 70, Section 2 of the Belgian VAT Code (Exhibit RME-1426).

1895 *See* Article 1, ¶ 2 and Article 5, ¶ 4, of Legislative Decree (Dec. 18, 1997) No. 471 (Exhibit RME-1427).

1896 *See* Articles 67d, 67e, 67f of the Dutch General Taxation Act (Exhibit RME-1428). *See* also E.B. Pechler, *The Decree on Tax Penalties*, Dutch Journal on Tax Law – Opinions, NTFRB 2010/14 (Apr. 8, 2010) (Exhibit RME-1429).

1897 Tax Administration Act 1994 Sections 141D and 141E (Exhibit RME-1430). It is not a defense to a charge of evasion that the taxpayer did not have knowledge of the unlawfulness of the scheme, provided that the taxpayer implemented it "willfully." Unless a statute expressly requires knowledge of the unlawfulness of an act, ignorance of the law is no excuse (*R v.Gill* (1999) 19 NZTC 15, 526 (Exhibit RME-1431)).

1898 Article 175 of the Swiss Federal Tax Code (Exhibit RME-1457).

1899 Australia has a similar provision, prescribing that a taxpayer is generally entitled to a reduction on penalties if the taxpayer advises of a tax shortfall in advance of any audit

have a provision that, like Russia's Article 179, allows taxpayers to reduce or avoid penalties by filing last-minute amended returns, a very valuable right that Yukos appears to have senselessly failed to excercise.

(c) Enforcement Fees

1225. In most countries, as in Russia, tax authorities may levy enforcement or other fees against a taxpayer which fails to pay the assessed taxes within the due date. They are intended to provide an incentive for prompt and voluntary payment of amounts which, by definition, are overdue.

1226. The Russian rate of 7% levied on Yukos following its failure to pay the overdue taxes being enforced is not excessive as compared to the rates existing in other countries, which are sometimes significantly higher. For instance, Australia levies a delinquency penalty of 7% plus late interest;[1900] France applies a 5% fixed penalty for late payment of corporate income tax (plus a seizure fee of 5%);[1901] Italy levies a 9% enforcement fee;[1902] Germany charges a delinquency penalty of 1% per month;[1903] New Zealand assesses a delinquency penalty of 5% (plus an incremental penalty of 1% per month and interest of 8.89%

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activity (*see* Sections 284-225(2) of the Taxation Administration Act 1953 (Exhibit RME-1433). Typically, however, the tax authorities do not provide the taxpayer with a window of opportunity between the audit of the first year of the scheme and subsequent years. Normally, as soon as the scheme is uncovered, all relevant years are audited at the same time, which effectively prevents "11th hour" use by the taxpayer of the penalty-reduction mechanism under Sections 284-285(2) (Exhibit RME-1433). Indeed, in a number of other countries, amended returns, even if filed before any audit has began, do not abate panelties. *See, e.g.*, ¶ 25 of Schedule 18 Finance Act 1998 of the United Kingdom (Exhibit RME-1432).

1900 *See* Sections 8AAB in Part IIA of the Taxation Administration Act (Exhibit RME-1437).

1901 Pursuant to Article 1730 of the French Tax Code, a delinquency penalty of 10% can be levied for "*any lateness in the payment of the sums due for income taxes*" and local taxes, and pursuant to Article 1731 of the French Tax Code (Exhibit RME-1438) a delinquency penalty of 5% can be levied on corporate income tax. In addition, interest (0.40% per month) on the late payment penalty will apply pursuant to Article 1727 of the French Tax Code (Exhibit RME-1438). An additional seizure fee of 5% of the amount of the debt is levied pursuant to Article 1912 of the French Tax Code (Exhibit RME-1438).

1902 *See* Article 17 of Legislative Decree No. 112/99 (Exhibit RME-1439).

1903 *See* Section 240 (1) German Tax Code (Exhibit RME-1440). In addition, while Section 152.2 German Tax Code, which contains a provision on fees in case of late submissions of a tax return, entails the maximum amount of € 25,000 for late submission fees, in Section 240 (1) there is no maximum amount for late payment fees.

per annum);[1904] Spain has an enforcement fee of 20% plus late interest;[1905] the United Kingdom levies a delinquency penalty up to 20%;[1906] and the United States charges a delinquency penalty of 5% per month (up to 25% in the aggregate).[1907]

(d) Tax Assessments As Percentage Of Income

1227. Claimants criticize the fact that the tax assessments at issue amounted to a high -- sometimes very high -- percentage of Yukos' revenue for the relevant years. This argument mixes apples and oranges, because VAT is assessed even on taxpayers with no income at all. Even in the area of income taxes, the combination of taxes, interest, and penalties not infrequently exceeds 100% of income. In fact, Yukos and its advisors recognized that one of the risks inherent to Yukos' "tax optimization" scheme was that, if it were ever discovered and challenged by the Russian tax authorities "*we may face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which would have a material impact on our financial condition and results of operation*."[1908]

1228. In other countries, arguments similar to the ones made by Claimants are rarely heard, in all likelihood because they would be dismissed as frivolous. For example, the U.S. Supreme Court has firmly rejected a constitutional argument that a tax is invalid if it brings about the destruction of a business, even where the allegedly excessive and destructive impact of the tax was assumed to be factually correct.[1909]

1904 *See* Sections 120D, 120E, 139B, Part I, of the 1994 Tax Administration Act and Orders in Council (2010) (Exhibit RME-1441). Pursuant to Section 139B of the 1994 Tax Administration Act, the incremental 1% delinquency penalty "*is to be added to the tax to pay to which it relates on the day after the last day of successive monthly intervals during which the tax to pay remains unpaid*."

1905 Pursuant to Article 28 of the Spanish General Tax Law No. 58/2003, the "regular" fee is 20% (Exhibit RME-1442). A 10% fee is applied if the taxpayer discharges the debt in full before receiving the notice of enforcement.

1906 *See* ¶ 18(2), Schedule 18 FA, of the 1998 Financial Act (Exhibit RME-1624).

1907 *See* Section 6651 of the U.S. Internal Revenue Code (Exhibit RME-1416).

1908 Extract from Yukos' Draft F-1 Form, 134 (Exhibit RME-1477).

1909 *Pittsburg v. Alco Parking Corp.*, 417 U.S. 369, 374 (1974) (Exhibit RME-1434).

(6) In Other Countries, The Authorities Would Have Reassessed Yukos' Taxes Even For Years Prior to 2000

1229. While Claimants have not raised the issue, it is worth mentioning in the interest of completeness that, due to the very limited exceptions to Russia's three-year statute of limitations for tax violations[1910], Yukos -- whose abuses of the low-tax region program commenced prior to 2000 but were comprehensively ascertained by the authorities only in December 2003 -- was able to avoid any reassessments for those earlier periods, thus permanently retaining the full benefits of its wrongdoing before January 1, 2000.

1230. Few if any other countries would have been equally indulgent with Yukos, because almost everywhere else, Yukos' attempts to conceal its abuses would have either extended the statute of limitations by a significant number of years, or would have tolled it *sine die*. This is true in Cyprus[1911] as well as the

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1910 After much litigation in the Yukos case, the Russian Constitutional Court held that the statute of limitations could be tolled only where the taxpayer had interfered with a tax audit, something Yukos was found to have done with respect to the December 2003 audit. *See* Ruling of the Constitutional Court No. 9-P (July 14, 2005) (Exhibit RME-1458). In that regard, it is also worth noting that arbitrazh courts in various districts (including the Moscow district) have followed that approach in a number of unrelated and post-Yukos cases. Specifically, in the Resolution of the Federal Arbitrazh Court of Moscow District in case No. KA-A40/5876-06 (July 28, 2006) (Exhibit RME-1459), the court applied the same audit obstruction provision as in Yukos case by stating that "The taxpayer failing to present necessary documents in due time and resisting to the tax audit leading to missing the limitations period and making it impossible to charge fines with respect to such taxpayer (specifically, when committing acts provided by Articles 119, 120, and 122 of the Tax Code of the Russian Federation) would obtain unfair advantage over the taxpayer who committed the same acts but did not resist to the tax audit and was, subject to compliance with the limitations period, held liable for taxes Therefore, the disputed provisions of Article 113 of the Tax Code of the Russian Federation may not be interpreted as suggesting that the limitations period determined by them applies equally to those taxpayers who observe their duties during a tax control and those who resist to such control". *See also* Resolution of the Federal Arbitrazh Court of the North Caucasian District No. F08-2786/2007-1290A (May 31, 2007) (Exhibit RME-1460), in which the cassation court noted that in the course of the field tax audit of the entrepreneur's activities, the taxpayer had caused delays in providing the requested documents and various obstacles to the audit activities undertaken by the tax authorities, and therefore the court's conclusion that the statute of limitation had not expired was correct. Because the authorities were precluded from reassessing any period before January 1, 2000, the stakes in the litigation regarding the statute of limitations in the Yukos case were quite limited, involving only tax year 2000, and within that year only the 40% fine that had been levied, because Yukos conceded that the assessment for taxes and interest (which was subject to a different rule) had been made by the authorities in timely fashion.

1911 Pursuant to Article 23, Sections 1 and 2 of the Assessment and Collection Tax Law "*[w]here it appears to the Director that any person on whom tax has been imposed under any Law, including a Communal Chamber Law imposing a personal contribution in the form of income tax enacted either*

United Kingdom[1912], of which Claimants claim to be citizens for the purposes of these proceedings. The statute of limitations is extended in cases of fraud or concealment in many other countries.[1913] In the United States, it never expires with respect to any underpayments attributable to fraud or willful attempts to evade tax.[1914] A number of other countries have similar rules.[1915]

(7) In Other Countries, Claimants' "Double Taxation" Argument Would Be Rejected

1231. Claimants complain that, in addition to the Yukos assessments at issue, the Russian authorities assessed other taxpayers (notably YNG) in ways

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before or after the commencement of this Law, has not be assessed or has been assessed at the less amount that which he ought to have been assessed, the Director may, within the year of assessment or within six years of the expiration thereof, asses such person at such an amount of tax or additional amount of tax as was imposed an ought to have been assessed and collected under the provisions of the Law imposing the tax, and the provisions of this Law shall apply to such assessment and to the tax assessed there under: […] (2) Where any person has been guilty of fraud or willful default, the time-limit of the six years mentioned in sub-section (1) shall be increased to twelve years" (Exhibit RME-1443).

1912 *See,* Cullen Report, ¶¶ 48-51. In the United Kingdom, the normal statute of limitations is four years, but this rises to six years in cases of negligence and to 20 years in cases of "deliberate" action. *See* Schedule 39 to the Finance Act 2008 which (subject to certain exceptions and transitional rules) came into force on April 1, 2010 (Exhibit RME-1435).

1913 In France, the normal statute of limitations of three years, is extended to 10 years in case of fraud (*see*, Articles L169 *et seq.* of the French Tax Code (Exhibit RME-1436); in Germany (generally, from four to ten years; *see* Sections 169 (2) s.1 No.2, s.2 German Tax Code) (Exhibit RME-1444); and in Italy (the normal four year period is generally doubled. S*ee* Article 43, of Presidential Decree (Sept. 29, 1973) No. 600, and Article 57, of Presidential Decree (Oct. 26, 1972) No. 633) respectively, (Exhibit RME-1445) and (Exhibit RME-1446). In Austria, the statute of limitations is generally five years, but it may be extended–to ten years–for tax evasion. *See* Section 207(2) of the Austrian General Tax Code (Exhibit RME-1447).

1914 *See,* Hart Report, ¶ 17. *See* Sections 6501 (c) and (e) of the U.S. Revenue Code (Exhibit RME-1448). The normal statute of limitations of three years is automatically extended to six years when the taxpayer omits more than 25% of its gross income from a tax return, and the statute of limitations is tolled indefinitely in cases when a taxpayer files a false or fraudulent return with the intent to evade tax, or engages in any other wilful attempt to defeat or evade tax.

1915 In Canada, there is no timing limitation in cases of "*wilful default or fraud*," or even in cases when there is a misrepresentation that is due to mere "*neglect*" or "*carelessness.*" *See* Subparagraph 152(4)(a)(i) of the Income Tax Act (Exhibit RME-1449). In New Zealand, there is no statute of limitations at all if, *inter alia*, the authorities are of the "opinion" that the taxpayer has acted fraudulently or misleadingly. Tax Administration Act 1994, Sections108(1), 108(2), 108(3), 108A (Exhibit RME-1450). The Australian rule is similar: the normal four-year statute of limitations is suspended *sine die* if the tax authorities are "*of the opinion there has been fraud or evasion*." Sections 170(1)4, Income Tax Assessment Act 1936 (Exhibit RME-1451); *see* generally Australian Taxation Office Practice Statement PS LA 2008/6 (Exhibit RME-1452).

that, from an economic standpoint, could be regarded as double taxation.[1916] In reality, it is not infrequent or anomalous that, in disassembling a multiparty fraudulent scheme and reassessing its participants, tax authorities will tax more than one party with respect to the same income. In Russia[1917] as elsewhere this risk is inherent to fraudulent schemes like Yukos'. In the end, most of the assessments against YNG were cancelled (a circumstance that, somewhat contradictorily, Claimants also criticize).[1918] However, the elimination of double taxation is not automatic, and in many countries, the authorities do not have an obligation to treat all of the various parties to a contested scheme in a consistent manner, even in the absence of fraud.[1919] *A fortiori* this is true in instances of fraud, such as the present case. As pointed out by a court in the United Kingdom that was dealing with a scheme based on shell companies such as Yukos', it "*scarcely lies in the mouth of the taxpayer who plays with fire to complain*" of double taxation that results from the unraveling of such frauds.[1920]

1232. In sum, it can be seen that the Russian authorities (and courts) acted in ways that were fully compatible with international practices. Among other things, virtually all other countries would have considered Yukos' "tax optimization" scheme obviously unlawful, and they would not have hesitated to

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1916 Claimants' Memorial on the Merits, ¶ 314.

1917 *See* Konnov Report, ¶ 90.

1918 Claimants' Memorial on the Merits, ¶¶ 778-788.

1919 *See, e.g.,* Austria (in domestic transfer pricing cases, taxpayers are not automatically entitled to compensating adjustments); Cyprus (pursuant to Article 33 of the Income Tax Law and Article 33 of the Assessments and Collection of Taxes law (Exhibit RME-1240 and RME-1287), the authorities may issue an assessment claiming additional taxes for a company without any obligation to accept a corresponding adjustment to the accounts of the counterparty to the same challenged transaction); France (when a company is reassessed on transfer pricing grounds, the authorities do not automatically grant symmetrical relief to the other party to the challenged transaction); Germany (there is no principle of correspondence for taxpayers that are parties to the same transaction (s*ee* Koenig in Pahlke-Koenig, AO, 2nd edition, ¶ 174, RN 20) (Exhibit RME-1454); New Zealand (in transfer pricing disputes, the authorities do not automatically make corresponding adjustments, but will do so only if they believe that it is "*fair and reasonable*" to grant such relief (GC 11 Requests for Matching Treatment (Exhibit RME-1462)); in settlements with multiple taxpayers, the tax authorities generally seek consistency, but are not legally bound to do so (*see* ¶ 159 of Interpretation Statement 10/07 of Oct. 22, 2010 (Exhibit RME-1368).

1920 *RV Dimsey* [2001] STC 1570 (Exhibit RME-2796), citing House of Lords in *Howard de Walden v IRC* [1941] 25 TC 121; *see* Cullen Report, ¶¶ 77-80.

assess on Yukos the taxes that had been evaded through the trading shells. Yukos' claims of discrimination and political persecution—even if accepted, *quod non,* as true—would not have relieved it of the obligation to pay taxes (and fines) otherwise due. In fact, in a number of countries, those fines would have been higher than in Russia. In the European Union, as well as in some non-EU countries, the fact that the goods in question had been exported would not have prevented the tax authorities from assessing VAT. In sum, by international standards, the measures of which Claimants complain were well within the norm.

4. The Alleged Discrimination Does Not Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*" And, In Any Event, No Discriminatory Conduct Cognizable Under Article 13(1)(b) ECT Has Been Established

1233. Nor does Claimants' discrimination claim establish that the assessments are "*measures having effect equivalent to nationalization or expropriation*."

a) The Alleged Discrimination Does Not By Itself Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1234. As set forth at ¶¶ 1096 to 1103 above, Article 13 ECT prohibits nationalization, expropriation and "*measures having effect equivalent to nationalization or expropriation*," *i.e.*, measures causing total or substantial deprivation of the investment. Claimants thus have the burden of showing that the allegedly discriminatory measures caused total or substantial deprivation of their rights as Yukos shareholders.

1235. In the absence of proof of total or substantial deprivation caused by allegedly discriminatory measures, such measures by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*." The tribunal in *Corn Products International, Inc. v. Mexico* underscored this requirement:

> "[I]t is necessary to bear in mind that there is a distinction between discriminatory treatment of the property of an investor (and, for that matter, unfair and inequitable treatment) and expropriation. It

> is not the case that, because a measure which affects property rights is discriminatory, it is therefore an expropriation (or something tantamount to expropriation). Rather, if a measure is established to be an expropriation (or something tantamount thereto), it cannot then be justified if it is discriminatory."[1921]

1236. As set forth at ¶ 1105 above, Claimants have failed to establish that the allegedly discriminatory measures resulted in total or substantial deprivation of their rights as Yukos shareholders.

1237. In any event, as shown above (*see* ¶¶ 1105 *supra*), the diminution in the value of Claimants' Yukos shares about which they now complain was caused by Claimants themselves, their controlling Oligarchs, and the Yukos directors and officers they installed and repeatedly reappointed to manage their investment in Yukos, and not by the Russian Federation due to wholly to:

(i) Yukos' illegal "tax optimization" scheme;

(ii) Yukos' failure to avail itself of multiple opportunities to pay its 2000 tax year assessment, stemming from its illegal "tax optimization" scheme;

(iii) Yukos' payment instead of an unprecedented US$ 2 billion "giga-dividend," primarily to Claimants;

(iv) Yukos's pre-payment to the Oligarchs' company of a substantial loan obligation;

(v) Yukos' failure either to amend its tax returns, or pay subsequent assessments, for tax years 2001, 2002, and 2003;

(vi) Yukos' repeated and consistent attempts to mislead Russian tax authorities by making spurious and insincere settlement offers;

1921 *Corn Products International, Inc. v. The United Mexican States*, ICSID ARB(AF)/04/01, Decision on Responsibility (Jan. 15, 2008), ¶ 90 (Exhibit RME-1132). *See also Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. The United Mexican States*, ICSID ARB(AF)/04/05, Award (Nov. 21, 2007), ¶ 251 (Exhibit RME-1108): "[T]he loss of benefits or expectation, or the alleged discriminatory character of the Tax –standing alone– is not a sufficient criterion for an expropriation."

(vii) Yukos' decision to file unacceptable amended VAT returns;

(viii) Yukos' failure during this entire period to file a voluntary bankruptcy petition in Russia, despite its admitted insolvency;

(ix) Yukos' sabotaging of the YNG auction;

(x) Yukos' stripping of valuable assets from the company and its segregation of those assets in Dutch Stichtings;

(xi) Yukos' default on its obligations to the SocGen syndicate, leading the syndicate to commence bankruptcy proceedings against Yukos;

(xii) Yukos' and the Oligarchs' repeated and consistent lies to PwC, and through PwC to Yukos' creditors and the investing public.

b) In Any Event, No Discriminatory Conduct Cognizable Under Article 13(1)(b) ECT Is Alleged

(1) Claimants Do Not Allege Any Discrimination Based On Foreign Ownership Or Residence

1238. The Convention organs have confirmed that a State's margin of discretion is necessarily broader in the context of taxation than in other areas:

> "The Commission is of the opinion, however, that it is for the national authorities to make the initial assessment, in the field of taxation, of the aims to be pursued and the means by which they are pursued; accordingly, a margin of appreciation is left to them. The Commission is also of the view that the margin of appreciation must be wider in this area than it is in many other."[1922]

1239. The ECT does not define the term "*discriminatory*" in Article 13(1)(b) ECT. Article 21(5)(b)(ii) ECT, however, provides that the issue of whether a tax is discriminatory shall be determined pursuant to the "*non-discrimination provisions of the relevant tax convention or, if there is no non-discrimination provision in the relevant tax convention applicable to the tax or no such tax convention is in force between the Contracting Parties concerned,* […] *the non-*

[1922] *Lindsay v. United Kingdom*, ECHR Application No. 11089/84, Decision on Admissibility (Nov. 11, 1986), 49 European Commission of Human Rights, Decisions and Reports 181 (1986), 190 (Exhibit RME-1129).

discrimination principles under the Model Tax Convention on Income and Capital of the Organisation for Economic Co-operation and Development."

1240. The non-discrimination provisions of the Russia-Cyprus double taxation treaty, the Russia-U.K. double taxation treaty and the OECD Model Tax Convention imported by Article 21(5)(b) ECT into Article 13(1) of the ECT all lead to the same conclusion. Each non-discrimination provision prohibits tax discrimination on grounds of nationality, permanent establishment, residence, or foreign origin of funds.[1923] Specifically, as regards taxation of a company owned or controlled by residents of the other Contracting State, Article 24(4) of the Russia-U.K. and Russia-Cyprus double taxation treaties prohibit tax discrimination based on foreign capital ownership or control:

> "Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected."[1924]

1241. Each of the non-discrimination provisions in the Russia-Cyprus and Russia-U.K. double taxation treaties tracks, with only minor variations, the language of the OECD Model Tax Convention, which provides in Article 24(5):

> "Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected."[1925]

1923 Russia-Cyprus Tax Treaty, Art. 24 (Non-Discrimination) (Annex (Merits) C-916); Russia-U.K. Tax Treaty, Art. 24 (Non-Discrimination) (Annex (Merits) C-915); 2010 OECD Model Tax Convention on Income and Capital, Art. 24 (Non-Discrimination) (Exhibit RME-1017).

1924 Russia-Cyprus Tax Treaty, Art. 24 (Non-Discrimination) (Annex (Merits) C-916) [emphases added]. *See also* Russia-U.K. Tax Treaty, Art. 24 (Non-Discrimination) (Annex (Merits) C-915).

1925 2010 OECD Model Tax Convention on Income and Capital, Art. 24 (Non-Discrimination) (Exhibit RME-1017). [emphases added]

1242. The leading commentator to the OECD Model Tax Convention sets forth what is and what is not forbidden:

> "What is forbidden is only other or discriminatory taxation which **attaches** to capital ownership by non-resident shareholders or partners. The provision does **not** protect enterprises in which non-residents participate, against discrimination **generally**, when there is no connection between the discrimination and the ownership of capital by foreigners. For instance, Article 24(5) is not violated if – say, as a result of an embargo – all enterprises of a third State were subject to tax discrimination and that such discrimination also affected enterprises in which residents of the contracting State held shares. For in such cases, shareholding would not be the factor which causes the tax discrimination of the enterprise."[1926]

1243. It is obvious that Claimants' allegations fall into a category of what is not prohibited. Claimants allege that the tax authorities singled Yukos out for Russian domestic political reasons. There is no allegation that would bring Claimants into a category which is prohibited, *i.e.*, a taxation measure targeting foreign ownership or control of Yukos.

1244. The standard set forth in Article 21(5)(b)(ii) ECT elaborates on and specifies the meaning of the term "*discriminatory*" in the tax context. Even apart from the specific standard applicable to taxation, no claim of discriminatory conduct is cognizable under Article 13 ECT in the absence of an allegation that the actions complained of targeted Yukos' foreign shareholders. Under the RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, the relevant comment states:

> "*Discriminatory takings*. Formulations of the rules on expropriation generally include a prohibition of discrimination, implying that a program of taking that singles out aliens generally, or aliens of a

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1926 KLAUS VOGEL, ON DOUBLE TAXATION CONVENTIONS (3rd ed. 1997), 1331 ¶ 165 (Exhibit RME-1019) [emphases in the original]; *Boake Allen Ltd v. Revenue and Customs Commissioners*, [2007] UKHL 25, ¶ 22 (Exhibit RME-1133) (dismissing claims that Section 247 of the U.K. Income and Corporation Taxes Act 1988 which provided for a tax advantage in the case of payment of dividends between a parent and a subsidiary company both residents in the U.K. infringed the non-discrimination provisions of two double taxation treaties similar to the OECD Convention because "[a]s the commentary on the OECD model says, the equality it ensures is only that any enterprise it owns in the other country will not be subject to taxation which discriminates on the ground of its foreign control.").

particular nationality, or particular aliens, would violate international law."[1927]

1245. Claimants' own authorities support this understanding.[1928]

1246. Claimants' allegations of discrimination do not turn on nationality. Claimants allege discrimination against Russians for their political views, not in any sense against nationals of another party.

1247. The investment treaty tribunal in *Feldman v. Mexico* in the specific context of a tax-related claim, explained that:

> "[U]nder international law, there is considerable doubt whether the discrimination provision of Article 1110 [NAFTA] covers discrimination other than that between nationals and foreign investors, i.e., it is not applicable to discrimination among different classes of investors, such as between producers and resellers of

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1927 RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987), 200 § 712, Comment f (Exhibit RME-1134). *See also*, *Government of Kuwait v. American Independent Oil Company (Aminoil)*, *Ad hoc* Arbitration, Award (Mar. 24, 1982), 66 I.L.R. 519 (1984), 585 ¶ 87 (Annex C-225) (Exhibit RME-1135): "In 1977 nationalization was not extended to both of the Companies then operating as concessionaires, *viz*. Aminoil and the 'Arabian Oil Company' (AOC). The latter was spared. The question accordingly arises whether the nationalization of Aminoil was not thereby tainted with discrimination, and whether this differentiation does not show that the Decree Law had other objects than that of realising a programme of economic development. The Tribunal does not think so. First of all, it has never for a single moment been suggested that it was because of the American nationality of the Company that the Decree Law was applied to Aminoil's Concession. Next, and above all, there were adequate reasons for not nationalizing Arabian Oil."; *Banco Nacional de Cuba v. Chemical Bank New York Trust Company and Others*, United States Court of Appeals, Second Circuit, Judgment (June 10, 1987), 92 I.L.R. 431 (1993), 438 (Exhibit RME-1136): "As a general principle of international law, a state is liable to a private person who is a national of another state if it takes the foreign national's property and the taking is 'discriminatory.' A taking pursuant to a program that excludes from compensation all aliens or all aliens of a particular nationality is discriminatory."

1928 Newcombe and Paradell explain that "IIA tribunals have found a violation of the condition that an expropriation be non-discriminatory where the state has discriminated against foreign nationals" and that "[o]ther tribunals have highlighted that not all distinctions between different types or classes of investors are discriminatory." A. NEWCOMBE AND L. PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES (2009), 374 (Annex (Merits) C-1015). Newcombe and Paradell further criticize the reasoning of one of the two investment treaty cases cited by the Claimants, *ADC v. Hungary* for being "not entirely convincing." *Id.* The single other investment treaty case cited by the Claimants, *Eureko BV v. Republic of Poland*, in fact concerns discriminatory expropriation based on nationality. *Eureko BV v. Republic of Poland*, *ad hoc* Arbitration, Partial Award (August 19, 2005), ¶ 242 (Annex (Merits) C-975): "[T]he measures taken by the RoP in refusing to conduct the IPO are clearly discriminatory. As the Tribunal noted earlier, these measures have been proclaimed by successive Ministers of the State Treasury as being pursued in order to keep PZU under majority Polish control and to exclude foreign control such as that of Eureko."

> tobacco products, at least unless all producers are nationals and all resellers are aliens. Thus, under the Restatement, the relevant comment states that 'a program of taking that singles out aliens generally, or aliens of a particular nationality, or particular aliens, would violate international law.'"[1929]

1248. In the tax context, Claimants would certainly need to allege, which they do not, that Yukos was discriminated on the basis of foreign nationality.

1249. Claimants' case is that Yukos was targeted by and received less favorable treatment from the Russian tax authorities than other Russian oil companies because of Mr. Khodorkovsky's domestic political agenda. The incidental fact that the controlling Russian shareholders held their Yukos shares through one or more foreign companies is not sufficient to establish a discrimination for purposes of Article 13(1)(b) ECT.[1930] There is no allegation that the alleged differential treatment of Yukos was based on "foreign" capital ownership or control of Yukos.

1250. Moreover, as confirmed in *Feldman v. Mexico*, in most tax regimes, tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, while others less favored or even disadvantaged. Such differential tax treatment does not, however, violate Article 13 ECT:

> "Here, it is undeniable that the Claimant has experienced great difficulties in dealing with SHCP officials, and in some respects has been treated in a less than reasonable manner, but that treatment under the circumstances of this case does not rise to the level of a violation of international law under Article 1110 [NAFTA]. Unfortunately, tax authorities in most countries do not always act

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1929 *Marvin Feldman v. The Government of Mexico*, ICSID ARB(AF)/99/1, Award (Dec. 16, 2002), ¶ 137 note 26 (Annex (Merits) C-964). [emphasis added]

1930 Although in the national treatment context, the reasoning of the award in *GAMI Investments, Inc. v. The Government of the United Mexican States,* UNCITRAL, Final Award (Nov. 15, 2004) (Exhibit RME-1137) is equally applicable to an alleged discriminatory expropriation, *see* ¶ 115: "The Arbitral Tribunal ultimately accepts (as Mr Perezcano put it in his oral summation) that GAMI has failed to demonstrate that the measures it invokes 'resulted from or have any connection to GAMI's participation in GAM; nor were they geared towards treating GAM in a different mode because of GAMI's participation in their social capital.' In the circumstances of this derivative claim that defence is decisive. It is not conceivable that a Mexican corporation becomes entitled to the anti-discrimination protections of international law by virtue of the sole fact that a foreigner buys a share of it."

> in a consistent and predictable way. The IEPS law on its face (although not necessarily as applied) is undeniably a measure of general taxation of the kind envisaged by Restatement Comment g (*see supra*, paras. 105, 106). As in most tax regimes, the tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, with others less favored or even disadvantaged."[1931]

1251. Quite simply, whether taxation was used as an instrument of public policy or favored or disfavored certain taxpayers is not even relevant to whether there has been a violation of an investment treaty. Certainly it is not sufficient for Claimants to allege that Yukos was disfavored as a result of selective tax enforcement.

(2) Selective Tax Enforcement Is Not "Discriminatory" Within The Meaning Of Article 13(1)(b) ECT

1252. As set forth at ¶¶ 958 and 959 above, an investor and its investment are obliged to abide by host State laws. It is a universally recognized principle that no one may claim exemption from laws in force in the host State by alleging that there are instances of violations involving other persons that have not been prosecuted.[1932] Russian law is no exception.[1933]

1253. Differential treatment as a result of legitimate governmental policies or based on reasonable and objective justification is not for a "*discriminatory*" purpose within the meaning of Article 13(1)(b) of the ECT. Discrimination necessarily implies an "*unreasonable distinction*."[1934]

1254. As stated in *Amoco International Finance Corp. v. Iran*:

> "The Tribunal finds it difficult, in the absence of any other evidence, to draw the conclusion that the expropriation of a concern was discriminatory only from the fact that another concern in the same economic branch was not expropriated. Reasons

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1931 *Marvin Feldman v. The Government of Mexico*, ICSID ARB(AF)/99/1, Award (Dec. 16, 2002), ¶ 113 (Annex (Merits) C-964).

1932 *See* Section VI.C.3.(c)(4) *supra*, ¶¶ 1258-1275 *infra*.

1933 Konnov Report, ¶¶ 60.

1934 RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987), 200 § 712, Comment f (Exhibit RME-1134).

> specific to the non-expropriated enterprise, or to the expropriated one, or to both, may justify such a difference of treatment."[1935]

1255. As the largest and the most blatant abuser of Russian tax shelters of all the Russian oil and gas companies, and the only Russian oil or gas company that refused to renounce its abuse of domestic tax havens, Yukos was a visible and logical candidate for tax assessments, penalties, and enforcement actions.

1256. It has long been recognized that not every violation of tax law can be prosecuted. Proper use of tax administration resources necessarily involves decisions that will have an impact not only on the taxpayer against whom action is taken, but on other taxpayers generally. For example, as stated by the European Court of Human Rights in *Hentrich v. France*:

> "The Court reiterates that the notion of 'public interest' is necessarily extensive and that the States have a certain margin of appreciation to frame and organise their fiscal policies and make arrangements – such as the right of pre-emption – to ensure that taxes are paid. It recognises that the prevention of tax evasion is a legitimate objective which is in the public interest."[1936]

> "Furthermore, the State has other suitable methods at its disposal for discouraging tax evasion where it has serious grounds for suspecting that this is taking place; it can, for instance, take legal proceedings to recover unpaid tax and, if necessary, impose tax fines. Systematic use of these procedures, combined with the threat of criminal proceedings, should be an adequate weapon."[1937]

1257. Yukos presented a highly-visible, logical subject for tax enforcement. Not only was its conduct egregious in its abuse of the low-tax

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1935 *Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran*, Iran-U.S. Claims Tribunal, Case No. 56, Award (July 14, 1987), 15 Iran-U.S.C.T.R. 189 (1988), 232 ¶ 142 (Annex (Merits) C-939) [emphasis added]. *See also Government of Kuwait v. American Independent Oil Company (Aminoil), Ad hoc* Arbitration, Award (Mar. 24, 1982), 66 I.L.R. 519 (1984), 585 ¶ 87 (Annex C-225) (Exhibit RME-1135); *Noble Ventures, Inc. v. Romania*, ICSID ARB/01/11, Award (Oct. 12, 2005), ¶ 180 (Exhibit RME-1138); NOAH RUBINS, N. STEPHAN KINSELLA, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE RESOLUTION (2005), 177 (Exhibit RME-1139): "An expropriation must [...] be 'nondiscriminatory' to be considered 'legal' under international law. A discriminatory taking is one that singles out a particular person or group of people without a reasonable basis."

1936 *Case of Hentrich v. France*, ECHR, Application No. 13636/88, Judgment (Sept. 22, 1994), 296-A Publications of the European Court of Human Rights, Series A: Judgments and Decisions 7 (1995), 19 ¶ 39 (Exhibit RME-1140). [emphasis added]

1937 *Ibid.*, 21 ¶ 47. [emphasis added]

region policy, but the amount of taxes it evaded was very substantial and substantially more than other companies Claimants cite. As explained below, there was no differential treatment of Yukos because the other oil companies to which Claimants refer did not present similar circumstances.

1258. Claimants contend that Yukos was the victim of politically-motivated discrimination, and that although other companies engaged in the same schemes as Yukos, they were largely spared any consequences.[1938]

1259. This contention is simply wrong as a factual matter and, in any event, unavailing both as a matter of Russian law and international practice.

1260. As regards the facts, it is clear that a number of Russian oil companies never resorted to abusive tax minimization schemes involving the use of low-tax regions.[1939] Thus, for instance, there is no evidence that Rosneft ever did so.[1940] The same appears to be true of Tatneft and Surgutneftgaz.[1941]

1938 Claimants' Memorial on the Merits, ¶ 777.

1939 Counsel for the Russian Federation has had no access to any confidential tax information relating to other companies, insofar as Article 84(9) of the Russian Tax Code provides that "[a]*ny information about a taxpayer from the moment it is registered with tax authorities constitutes tax secret, unless otherwise provided by the present Code*" (Exhibit RME-1514). Pursuant to Article 102 of the Tax Code, "[t]*ax secret shall not be disclosed by tax authorities, bodies of internal affairs, investigation agencies, agencies of governmental extra-budgetary funds and customs agencies, their officials and engaged specialists or experts, with the exception of instances stipulated by federal laws*" (Exhibit RME-1515). The definition of tax secret is interpreted by the tax authorities and Russian courts as preventing disclosure of facts, which are "*included into tax audit reports* [...], for example, *information on particular taxpayers, and specific transactions performed thereby, as well as information on financial and economic operations*" (*see* S.V. Zhukova, Counsel of Tax Service of Second Rank, Expert Consultation, Konsultant Plus (June 7, 2001) (Exhibit RME-1516)), or which are not otherwise in the public record, as well as any information on tax and accounting reporting, including submitted tax returns and information on the amounts of paid taxes. *See, e.g.,* Resolution of the Federal Arbitrazh Court of the Povolzhskiy District, Case No. A12-1085/07 (Sept. 06, 2007) (Exhibit RME-1517), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/2027-07A (Mar. 27, 2007) (Exhibit RME-1518).

Virtually every country has similar rules. *See, e.g.*: (i) Austria (*e.g.,* § 48 of the Austrian General Tax Code (*Bundesabgabenordnung*)) (Exhibit RME-1519); (ii) Canada (*e.g.,* "*Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer RC17 (E)*") (Exhibit RME-1520); (iii) Cyprus (*e.g.,* Article 4 of the Income Tax Law 2002) (Exhibit RME-1521); (iv) France (*e.g.,* French Code of Fiscal Procedure (*Livre des procédures fiscales*), Art. L103 *et seq.*) (Exhibit RME-1522); (v) Germany (*e.g.,* § 30 of the German Tax Code) (Exhibit RME-1523); (vi) Italy (*e.g.,* Article 68 of the Presidential Decree, No. 600 (Sept. 29, 1973)) (Exhibit RME-1524); (vii) Netherlands (*e.g.,* Article 67 of the General Tax Act *(Algemene wet inzake rijkbelastingen*))

1261. Some other companies that used minimization schemes involving low-tax regions abandoned those schemes much earlier than Yukos. In particular, Yukos' most direct competitor, Lukoil, publicly declared in 2002 that it had terminated all abuses of those regions' legislation as of December 31, 2001.[1942]

1262. Still other companies continued to rely on the low-tax region program, but -- unlike Yukos -- did so in ways that satisfied the "proportionality of investments" requirement of the Russian anti-avoidance rules. Thus, Sibneft made substantial contributions to local economic development. For instance, Sibneft's contributions in Chukotka for 2002 totaled at least 50% of its tax savings in that region. In sharp contrast, Yukos' contributions in Mordovia -- the region

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(Exhibit RME-1525); (viii) Spain (*e.g.,* Article 95 of the Genral Tax Law (*Ley General Tributaria*) (Exhibit RME-1526); (ix) Sweden (*e.g.,* Chapter 27, ¶¶ 1, 2 and 4 of Law No. 2009:400) (Exhibit RME-1527); (x) Switzerland (*e.g.*, Article 110 of the Swiss Federal Income Tax) (Exhibit RME-1528); (xi) United Kingdom (§ 18 of the Commissioners for Revenue and Customs Act 2005) (Exhibit RME-1529); and (xi) United States (*e.g.,* § 6103 of the Internal Revenue Code) (Exhibit RME-1530).

1940 As stated by Sergey Bogdanchikov, Rosneft's former Chief Executive Officer, "[t]*here are transfer prices, which oil companies use in order to consolidate their revenues. This, however, does not reduce the aggregate revenues, and, consequently, the taxes. However, various off-shore schemes, Baikonur schemes,* [ZATOs] *or disabled companies are sometimes used along with transfer pricing. We have never used these schemes. We have been using only the first element, i.e. transfer prices, in order to centralize the management*." *See* Interview of Sergey Bogdanchikov to AU92 Information Agency (Feb. 5, 2004) (Exhibit RME-324).

1941 *See, e.g.,* Leonid Fridkin, *Surgutneftegaz Giving Lessons of Capitalism*, Economicheskaya Gazeta (May 31, 2002), 1 (Exhibit RME-1532): "*Surgutneftegaz's style is its meticulous observance of taxation obligations. The company is not lured by all sorts of convoluted schemes of tax evasion through offshore firms or price rigging*." *See also* OAO Surgutneftegaz profile, Rb.ru (Exhibit RME-1533): "*Surgutneftegaz strictly adheres to the letter of the law and for that reason runs no risks associated with any irregularities concerning its tax payments*." *See also* Surgutneftegaz: Drilling Power, Renaissance Capital (Mar. 2005), 41 (Exhibit RME-323).

1942 In mid-2002, Lukoil publicly announced that it had abandoned the use of low-tax regions to minimize its taxes as of December 31, 2001. In its 2001 financial statements, Lukoil noted that: "[i]*n the past, the Group has been able to establish strategies which have reduced its overall cost of taxation. It may not be possible to establish other arrangements which facilitate similar tax efficiencies in the future to replace the arrangements which have reduced the cost of taxation in the years ended December 31, 2001, 2000 and 1999*." *See* Annual Report of Lukoil Oil Company for 2001, 93 (Exhibit RME-1541). Lukoil made a similar announcement in its November 2002 offering circular for a bond placement: "[i]*n 2002 substantially all of the tax-planning initiatives that we formerly used were phased out, and we expect to pay higher taxes in 2002 and thereafter. Accordingly, our results of operations may be adversely affected*." *See* OAO Lukoil, Securities Filing, Offering Circular (Nov. 26, 2002), 36 (Exhibit RME-322).

to which it made its largest payments [1943]-- amounted in 2002-2003 to a miserly 2% of Yukos' tax savings.[1944] As a result, Sibneft could plausibly claim that, instead of abusing the low-tax region program, it had made lawful use of it, by acting in ways that were fully consistent with the program's objective of furthering local economic development. In any event, it is far from clear that Sibneft's breaches were comparable to Yukos', even if one sets aside those companies' fundamental differences with regard to local investments.[1945]

1263. The distinction between lawful use and abuse is of course critical. Not surprisingly, and quite legitimately, different behaviors begat different consequences.[1946] Obviously the authorities did not reassess companies that never abused the low-tax region program. As for the others, the reassessments quite properly took into account the widely varying degrees of seriousness of the alleged misconduct. However, no major oil company that abused the program appears to have been able to avoid reassessment.

1264. Thus, for instance, TNK-BP (in which British Petroleum is a 50-50 partner) reported that it had been assessed, and had paid, taxes, default interest

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1943 Dubov Witness Statement, ¶¶ 31-36, discussing only the Mordovian contributions.

1944 In particular, as pointed out by a 2004 Report of the Audit Chamber of the Russian Federation, in 2002 Yukos obtained tax benefits from the Republic of Mordovia in excess of RUB 20 billion (approximately US$ 720 million), whereas the overall amount of investments made by Yukos in that region in 2002 amounted to only RUB 0.5 billion (approximately US$ 17 million), *i.e.*, a mere 2% of its overall tax benefits. *See* Audit Chamber Report on Yukos, Lukoil and Sibneft for 2003 and Jan.–Mar. of 2004, 18-19 (Exhibit RME-266). In contrast, in the same period, the amount of tax benefits granted to Sibneft by the Chukotka Autonomous District in 2002 totaled RUB 17.9 billion, whereas the amount of Sibneft's investments in that region for the same period amounted to RUB 8.9 billion, *i.e.*, 50% of its overall tax benefits. The investments undertaken by Sibneft in Chukotka were used "*for the construction and modernization of the hospitals, renovation of the office and residential buildings and other facilities located within the territory of the Chukotka Autonomous District.* [...] *The transfer of the property or the results of work or services by the investors into the district's ownership was documented by means of an act, showing the performance by the investor of its investment commitments*." *Ibid*., 17. Equally *de minimis* in comparison with the tax benefits received were Yukos' 2000 contribution in the ZATO of Trekhgorny, which totaled 0.006% of Yukos' tax savings in that region. *See also*, *e.g.*, ¶¶ 249-255 *supra*.

1945 In this connection, Claimants' reliance on Sibneft's Quarterly Report 2nd quarter of 2005 (*see* Claimants' Memorial on the Merits, ¶ 760, note 1158) is unavailing. Contrary to Claimants' suggestions, the alleged "similarity" between the schemes used by Yukos as opposed to Sibneft's is based on unsubstantiated hearsay reported by rating agency Standard & Poor's.

1946 *See* Konnov Report, ¶¶ 40, 45.

and fines on the order of US$ 2 billion arising out of abuses of the low-tax region program over a period of three years.[1947] Likewise, Sibneft was reported to have paid the tax authorities at least US$ 300 million to settle tax claims in connection with its use of the low-tax region program for the 2000-2001 tax years.[1948] Lukoil too is reported to have paid sizeable amounts.[1949]

1265. These payments by other companies fatally undermine Claimants' contention that Yukos' tax assessments were politically-targeted aberrations, rather than *bona fide* attempts to enforce the tax laws throughout the oil industry.

1266. Indeed, Yukos' audits and assessments arose in the context of an even more broad-based effort by the authorities to increase compliance with the tax laws in all sectors.[1950]

1947 *See* TNK-BP International Limited Consolidated Financial Statements as of and for the years ended December 31, 2007 and December 31, 2006, 25 (Annex (Merits) C-394); *See also* TNK-BP International Limited Consolidated Financial Statements as of and for the years ended December 31, 2006 and December 31, 2005, 15 (Exhibit RME-1531). Specifically, TNK-BP financial statements for 2005-2007 show that the company paid: (i) US$ 7 million in August 2005 for the 2001 tax year, 15 (Exhibit RME-1531); (ii) US$ 247 million in August 2005 for the 2001 tax year (Annex (Merits) C-394), 25; (iii) US$ 143 million in December 2006 for the 2001 tax year (*Ibid.*, 25); and (iv) US$ 1,418 billion in November 2006 for the tax years 2002 and 2003 (*Ibid.*).

When TNK-BP received its tax assessments, it immediately made provisions of approximately US$ 1.5 billion to cover its overdue tax liabilities. *See, e.g., TNK-BP Pays Off $ 1.44 Bln Tax Bill*, Moscow Times (Nov. 13, 2006) (Exhibit RME-1535): "*TNK-BP said Friday that it had expected the charge and settled the claim for 2002 and 2003 from a $ 1.46 billion reserve created for the tax case. 'This will have no impact on the company's financial results for this year, or on the company's operations,' said Alexander Shadrin, a TNK-BP spokesman*." In contrast, Yukos never made provisions in its financial statements to cover its overdue taxes. Quite to the contrary, anticipating the 2003 tax audit report, it siphoned off from Russian US$ 2 billion cash in the guise of dividend distributions. *See* Auditor's Opinion on 2003 Financial (Accounting) Statements of Yukos under Russian Accounting Standards, 4 (Exhibit RME-1542).

1948 *Report: Sibneft Pays Off Tax Claim*, Moscow Times (Apr. 19, 2005) (Exhibit RME-1536).

1949 Lukoil was assessed (and voluntarily paid) US$ 103 million for year 2002. *See* Alexander Tutushkin, *Pay Taxes and Live a Calm Life*, Vedomosti (Jan. 14, 2004) (Exhibit RME-1543): "*The company prevailed in all trials against the tax authorities, but nevertheless preferred calm life to money*."

1950 This is confirmed, *inter alia*, by the rapid growth of the number of tax disputes before the Russian courts during the relevant period. For example, in 2000 there were 138,192 tax cases pending before the Russian courts; in 2001, 188,162 cases (an increase of 36.2%); in 2002, 207,485 cases (an increase of 10.3%); in 2003, 253,026 cases (an increase of 21.9%); in 2004, 350,391 cases (an increase of 38.5%); in 2005, 425,236 cases (21.4%). In short, in only five years, the number of tax disputes before Russian courts increased threefold. *See* Supreme Arbitrazh

1267. Claimants nevertheless allege that the tax assessments against Yukos were so much larger than those against other companies that some degree of politically-motivated discrimination should be assumed.[1951] The Tribunal should reject this argument because it rests entirely on unproven speculation, whereas the numerous objective reasons that justified the larger assessments on Yukos are factually indisputable.

1268. First, in sheer quantitative terms, Yukos abused the low-tax region program at a scale vastly greater than any other company. Thus for instance, as noted by Claimants,[1952] TNK-BP reported tax savings in connection with the low-tax region program amounting to US$ 249 million in 2001, whereas the taxes that Yukos claimed to have saved in that same year as a result of "*income taxed at other rates*" amounted to US$ 1 billion (and to US$ 1.3 billion in 2000).[1953] Thus, even if, *quod non*, all other factors were identical, the sheer volume of Yukos' abuses would explain its larger assessments.

1269. Second, as noted above, some other companies terminated their abuses long before Yukos did. Lukoil, for example, committed no abuses after 2001,[1954] whereas Yukos continued its scheme through the first half of 2004.[1955] This difference is critical: more than two-thirds of the aggregate taxes, interest

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Court of the Russian Federation, Results of the Work of Courts of the First Instance in 2000, Court Statistics Information (Exhibit RME-1537). *See also*, *e.g.*, *Yukos Was Not Alone*, Vedomosti (Oct. 10, 2005) (Exhibit RME-1538), noting that "[t]*he Federal Tax Service seems to have been setting ever new records in claims against major companies.* […] *In 2004-2005, nearly all major companies faced claims from the tax authorities. Anatoly Chubais, chairman of the board of RAO EES, the state-run energy holding, was quoted half a year ago as saying that some 90% of businessmen had tax problems. 'Everybody keeps asking everybody how many more millions or billions they have had to pay in additionally assessed taxes,' he said*."

1951 Claimants' Memorial on the Merits, ¶ 770.

1952 Claimants' Memorial on the Merits, ¶ 763.

1953 Yukos Oil Company U.S. GAAP Consolidated Financial Statements (Dec. 31, 2001), 19 (Annex (Merits) C-28).

1954 *See* Section II.H.2(f) *supra*.

1955 Yukos continued to use shell companies created to carry out its "tax optimization" scheme into the summer of 2004, *i.e.*, well after its receipt (on Dec. 29, 2003) of the audit report for tax year 2000.

and penalties assessed on Yukos for the 2000-2004 tax years involved abuses perpetrated by Yukos after Lukoil abandoned its tax minimization scheme.[1956]

1270. Third, not all uses of the low-tax region program were unlawful. *Bona fide* trading companies that bought and sold at arm's length prices, with their own locally-based professional staffs, could have lawfully claimed the benefits of the low-tax region program, provided that they also made "proportionate" investments in the local economy consistently with the developmental objectives of the program. Yukos did not satisfy any of these requirements, of course, but other companies were no doubt able to do so and thereby to justify lower assessments (or avoid assessments altogether).

1271. Fourth, as explained in paragraphs 1087-1090 above, Yukos could have greatly reduced its tax liabilities by taking advantage of the possibilities offered to it under Russian law to mitigate its exposure. In particular, Article 81(4) of the Russian Tax Code allows companies that have evaded taxes the possibility to avoid fines by filing last-minute amended returns and paying only overdue taxes and interest. While Yukos failed to take advantage of this opportunity, there is no reason to believe that other companies were equally irresponsible.

1272. Fifth, other companies, in all likelihood, structured their use of the low-tax region program in a way that made them less vulnerable to assessments of VAT, which accounted for more than half of Yukos' overall tax liabilities. As discussed at ¶¶ 1073 to 1079 *supra*, Yukos was found liable for VAT because: (i) the authorities determined that its trading shells were sham entities and thus treated their exports as having been made by Yukos rather than the trading shells; and (ii) Yukos never filed timely and proper amended VAT returns in its own name.[1957] There is no reason to believe that other companies exposed themselves to the risk of VAT assessments to the same extent as Yukos, whose

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1956 *See* ¶ 302 *supra*.

1957 *See* ¶¶ 1073-1079 *supra*.

vulnerability in this regard arose in part because it sought to conceal its control over most of the trading shells.

1273. Instead, what is clear from the record is that none of the other Russian oil companies was ever accused of engaging in any of the following types of reprehensible misconduct, all of which were Yukos' hallmarks:

(i) Yukos' schemes were egregiously predatory, resulting in very small or non-existent contributions to the local economies that the favorable low-tax regime was intended to stimulate;[1958]

(ii) Yukos demonstrated a particularly virulent form of bad faith by adopting measures whose sole purpose was to conceal its "tax optimization" scheme and to mislead the tax authorities if and when they ever attempted to audit it, including by concealing its ownership of Russian and offshore trading shells through "call options" and other subterfuges;[1959]

(iii) Yukos took advantage of similarly opaque schemes to improperly divert funds into offshore entities ultimately owned by the Oligarchs;[1960]

(iv) before 2003, when the tax authorities attacked Yukos' "tax optimization" scheme at the local level, Yukos frustrated the impact of those initiatives and concealed its affiliation with the

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1958 *See* ¶¶ 249-255 *supra*. *See also, e.g.,* Field Tax Audit Report No. 52/907 (Nov. 19, 2004), 52 (Exhibit RME-1583), finding that "*in 2003 the Republic of Mordoviya received investments from the above entities* [OOO Alta Trade, OOO Fargoil, OOO Yu-Mordovia, OOO Energotrade, OOO Makro Trade, ZAO Yukos-M and OOO Ratmir] *(as confirmed by the payment orders) in the aggregate amount of RUB 619,450,000, while at the same time these entities enjoyed the incentives on profit tax and property tax* […] *in the amount of RUB 30,309,232,595. The amount of the benefits enjoyed by the entities is 49 times higher than the amount of the investments transferred.*" [emphasis added]. *See also, e.g.,* with respect to Nortex, a trading shell in the ZATO of Trekhgorny, "*the entity made investment payments of RUB 199,071* […] *as a result of which it subsequently enjoyed tax benefits of RUB 3,152,537,572* […], *given the obvious incommensurability between the amounts invested and the benefits granted, the tax payer has abused the law.*" Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 28 (Annex (Merits) C-103).

1959 *See* ¶¶ 237-243 *supra*.

1960 *See* ¶¶ 267-277 *supra*.

trading shells by engaging in artificial corporate restructurings resulting in the liquidation of the affected trading shells;[1961]

(v) anticipating major tax assessments, Yukos hastily emptied its coffers of US$ 2 billion in cash reserves, distributing that sum in large part to Claimants themselves in the guise of an unprecedentedly large "interim" dividend;[1962]

(vi) when Yukos was audited in 2003 and 2004, it refused to cooperate with the tax inspectors, concealing evidence of its wrongdoing by withholding key documents, and causing its affiliates to be equally obstructive;[1963]

1961 *See* ¶¶ 281-287 *supra*.

1962 *See* ¶¶ 349-352 *supra*. *See also*, *e.g.*, *Yukos Is Planning to Pay Dividends, Which Are "Unprecedented" for a Russian Company*, Vsluh.ru (Oct. 30, 2003) (Exhibit RME-1577); Yukos: Investor Relations, Yukos Website, 9 (Annex (Merits) C-4), Yukos' Quarterly Report for the 4th Quarter of 2003 (Exhibit RME-330); *On November 28, 2003 Shareholders of Yukos Oil Company Will Take a Decision on Payment of Dividends*, SKRIN, (Sept. 26, 2003) (Exhibit RME-355); and *Yukos Oil Company Shareholders' Meeting Approves Dividend of About $2 Billion*, Yukos Website (Nov. 28, 2003), 8 (Exhibit RME-331).

1963 *See* ¶¶ 353-365. *See* Field Tax Audit Report No. 08-1/1 (Dec. 29, 2003), 5-7 (Annex (Merits) C-103). *See also*, *e.g.*, Report on the cross-audit of Open Joint Stock Company Tomskneft VNK (Dec. 24, 2003) (Exhibit RME-326); Demand to submit documents of the Interdistrict Inspectorate for Major Taxpayers of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 9, 2003) (Exhibit RME-1584); Demand to submit documents of the Chief State Tax Inspector of the Profit (Income) Taxation Sub-Department of the Department of the MTL of Russia for the Samara Region to the General Director of OAO Kuybishevskiy Refinery (Dec. 17, 2003) (Exhibit RME-1585); Ministry of Taxes and Levies of the Russian Federation, Interview Report of I.A. Karmakova (Dec. 18, 2003) (Exhibit RME-329). Yukos was also unique in refusing to provide the Audit Chamber with documents and information relating, *inter alia*, to (a) the company's taxable base, and (b) its compliance with tax legislation. Specifically, in a 2004 report, the Audit Chamber of the Russian Federation noted that "[t]*he audit of* [Yukos] *and its subsidiaries was conducted under conditions of limited access of the auditors of the Audit Chamber of the Russian Federation to financial and accounting documents, once again showing the Company's 'non-transparency', for which reason the auditors were unable to draw conclusions as to the level of the tax burden of this company*." *See* Audit Chamber Report on Yukos, Lukoil and Sibneft for 2003 and Jan.- Mar. of 2004, 12 (Exhibit RME-266). In particular, "*OAO NK YUKOS failed to produce source accounting documents for the year of 2003 and the 1st quarter for 2004 reporting the volumes and prices of the sold products. Besides, in the course of the audit, the Company failed to produce documents showing the source of financial funds applied for its subsidiaries investment. As a result, it was impossible to draw any conclusions as to the effect of the said transactions on the formation of the taxable base of* [Yukos], *as well as the correctness of assessment, completeness and timeliness of payment of all the taxes, duties and other mandatory payments envisaged by the Russian law*." *Ibid.*, 6). The Audit Chamber concluded that Yukos' refusal to cooperate was aimed at "*a disruption of the scheduled audit and an evasion of state control*." *Ibid.*, 3. In contrast, the report suggests that Lukoil and Sibneft –

(vii) Yukos persisted with its use of "tax optimization" shells well after the first of the complained-of assessments;[1964]

(viii) when the overdue taxes began to be assessed, Yukos falsely protested its innocence, despite overwhelming evidence to the contrary;[1965]

(ix) when the tax assessments became due, Yukos refused to pay, falsely blaming the April Injunction and the Cash Freeze Orders;[1966]

(x) while pretending that it was unable to pay, Yukos continued to divert Yukos corporate assets for the benefit of the Oligarchs;[1967]

(xi) in settlement proposals, Yukos attempted to trick the authorities into accepting an asset -- Sibneft shares -- which it knew to be subject to competing third-parties' claims;[1968]

(xii) in order to frustrate the tax authorities' collection efforts, Yukos attempted to conceal the registers of its subsidiaries;[1969]

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the two other entities which were jointly audited with Yukos on that occasion – fully cooperated with the Russian authorities. *See* Audit Chamber Report on Yukos, Lukoil and Sibneft for 2003 and Jan.-Mar. of 2004 (Exhibit RME-266).

1964 *See* ¶ 1269 *supra*.

1965 Even after the authorities finally discovered Yukos' misconduct, the company's management continued to insist that the companies' tax practices were legal -- a position that was by then utterly untenable. In fact, when Yukos' Deputy CEO Yuri Beilin finally acknowledged (on June 9, 2004) that Yukos had underpaid taxes in 2000 to 2003 (*see* Letter from Y. Beilin to M.E. Fradkov, No. 401-658 (June 9, 2004) (excerpt published in the June 18, 2004 edition of Finansovye Izvestia) (Exhibit RME-1587), other members of Yukos' management disavowed his confession, persisting in denying that Yukos owed anything at all. Gregory L. White, Guy Chazan, *Yukos, Russian Officials Discuss Payment Terms for Back Taxes,* Wall St. J. (June 22, 2004), A3 (Exhibit RME-586): "*Yukos Chief Financial Officer Bruce Misamore said yesterday the company continues to reject the tax claim as politically motivated. His position contrasts with that laid out by Deputy Chief Executive Yuri Beilin in a letter to authorities two weeks ago.*"

1966 *See* ¶¶ 376-394, 399-401 *supra*.

1967 *See* ¶¶ 386, 390-391 *supra*.

1968 *See* ¶¶ 420-430.

1969 Immediately after commencement of the enforcement proceedings on June 30, 2004, Yukos caused its main production subsidiaries (YNG, Tomskneft and Samaranefegaz) to terminate

(xiii) when the authorities began the procedure for auctioning the YNG shares, Yukos attempted to sabotage the auction by instituting patently obstructionist bankruptcy proceedings in the United States (for which it had manufactured a sham jurisdictional nexus only a few days beforehand), and by threatening "*a lifetime of litigation*" against potential bidders and their banks;[1970] and

(xiv) thereafter, the management of Yukos -- which continued to work in concert with Yukos' core shareholders, the Claimants in these proceedings -- diverted billions of dollars in non-Russian assets from the estate of the soon-to-be bankrupt company into the hands of the Oligarchs and those managers.[1971]

1274. In sum, Yukos was in a league of its own when it came to abusing Russian tax laws and resisting the efforts of the Russian authorities to enforce them. The egregiousness of Yukos' conduct fully justified the assessments against the company, and the ensuing enforcement measures.

1275. Finally, as discussed at paragraphs 1182 to 1203 above, Yukos' claims of discrimination would have been dismissed summarily in most other countries.

5. The Alleged Violations Of Due Process Do Not Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*" And, In

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their contracts with their common share register company (ZAO "M-Reestr"), instructing it to send the share registers by ordinary post from a central location in Moscow to remote locations around the country, with a view to preventing, or at least delaying, the effectiveness of the seizures, which under Russian law needed to be recorded in the relevant share registers. *See* ¶ 403 *supra*.

1970 *See* ¶¶ 490-506 *supra*. Yukos' management and controlling shareholders caused the company to file a spurious bankruptcy petition in the United States, with the avowed purpose "*to stop the sale of Yuganskneftegaz*." *See In re Yukos Oil Co.*, U.S. Bankruptcy Court for the Southern District of Texas, No. 04-47742-H3-11, Deposition of Steven Theede (Feb. 24, 2005), 321 B.R. (Bankr. S.D. Tex. 2005), 22:20;23:8-11 (Exhibit RME-1540). In addition, in response to the Ministry of Justice's announcement that the YNG shares would be sold to cover Yukos' still unpaid tax bill, Tim Osborne, a director of Group Menatep and a representative of Claimants in these proceedings, threatened sustained and aggressive legal action: "*Whoever buys* [YNG] *is going to be buying themselves a lifetime of litigation*." *See* Guy Faulconbridge, *Yukos Unit Up for Sale at Discount Price*, Moscow Times (Oct. 13, 2004) (Exhibit RME-625).

1971 *See* ¶¶ 528-539 *supra*.

Any Event, No Due Process Violations Cognizable Under Article 13(1)(c) ECT Have Been Established

1276. Nor do Claimants' due process claims establish that the assessments are "*measures having effect equivalent to nationalization or expropriation*."

a) The Alleged Violations Of Due Process Do Not By Themselves Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1277. As set forth at paragraphs 1096 to 1103 above, the jurisdiction of the Tribunal is limited to claims under Article 13(1) ECT, which protects investors from nationalization, expropriation and "*measures having effect equivalent to nationalization or expropriation*," *i.e.*, measures causing total or substantial deprivation of the investment. In the absence of proof of total or substantial deprivation caused by alleged due process violations, such violations by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*." The tribunal in *Feldman v. Mexico* underscored this requirement:

> "While there may be an argument for a violation of Article 1105 [NAFTA] under the facts of this case (a denial of fair and equitable treatment), this Tribunal has no jurisdiction to decide that issue directly. As noted earlier, Article 1105 is not available in tax cases, but may be relevant in the cross-reference of Article 1110(1)(c). The Tribunal does not need to decide whether this cross-reference makes a full Article 1105 consideration appropriate in a tax matter. Even assuming, *arguendo*, that the Respondent's actions in the aggregate do constitute a denial of fair and equitable treatment that reaches the relatively egregious level of a violation of international law, this alone does not establish the existence of an illegal expropriation under Article 1110. As *S.D. Myers* indicates, it may be appropriate for a NAFTA tribunal to find a violation of Article 1105 and at the same time decline to find a violation of Article 1110(1)(c)."[1972]

[1972] *Marvin Feldman v. The Government of Mexico*, ICSID ARB(AF)/99/1, Award (Dec. 16, 2002), ¶ 141 (Annex (Merits) C-964) [italics in original]. *See also Fireman's Fund Insurance Company v. The United Mexican States*, ICSID ARB(AF)/02/01, Award (July 17, 2006), ¶ 174 (Exhibit RME-1141): "In determining whether a State Party to the NAFTA has violated its obligations under Article 1110 of the NAFTA, an arbitral tribunal has to start with the analysis whether an expropriation has occurred. Mexico correctly points out that one cannot start an inquiry into whether expropriation has occurred by examining whether the conditions in Article 1110(1) of the NAFTA for avoiding liability in the event of an expropriation have been fulfilled. That

1278. As set forth at paragraph 1105 above, Claimants have failed to establish that the alleged violations of due process resulted in total or substantial deprivation of their rights as Yukos shareholders.

1279. In any event, as shown above (*see* ¶ 1105 above), the diminution in the value of Claimants' Yukos shares about which they now complain was caused by Claimants themselves, their controlling Oligarchs, and the Yukos directors and officers they installed and repeatedly reappointed to manage their investment in Yukos, and not by the Russian Federation due to wholly to:

(i) Yukos' illegal "tax optimization" scheme;

(ii) Yukos' failure to avail itself of multiple opportunities to pay its 2000 tax year assessment, stemming from its illegal "tax optimization" scheme;

(iii) Yukos' payment instead of an unprecedented US$ 2 billion "giga-dividend," primarily to Claimants;

(iv) Yukos's pre-payment to the Oligarchs' company of a substantial loan obligation;

(v) Yukos' failure either to amend its tax returns, or pay subsequent assessments, for tax years 2001, 2002, and 2003;

(vi) Yukos' repeated and consistent attempts to mislead Russian tax authorities by making spurious and insincere settlement offers;

(vii) Yukos' decision to file unacceptable amended VAT returns;

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would indeed by putting the cart before the horse ('*poner la carreta delante de los caballos*'). Paragraphs (a) through (d) do not bear on the question as to whether an expropriation has occurred. Rather, the conditions contained in paragraphs (a) through (d) specify the parameters as to when a State would not be liable under Article 1110."; *Corn Products International, Inc. v. The United Mexican States*, ICSID ARB(AF)/04/01, Decision on Responsibility (Jan. 15, 2008), ¶ 89 (Exhibit RME-1132): "First, it is important not to confuse the question whether there has been an expropriation with that of whether the four criteria in paragraphs (a) through (d) of Article 1110 have been satisfied. Those paragraphs come into play only if it has been decided that there has been an expropriation, or a measure tantamount to expropriation, but the absence of one or more of them is not in itself indicative of expropriation."

(viii) Yukos' failure during this entire period to file a voluntary bankruptcy petition in Russia, despite its admitted insolvency;

(ix) Yukos' sabotaging of the YNG auction;

(x) Yukos' stripping of valuable assets from the company and its segregation of those assets in Dutch Stichtings;

(xi) Yukos' default on its obligations to the SocGen syndicate, leading the syndicate to commence bankruptcy proceedings against Yukos;

(xii) Yukos' and the Oligarchs' repeated and consistent lies to PwC, and through PwC to Yukos' creditors and the investing public.

b) In Any Event, Claimants Have Failed To Establish Due Process Violations Cognizable Under Article 13(1)(c) ECT

1280. As set forth at paragraphs 1107 to 1108 above, administrative authorities cannot be faulted for conduct upheld by their own courts unless the court system is disavowed at the international level. Further, as established at paragraphs 1109 to 1114 above, where local remedies are sought by the investor or the company in which an investment was made, it is not the function of investment treaty tribunals to act as courts of appeal. In such circumstances, a treaty violation occurs only if it is shown that the relevant court decisions themselves are a violation of the investment treaty, in this case a violation of Article 13(1) ECT.

1281. The treatment of an investor or investment by national courts must be examined in its entirety to determine whether there was a violation of due process or a denial of justice:

> "[T]he experience of an investor in domestic courts may involve a series of decisions, and these decisions should be considered in their entirety."[1973]

[1973] *Limited Liability Company AMTO v. Ukraine*, SCC 080/2005, Final Award (Mar. 26, 2008), ¶ 76 (Annex (Merits) C-989); *Bayindir Insaat Turizm ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID ARB/03/29, Decision on Jurisdiction (Nov. 14, 2005), ¶ 252 (Exhibit RME-1038): "[A] claim based on failure of natural justice in judicial proceedings must take into account the

1282. As confirmed by the tribunal in *Loewen v. United States*, even where one proceeding is clearly improper and incompatible with the minimum standards of international law, due process violations and other illegalities in this proceeding do not by themselves establish a treaty violation if the proceeding is only part of the judicial process available to the parties:

> "In the light of the conclusions reached in paras. 119-123 (inclusive) and 136, the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment. However, because the trial court proceedings are only part of the judicial process that is available to the parties, the rest of the process, and its availability to Loewen, must be examined before a violation of Article 1105 is established."[1974]

1283. The assessment of the conduct of the national courts must include the availability of remedies in the host State's legal system, whether or not such remedies were exercised and, if they were exercised, whether they were exercised wisely. As stated by the tribunal in *AMTO LLC v. Ukraine*:

> "[T]he available means within the host State's legal system to address errors or injustices, and whether or not they were exercised, are relevant to the assessment of the propriety of the outcome. The investor that fails to exercise his rights within a legal system, or exercises its rights unwisely, cannot pass his own responsibility for the outcome to the administration of justice, and from there to the host State in international law."[1975]

1284. The tribunal in *Thunderbird v. Mexico* came to the same conclusion:

> "Finally, the SEGOB proceedings (including the Administrative Resolution) were subject to judicial review before the Mexican courts. The Tribunal notes in this regard that EDM filed a nullification (*juicio de nulidad*) of the 10 October Ruling before the federal tax and administrative court (in which it did not raise any complaint about Lic. Aguilar Coronado's absence at the

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system of justice as a whole, not only an individual decision in the course of proceedings […]."; *Waste Management, Inc. v. United Mexican States,* ICSID ARB(AF)/00/3, Award (Apr. 30, 2004), ¶ 97 (Annex (Merits) C-968).

1974 *Loewen Group Inc and Loewen v. United States of America*, ICSID ARB(AF)/98/3, Award (June 26, 2003), 42 I.L.M. 811 (2003), 833 ¶ 137 (Exhibit RME-1142).

1975 *Limited Liability Company AMTO v. Ukraine*, SCC 080/2005, Final Award (Mar. 26, 2008), ¶ 76 (Annex (Merits) C-989).

> Administrative Hearing). EDM went on to appeal the court's decision on the nullification (*jucio de amparo*), but subsequently withdrew from the proceedings, which decision cannot be attributed to Mexico."[1976]

1285. The tribunal in *EDF v. Romania* specifically elaborated on the rule that an expropriation guarantee in an investment treaty does not protect the investor against confiscatory sanctions imposed by the financial authorities of the host State if the sanction becomes irrevocable as a result of the investor's failure to enforce the rights available to it under the host State's legal system:

> "The analysis convincingly shows that:
>
> a. the Romanian legal system made available to Claimant the necessary means to redress its position if good grounds to that effect had been found to exist;
>
> b. Claimant, through ASRO, did what it believed should have been done in order to obtain the revocation of the confiscatory measures; however, it failed mistakenly (i) to invoke the proper ground under the Civil Procedure Code for requesting the revision of the prior court decision validating the Financial Guard's action, and (ii) to file the recourse within the required time limit;
>
> c. as a result, under an irrevocable decision of the competent court, the sanction applied by the Financial Guard to ASRO was maintained.
>
> The Tribunal has duly noted the fact that due process was assured to Claimant by Romania and that the maintenance of the sanction applied by the Financial Guard to ASRO was due to ASRO's failure to comply with procedural requirements. These requirements, which were known or should have been known to Claimant and ASRO, are, in the Tribunal's view, in keeping with normal procedural rules. Unless a breach of the BIT is otherwise found, which the Tribunal has excluded, the BIT is not an appropriate instrument to provide the investor with a means to enforce rights available to it under the applicable legal system but that it failed to duly and timely invoke."[1977]

1976 *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL, Award (Jan. 26, 2006), ¶ 201 (Exhibit RME-1143).

1977 *EDF (Services) Limited v. Romania*, ICSID ARB/05/13, Award (Oct. 8, 2009), ¶¶ 312-313 (Annex (Merits) C-1001).

(1) The Alleged Due Process Violations In The Tax Proceedings Were Subject To Court Review

1286. Pursuant to Article 138 of the Russian Tax Code, a taxpayer is entitled to challenge any "*acts of the tax authorities*" as well as any "*actions or failure to act of the tax authorities' officials*" before the Arbitrazh Court.[1978]

1287. Rulings handed down at first instance by the Arbitrazh Court may be challenged on appeal before (i) the Appellate Arbitrazh Court, within one month from issuance,[1979] or (ii) the Federal Arbitrazh Court, within two months after the date of the ruling's entry into force.[1980] A ruling at first instance enters into force (i) if it is not appealed before the Appellate Arbitrazh Court within the above-mentioned one month period, or (ii) upon its upholding by the Appellate Arbitrazh Court.[1981] Appellate court rulings are subject to appeal before the Federal Arbitrazh Court within two months from the date of their issuance.[1982]

1288. The scope of the review of the Appellate Arbitrazh Court is *de novo*,[1983] while the Federal Arbitrazh Court exercises a review limited to issues of law and procedure.[1984]

1978 Pursuant to Article 138 of the Russian Tax Code, "[a]*cts of tax authorities*, *actions or failure to act of the tax authorities' officials can be appealed against to a higher tax authority (higher tax official) or a court. Filing a complaint to a higher tax authority (higher tax official) shall not rule out the right to a simultaneous or subsequent filing of a similar complaint with a court.*" (Annex (Merits) C-401).

More generally, in the Russian legal system, any administrative act is subject to judicial review by the Arbitrazh Court (*see*, *e.g.*, Article 198 of the Arbitrazh Procedure Code (Exhibit RME-1670) providing that "[c]*itizens, organizations and other persons have a right to submit to an arbitrazh court an application for declaring invalid non-regulatory acts, or declaring illegal decisions, actions (failure to act) by government bodies, bodies of local administration, other bodies, officials, if they believe that the non-regulatory act being challenged, decision and action (failure to act) do not comply with the law or other regulatory act and violate their rights and lawful interests in the sphere of business and other economic activity, unlawfully impose any obligations on them, create other obstacles for business and other economic activity")*.

1979 Russian Arbitrazh Procedure Code, Art. 257(1) (Exhibit RME-1677) and 259 (Exhibit RME-1678).

1980 Russian Arbitrazh Procedure Code, Art. 273 (Exhibit RME-1681) and 276(1) (Exhibit RME-1682).

1981 Russian Arbitrazh Procedure Code, Art. 180 (Exhibit RME-1679).

1982 Russian Arbitrazh Procedure Code, Art. 271(5) (Exhibit RME-1570) and 276(1) (Exhibit RME-1682).

1983 Russian Arbitrazh Procedure Code, Art. 268(1) (Exhibit RME-1695).

1289. Decisions handed down by the Federal Arbitrazh Court are subject to discretionary judicial review by the Supreme Arbitrazh Court.[1985] When appealing a decision of the Federal Arbitrazh Court, the applicant may also appeal the lower courts' decisions rendered in the same proceedings, in which case the Supreme Arbitrazh Court will review all the appealed decisions (if discretionary review is granted). The Supreme Arbitrazh Court may overrule the ruling of the Federal Arbitrazh Court, amend it or remand the case to the lower court for further consideration.

(2) The Alleged Due Process Violations In The Tax Proceedings Involving Yukos Were Reviewed By The Russian First Instance Courts Or Have Not Been Raised

1290. With the few exceptions discussed below, the purported due process violations Claimants allege in the court proceedings leading to the upholding of the tax assessments—including those for which Claimants feign that "*the Ministry* […] *decided to skip the judicial process*"[1986]—were subject to full

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1984 Russian Arbitrazh Procedure Code, Arts. 286(1) and 286(3), (Exhibit RME-1684). Pursuant to Article 289(5) of the Arbitrazh Procedure Code (Exhibit RME-1685), decisions of the Federal Arbitrazh Court enter into force upon issuance.

1985 Russian Arbitrazh Procedure Code, Art. 292(1) (Exhibit RME-1686). Appeals before the Supreme Arbitrazh Court are admissible only if: (i) all previous levels of appeal (*i.e.*, appellate courts and cassation courts) have been exhausted, (ii) the applicant shows that the decision of the appealed court significantly violated its rights and legal interests with respect to commercial or other economic activities due to a breach or the incorrect application of substantive or procedural rules of Russian law, and (iii) the appeal satisfies at least one of the following limited grounds for review: (x) uniformity in the interpretation and application of rules of law by arbitrazh courts, (y) human rights issues, and (z) issues of public interest or rights and legal interests involving broad categories of persons. *See ibid.*, Art. 292(2) (Exhibit RME-1686), 294 (Exhibit RME-1687), 299 (Exhibit RME-1688) and 304 (Exhibit RME-1689).

1986 Claimants' Memorial on the Merits, ¶ 287. With respect to tax assessments for the years 2001-2003, the tax authorities resorted to the standard executive enforcement procedure for the collection of tax arrears and default interest pursuant to Article 46 of the Tax Code (in force at the relevant time), which provides that the tax authorities may collect taxes and default interest "*by way of sending a collection order to the bank in which the accounts of the taxpayer* […] *have been opened for debiting and transferring the amount of tax from the accounts of the taxpayer* […] *to appropriate budgets/non-budget funds.*" (Exhibit RME-541). Upon expiration of the time limits for Yukos' payment of the amounts set out in the payment demands relating to each of the relevant tax years, the Russian tax authorities were entitled to collect the amounts due directly from Yukos' bank accounts. If there were no or insufficient funds in Yukos' accounts, the tax authorities had the right to collect taxes and default interest against Yukos' other property. Collection of taxes and default interest against Yukos' other property was carried out pursuant to resolution of the tax authority by sending the relevant enforcement resolution to bailiffs within three days from the issuance of such resolution. For instance, with reference to the executive enforcement procedure relating to taxes and default interest for tax year 2001,

judicial review in accordance with the above-mentioned provisions of Russian law, thoroughly scrutinized by Russian courts, and ultimately dismissed on the merits. The few alleged "due process" violations not raised by Yukos in the court proceedings, which Claimants have raised in these arbitrations, are utterly specious.

(a) "Pace" of the court proceedings leading to the upholding of the tax assessments

1291. Claimants allege that the court proceedings leading to the upholding of the tax assessments were "*of incredible speed*,"[1987] an argument that Yukos does not appear to have raised before the Russian courts.

1292. Claimants' allegations are plainly at odds with Article 215(1) of the Arbitrazh Procedure Code, which provides that, at first instance, judgments in tax disputes must be handed down no later than two months after institution of the court proceedings.[1988] The "pace" of these proceedings was thus entirely proper as a matter of Russian procedural law and consistent with the judicial practice at the time. As a factual matter, in 2004—the year in which most of the tax assessments were judicially upheld—97% of first instance court proceedings

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on September 2, 2004, the tax authorities issued tax payment demand No. 133, requesting the payment of taxes and default interest in the amount of RUB 79,279,641,154 (equal to approximately US$ 2.7 billion based on the RUB/US$ exchange rate on September 2, 2004), of which RUB 50,759,436,900 was for taxes and RUB 28,520,204,254 was for default interest by September 4, 2004 (*see* Tax Payment Demand No. 133 (Sept. 2, 2004) (Annex (Merits) C-156). On September 6, 2004, following the expiration of the time limits set out in the related payment demand, the tax authorities issued decision No. 52/595 and ordered that cash on deposit in Yukos' bank accounts be applied to satisfy Yukos' overdue tax liabilities for tax year 2001 (*see* Decision No. 52/595 of the Interregional Tax Inspectorate for Major Taxpayers No. 1 (Sept. 6, 2004) (Annex (Merits) C-159)). Since Yukos did not have sufficient cash in its Russian bank accounts, the Tax Inspectorate issued resolution No. 52/648 to collect taxes and default interest in respect of tax year 2001 against Yukos' other property and sent this resolution to the bailiffs for execution (*see* Resolution No. 52/648 of the Interregional Tax Inspectorate for Major Taxpayers No. 1 (Sept. 8, 2004) (Exhibit RME-1559). On the basis of the tax authorities' resolution the bailiffs then initiated enforcement proceedings (*see* Resolution of Bailiff D. A. Borisov to Initiate Enforcement Proceedings No. 13022/11/04 (Sept. 9, 2004) (Annex (Merits) C-161).

1987 Claimants' Memorial on the Merits, ¶¶ 581 and 587.

1988 *See* Arbitrazh Procedure Code, Art. 215 (Exhibit RME-1566).

in Russia were concluded within this time-period.[1989] The Yukos case was no exception.

(b) Time To Review Documents

1293. Yukos claimed due process violations with respect to its alleged inability to access the case file during the court proceedings relating to the 2000 tax assessments held by Judge Grechishkin.[1990] These allegations—which Claimants now make their own[1991]—are utterly specious.

1294. First, the bulk of the documents presented by the Tax Ministry during the hearing were Yukos' own documents, obtained during the tax audit. Under Article 66(1) of the Russian Federation Arbitrazh Procedure Code, "*copies of documents provided to the court by a person participating in the case shall be also provided by him/her to other parties to the case, if the latter do not have such documents*."[1992] Under the Russian procedural rules, therefore, the Tax Ministry was not required to provide Yukos with advance access to documents that Yukos also had.

1295. Second, Yukos waited until May 14, 2004 to ask the court to order the Tax Ministry to make disclosure.[1993] The court promptly granted that request.[1994] Claimants complain that the documents were "disordered" and "randomly placed in 21 trays," citing Yukos' May 24, 2004 motion to adjourn the court hearing.[1995] This is also incorrect. On May 17, 2004, the Tax Ministry

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1989 *See*, *e.g.*, Table of Main Indicators of Work of the Arbitrazh Courts of the Russian Federation in 2002-2006) (Exhibit RME-1567).

1990 Claimants emphasize that Judge Grechishkin was awarded a state medal in 2005 in recognition for his service on the bench (*see* Claimants' Memorial on the Merits, ¶ 253). Claimants failed to acknowledge, however, that same year, 60 other judges were likewise honored. *See* President of the Russian Federation Decrees "On granting awards of the Russian Federation" (Exhibit RME-1547).

1991 Claimants' Memorial on the Merits, ¶¶ 251, 289, 583-584.

1992 Russian Arbitrazh Procedure Code, Art. 66(1) (Exhibit RME-1571). [emphasis added]

1993 Yukos's Evidence Disclosure Application (May 14, 2004) (Exhibit RME-1581).

1994 *See* Ruling of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (May 14, 2004) (Exhibit RME-1907).

1995 Claimants' Memorial on the Merits, ¶ 251.

disclosed its evidence to Yukos, along with a 16-page index of the documents.[1996] The next day, the Tax Ministry produced a 27-page consolidated register of evidence.[1997] Not surprisingly, Yukos' representatives had no difficulties identifying and referring to particular documents during the hearing.[1998]

1296. Third, despite requesting the documents just before the hearing (apparently hoping for procedural delay), Yukos neither wanted nor used them. Despite its army of lawyers, Yukos sent only a few on May 18 to 20, 2004 to review the documents made available by the Tax Ministry.[1999] And although the documents remained available for examination for another six weeks, from May 21 until June 29 (when the *de novo* trial in the appellate court was concluded), not one Yukos lawyer ever returned to the Tax Ministry to review them. In addition, the documents remained available for review in the court. For these reasons, the Moscow Federal Arbitrazh Court found that the objection, now embraced by Claimants, that Yukos had not been given an adequate opportunity to review the documents lacked any foundation:

> "Thus, the defendants were given the opportunity to review the materials in the case file both in the court (from May to July 2004 - the period the case was under consideration of the first instance and appellate courts) and in the Russia's Ministry of Taxes and Levies offices, as evidenced by the record of the court proceedings. For that reason there appears to be no merit in the argument made by OAO NK Yukos in its cassation appeal as to the violation of the principles of adversarial process and equality of the parties and the

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1996 *See* Letter of the Tax Ministry to the Moscow Arbitrazh Court, No. 14-03-02/2213-1 (May 17, 2004) (Exhibit RME-1582).

1997 *See* Letter of the Tax Ministry to the Moscow Arbitrazh Court, No.14-03-02/2218-1 (May 18, 2004) (Exhibit RME-1908).

1998 *See* Transcript of the hearing held at the Moscow Arbitrazh Court on May 21-26, Case No. A40-17669-04-109-241, 6-7 (Annex (Merits) C-114) indicating that, *e.g.*:"*OAO YUKOS Oil Company pointed to the fact that the letter in case file volume No. 106, p. 163, does not have a date or an address of the entity. OAO YUKOS Oil Company indicated that the letter in case file volume No. 63, p. 58, lacks a date.* […] *OOO YUKOS-Moscow indicated that, on the analytical accounting document in case file volume 176, p. 11–13, there is no signature of the official.*"

1999 Yukos sent two lawyers on the first day, two on the second and three on the third. *See* Transcript of the hearing held at the Moscow Arbitrazh Court on May 21-26, Case No. A40-17669-04-109-241, 2 (Annex (Merits) C-114) indicating that: "[t]*he representatives for OAO YUKOS Oil Company did acquaint themselves with the case file, which is confirmed by one-time passes and applications. On one day, two people acquainted themselves with the materials; on another day – two people; on a third day – three people.*"

absence of the opportunity to examine the documents on record in the case file."[2000]

1297. It is not surprising that Yukos did not devote particular attention to review of these documents. They were not relevant to its defense. Yukos' January 2004 objections to the December 29, 2003 audit report presented to the Tax Ministry, were predominantly legal, not factual.[2001] The same was true in the courts. For instance, Yukos objected to the tax authorities' interpretation of "interdependence," the existence of a "sham company" concept, the imposition of the tax obligations on Yukos rather than the trading shells, the assertion that the shell companies abused the tax exemptions available in the low-tax regions, and the like. Yukos did not contest most of the underlying factual predicates for the Ministry's legal findings.[2002]

1298. Finally, Yukos never pointed to a single document to which it was denied access and neither do Claimants. In fact, when the court found that Yukos had not had an opportunity to review a particular document on which the Tax Ministry wanted to rely, the court refused to allow the document to be entered into the record or ordered an adjournment of the hearing to permit Yukos to inspect the document.[2003] Given the actions of the Russian court,

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2000 [emphasis added]. *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-6914-04-I, B (Sept. 17. 2004), 10 (Exhibit RME-1549). This court decision together with the lower court decisions were upheld by the Presidium of the Supreme Arbitrazh Court on October 5, 2005 (*see* Resolution of the Supreme Arbitrazh Court, Case No. 8665/04 (Oct. 4, 2005); Exhibit RME-1552)

2001 *See* Yukos Objections to the Audit Report for Tax Year 2000 (Jan. 12, 2004) (Exhibit RME-335).

2002 For instance, with regard to the concept of "interdependence," Yukos did not deny the facts as such: "*As a rule, we do not disprove the facts mentioned in the decision of the Ministry of Taxes and Levies of the Russian Federation – rather, we believe they can not provide legal grounds for establishing an interdependency between the persons." (see* Transcript of the Court Hearing Held on June 18, 2004 in the Appellate Instance of the Moscow Arbitrazh Court in Case No. A40-17669/04-109-241 (June 29, 2004), 15 (Exhibit RME-342).

2003 *See* Transcript of the hearing held at the Moscow Arbitrazh Court on May 21-26, Case No. A40-17669-04-109-241, 2 (Annex (Merits) C-114). For instance, with regard to the foundation documents of Korvit and other entities, the court ruled that "*said documents shall not be added to the case files since the respondents did not have an opportunity to review those documents in advance*." The court also refused to add to the record the minutes of the founders' meetings of ZAO Trigor No. 1, dated August 5, 1997, on the ground that the respondents did not have the opportunity to review them in advance: "*The RF Tax Ministry asked that Minutes No. 1 of the meeting of the founders of ZAO Trigor of 5.08.97 be introduced into the case file. The court is of the view that it*

Claimants cannot point to a single specific document relied upon by the Moscow Arbitrazh Court to which Yukos did not have access prior to the May 21, 2004 hearing.

1299. For the reasons discussed above, Judge Grechishkin's denial of Yukos' motions to adjourn the hearing "in order to review all these documents"[2004] was entirely appropriate.

(c) Impartial and Independent Judges Heard The Court Proceedings leading to the upholding of the tax assessments

1. Claimants' Criticism Of The Alleged Removal / Resignation Of Judges Is Unwarranted

1300. Yukos does not appear to have ever complained before the upper level courts in their review of the decision relating to the 2000 tax assessment about the replacement of Judge Cheburashkina and Judge Mikhailova. In any event, Claimants' allegations of "due process" violations in connection with those replacements are meritless.

1301. Claimants assert generally that judges who supported Yukos were forced out of their positions, complaining of: (i) the Tax Ministry's successful challenge to the impartiality of Judge Cheburashkina during Yukos' challenge to the 2000 tax assessment before the Moscow Arbitrazh Court,[2005] and (ii) the decision by Judge Mikhailova, the judge appointed to replace Judge Cheburashkina, to have herself recused (before hearing any evidence or making any decisions) based on a pre-existing relationship with one of Yukos' counsel that raised doubts as to her ability to act impartially in the case.[2006] These allegations are meritless.

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should refuse to introduce this indicated document into the case file, since the respondents were not familiarized with that document in advance." See also, e.g., ibid, 1, 7.

2004 Claimants' Memorial on the Merits, ¶ 251.

2005 Claimants' Memorial on the Merits, ¶ 248; *see also ibid*., ¶ 583.

2006 *See ibid.*, ¶¶ 248, 584.

(i) Review of the documents cited by Claimants shows that the removal of Judge Cheburashkina was sought — and presumably granted — to preserve an impartial decision-making process and was fully consistent with Russian law. The Tax Ministry challenged Judge Cheburashkina because she had, *inter alia*, violated certain procedural norms, in particular by preventing the Russian Federation from presenting evidence, which raised reasonable suspicions of her partiality.[2007] After reviewing the Tax Ministry's challenge and hearing from opposing counsel, the First Deputy Chairman of the Moscow Arbitrazh Court found it "*necessary*" to transfer Yukos' challenge to another judge of the court "*in order to avoid bias and interest in the outcome of the proceedings, and in order to obey the procedural and substantive law*."[2008] Claimants fail to explain how this decision was even a misapplication of Article 21(5) of the Arbitrazh Procedure Code, much less a gross departure cognizable as a deprivation of due process under international law.[2009]

(ii) Claimants' allegations concerning the recusal of Judge Mikhailova are similarly misplaced. The Moscow Arbitrazh Court accepted Judge Mikhailova's resignation — offered by the judge before she made any decisions regarding the 2000 tax resolution — after her impartiality was called into question by, *inter alia*, the undisputed fact that she had published articles in a journal edited by Sergey Pepeliayev, a lawyer who represented Yukos in the very case about to be put before her, and she published a book that he edited.[2010] Judge Mikhailova cited as grounds for resignation the fact that she

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2007 *See* Tax Ministry's Challenge to Judge N.P. Cheburashkina (June 11, 2004) (Annex (Merits) C-117).

2008 *See* Ruling of the Moscow Arbitrazh Court, Case No. 76-276 (June 11, 2004), 2 (Annex (Merits) C-118).

2009 Russian Arbitrazh Procedure Code, Article 21(5) (Exhibit RME-1590).

2010 *See* Ruling of the Moscow Arbitrazh Court, Case No. A40-21839/04 76-276 (July 19, 2004) (Annex (Merits) C-139).

regarded "*statements in the mass media*" related to the case as "*psychological pressure on the court in order to avoid an impartial hearing of th*[e] *case*."[2011] Claimants offer no evidence that the concerns expressed by the Tax Ministry — rather than Yukos' hyperactive media blitz — was the cause of Judge Mikhailova's resignation. Nor do they explain why the decision of the Moscow Arbitrazh Court to accept Judge Mikhailova's resignation was a misapplication of Article 21(5) of the Arbitrazh Procedure Code, much less a gross departure cognizable as a deprivation of due process.[2012]

2. Claimants' Criticisms Of Judges Korotenko And Dzuba Are Unwarranted

1302. Claimants allege that Judges Korotenko, a judge who reviewed Yukos' challenge to the 2001 tax assessment, and Judge Dzuba, a judge who reviewed Yukos' challenge to the 2002 tax assessment, were not impartial judges because Yukos' challenges of these judges were rejected. Yukos complained

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2011 *Ibid.*

2012 Claimants also cite to the alleged removal of Judge Vlada Bliznets, who, according to Claimants, was "another Moscow Arbitrazh Court judge who had proved insufficiently pliant in cases related to Yukos." Claimants' Memorial on the Merits, ¶ 585. Citing to press reports, Claimants contend that Judge Bliznets was fired for making "favorable decisions to the structures closely connected with Yukos." *Ibid.* But it is undisputed that Judge Bliznets was not assigned to any of Yukos' tax cases. Moreover, Judge Bliznets was not removed from any particular case, but instead her powers as a judge were terminated based on her commission of disciplinary offenses in a non-Yukos-related case. The article cited by Claimants in fact shows that Judge Bliznets was terminated for, *inter alia*, deferring judicial tasks to third parties, and then failing to take responsibility for her conduct during the course of the resulting judicial investigation (*Yukos Case Ricochets the Courts: Arbitrage Judge Was Fired for Making Favorable to YUKOS Decision*, Kommersant (July 25, 2005), 2 (Annex (Merits) C-761)). That disqualification decision was taken by a Higher Qualification Council of Judges, then twice considered and affirmed by the Supreme Arbitrazh Court of the Russian Federation. The Supreme Arbitrazh Court concluded that Judge Bliznets had "*committed gross negligence and violation of the procedure law*." Specifically, the Supreme Court explained that: "*Judge B. without any legal grounds intentionally changed the date of preparation of the resolution dated December 24, 2004 to December 28, 2004, which was accompanied by replacement of the sheets of its statement of reasons, which is unacceptable*." *See* Decision of the Supreme Court of the Russian Federation, Case No. GKPI05-823 (July 20, 2005) 4 (Exhibit RME-1594); *see also* Decision of the Supreme Court of the Russian Federation, No. KAS05-385 (Aug. 16, 2005) (Exhibit RME-1572). In any event, Claimants have offered no evidentiary link between the termination of Judge Bliznets and the tax proceedings against Yukos.

before the upper level courts that the challenge of the 2001 and 2002 tax assessments was considered by inappropriate judges. Having found no violations of Russian procedural law, the upper level courts dismissed Yukos' complaints.[2013]

1303. In these arbitrations, Claimants argue that the first instance proceedings concerning the 2001 resolution were held improperly before Judge Korotenko, who had previously chaired the appeal panel of the Moscow Arbitrazh Court that reviewed the May 26, 2004 decision upholding the 2000 tax assessment.[2014] Yukos' actions with respect to Judge Korotenko reinforce that Yukos engaged in abusive litigation tactics, not that Yukos was denied due process by a partial judge. Indeed, the Tax Ministry, not Yukos, had challenged Judge Korotenko's prior service as chairman of the Moscow Arbitrazh Court appeal panel that considered the decision upholding the 2000 tax assessment. Yukos (and Yukos-Moscow) did not agree with that challenge, and the Tax Ministry's motion was denied.[2015] Although Yukos would not support the removal of Judge Korotenko, it did earlier seek to remove the entire panel of judges, including Judge Korotenko. That motion, like the Tax Ministry's motion, was denied.[2016]

1304. After the 2000 tax assessment was affirmed by the appeals panel, Judge Korotenko was assigned to hear the case relating to the 2001 tax assessment in the first instance. Having been dissatisfied with the appellate

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2013 With respect to the challenge to Judge Korotenko, *see* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP -40/05-AK (Feb. 16, 2005), 24 (Annex (Merits) C-167). This court decision was upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588). The Supreme Arbitrazh Court did not find grounds for discretionary review of this case (*see* Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb. 20, 2006) (Exhibit RME-589)).

With respect to the challenge to Judge Dzuba, *see* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005), 55 (Exhibit RME-253). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KA-A40/3222-05 (June 30, 2005), 4-5 (Exhibit RME-1569).

2014 Claimants' Memorial on the Merits, ¶ 258.

2015 Transcript of the Court Hearing Held on June 18, 2004 in the Appellate Instance of the Moscow Arbitrazh Court in Case No. A40-17669/04-109-241 (June 29, 2004), 50 (Exhibit RME-342).

2016 *Ibid.*, 9.

decision concerning the 2000 tax assessment, Yukos sought to remove Judge Korotenko on the basis that the judge had been involved in the proceedings on the appeal against the May 26, 2004 decision with respect to the 2000 tax assessment.[2017] But Yukos then, and Claimants today, could not point to any Russian procedure or rule that would prohibit a judge from hearing related or similar cases.[2018] The same would be true in many other judicial systems, including those of the United States. Thus, it is not surprising that Yukos' challenge to Judge Korotenko was denied.

1305. Claimants similarly argue that Judge Dzuba was partial and should not have been permitted to participate in the judicial proceedings concerning the challenge of the 2002 tax resolution and collection of related fines on the basis that the judge had been involved in proceedings for the collection of fines for the year 2001.[2019] Again, however, Claimants point to no rule of Russian law or procedure that would prevent a judge from hearing related or similar cases.

(d) Yukos' Motions To Join Third Parties To The Court Proceedings And Appoint An Expert Were Misplaced

1306. Claimants also recycle Yukos' alleged "due process" violations[2020] with respect to the dismissal by Judges Grechishkin, Korotenko, and Dzuba of various motions raised by Yukos to "*join*" the trading shells in the court proceedings leading to the upholding of the 2000,[2021] 2001,[2022] and 2002[2023] tax

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2017 Claimants' Memorial on the Merits, ¶ 258.

2018 Under Russian law, a judge would only be precluded from hearing the same case in another instance court, if he or she has already participated in considering the case in one of the instances. *See* Arbitrazh Procedure Code, Art. 22 (Exhibit RME-1590).

2019 Claimants' Memorial on the Merits, ¶ 261.

2020 Claimants do not point to any specific flaw in Judge Korotenko's and Judge Dzuba's refusal to join Yukos' trading companies to the proceedings. Indeed, as Claimants concede, those decisions were consistent with one another.

2021 Claimants' Memorial on the Merits, ¶ 252, 289. In the court proceedings with respect to tax year 2000, Yukos sought to join trading shells as third parties making no independent claims with respect to the subject of the dispute. *See* Transcript of the hearing held at the Moscow Arbitrazh Court on May 21-26, 2004, 11 (Annex (Merits) C-114).

assessments.[2024] Yukos complained before the upper level courts that such dismissals were inappropriate. Having found no violations of Russian procedural law, the upper level courts dismissed Yukos' complaints.[2025]

1307. These contentions are utterly specious, and Yukos' motions constitute yet further examples of Yukos' abuses of the judicial process.[2026]

1308. Pursuant to Articles 50 and 51 of the Arbitrazh Procedural Code, a third party may be joined in Russian civil proceedings insofar as it has: (i) an

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2022 Claimants' Memorial on the Merits, ¶ 252, 289. In the court proceedings with respect to tax year 2001, Yukos sought to join trading shells as third parties making independent claims with respect to the subject of the dispute. *See* Transcript of the hearing held at the Moscow Arbitrazh Court on Nov. 16-17, 2004, 2 (Annex (Merits) C-166).

2023 Claimants' Memorial on the Merits, ¶ 261. In the court proceedings with respect to tax year 2002, Yukos slightly modified its motion to join the trading shells in the court proceedings. Yukos as claimant in these proceedings attempted to join the trading shells as co-respondents in the court proceedings against the tax authorities. Yukos, however, failed to substantiate any claims against the trading shells. *See* Transcript of the Preliminary Hearing held at the Moscow Arbitrazh Court on Dec. 8-9, 2004, 2 (Annex (Merits) C-181).

2024 Claimants' Memorial on the Merits, ¶ 252, 289.

2025 With respect Yukos' motion to join trading shells to the court proceedings:

(i) on the 2000 tax assessment, *see* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121); Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/6914-I,B (Sept. 17, 2004), 9 (Exhibit RME-1549).

(ii) on the 2001 tax assessment, *see* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP -40/05-AK (Feb. 16, 2005), 24 (Annex (Merits) C-167). This court decision was upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588). The Supreme Arbitrazh Court did not find grounds for discretionary review of this case (*see* Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb. 20, 2006) (Exhibit RME-589)).

(iii) on the 2002 tax assessment, *see* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005), 55 (Exhibit RME-253). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KA-A40/3222-05 (June 30, 2005), 4-5 (Exhibit RME-1569).

2026 Another notable example of Yukos' abuses of the judicial process in the first instance proceedings included Yukos' requests to postpone the hearing for 233 working days based on the false pretense that it would only have one lawyer working on the matter (*see* OAO NK Yukos, Calculation of Time Required for Familiarization with the Presented Case Files Submitted by Yukos with the Moscow Arbitrazh Court (May 21, 2004) (Exhibit RME–1551). In yet another instance, Yukos asked the Tax Ministry to disclose documents confirming the state registration of its own trading shells (*see* Ministry of Taxes and Levies of the Russian Federation, Response to the Motion on Disclosure of Evidence, No. 14-3-02/2287-2, Case No. A40-17669/04-109-241 (May 20, 2004) (Exhibit RME-1550).

interest that might be affected as a result of the proceedings;[2027] or (ii) an independent claim with respect to the subject matter of a dispute.[2028] Pursuant to Article 44 of the Arbitrazh Procedure Code a co-defendant may be joined in Russian civil proceedings insofar as it may be subject to a claim by one of the original parties in the proceedings.[2029]

1309. It is clear, however, that the proceedings which ultimately sustained the tax assessments at issue could not have affected the trading shells, insofar as: (i) the subject matter of those proceedings was the assessments of taxes against Yukos, not the trading shells; (ii) in any event Yukos did not raise any claims against the trading shells; and (iii) for the reasons discussed at paragraphs 237 to 243 above, the trading shells were mere shams and thus not capable of claiming any rights or being subject to any claim by Yukos.

1310. Perhaps the best evidence that Claimants' contentions lack substance is that Yukos itself vigorously opposed the Tax Ministry's similar application to join the trading shells in the parallel proceedings Yukos had instituted against the 2000 tax assessment on the grounds, *inter alia*, that the tax assessment "*does not affect the rights and obligations*" of the trading shells.[2030]

1311. In addition, Claimants allege that Judge Grechishkin improperly "*ignored Yukos' motion to join as a third party to the proceedings the Government of the Republic of Mordovia*,"[2031] an argument that Yukos had raised in the court proceedings as well.

1312. Claimants' contentions are meritless because, just like the trading shells, the Mordovian Government could not conceivably be deemed to have any interest in the outcome of proceedings which centered on the legality of tax

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2027 Russian Arbitrazh Procedure Code, Art. 51 (Exhibit RME–1573).

2028 Russian Arbitrazh Procedure Code, Art. 50 (Exhibit RME–1574).

2029 Russian Arbitrazh Procedure Code, Art. 44 (Exhibit RME–1575).

2030 *See* Yukos' Objections Against Joining Third Parties into the Proceedings, Case No. A40-21839/04-76-276 (May 28, 2004) (Exhibit RME-1548).

2031 Claimants' Memorial on the Merits, ¶252, 289.

assessments against Yukos. The Arbitrazh Court reviewed this matter and found no procedural violations.[2032]

1313. Finally, Claimants allege that during the first instance court proceedings relating to the 2001-2002 tax assessments,[2033] Judge Korotenko and Judge Dzuba improperly refused to grant Yukos' motions for the appointment of an expert to establish whether the oil prices at which the trading shells had traded oil and oil products among themselves in furtherance of Yukos' "tax optimization" scheme satisfied the requirements of the transfer pricing rules pursuant to Article 40 of the Tax Code.[2034] Yukos raised this objection in the court proceedings with respect to the 2002 tax assessment and the courts dismissed it.[2035]

1314. This contention too is meritless. As explained by Mr. Konnov in his expert report, the tax assessments against Yukos did not rest on the Article 40 transfer pricing rules.[2036] Rather, they were based on Yukos' failure to comply,

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2032 Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121). Specifically, Yukos made demonstrably frivolous suggestions that (i) the court's decision in this case could evidence illegality in Mordovian authorities' actions in granting benefits to Yukos' trading shells, and that (ii) as a result of the court's decision, Yukos' trading shells would gain the right to demand reimbursement of the tiny portion of taxes they paid to the Republics budget.

2033 Claimants' Memorial on the Merits, ¶ 258.

2034 Claimants do not point to any specific flaw in Judge Korotenko's and Judge Dzuba's resolution of Yukos' motions to call an expert witness on oil pricing. Indeed, as Claimants concede, those decisions were consistent with one another.

2035 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005), 35-36 (Exhibit RME-253): "*The appellate court considers the OAO NK YUKOS's argument that the court unlawfully refused to grant its motion for expert analysis unjustified. The issues raised by OAO NK YUKOS in the motion, which, in the taxpayer's opinion, require special knowledge to address, are not related to the subject of the examined dispute, since the tax body did not control the accuracy of the taxpayer's application of market prices. At the same time, the issues involved in this dispute and subject to examination by the court in this case do not require any special knowledge. Thus, for example, no special knowledge is required to establish that the price of RUR 5 thousand, at which oil was exported by OAO NK YUKOS allegedly acting as a commission agent, was five times higher than the price of RUR 1 thousand, at which the same officer of OAO NK YUKOS sold oil on behalf of a producing company to a dummy entity.*" This court decision was upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3222-05 (June 30, 2005) (Exhibit RME-1569).

Yukos did not raise this objection with respect to its similar motion in the court proceedings on the 2001 tax assessment.

2036 Claimants' Memorial on the Merits ¶ 258.

inter alia, with the federal anti-avoidance rules requiring, among other things, that a taxpayer's investments in the low-tax region be proportionate to the tax benefits received.[2037] Therefore, the Arbitrazh Court's refusal to appoint the expert was entirely proper.

(3) Claimants Have Failed To Raise Or Establish Due Process Violations In The Court Proceedings Upholding The Tax Assessments

1315. All of Yukos' challenges of the tax assessments underwent substantial judicial review not only at first instance, as discussed above, but also at the appellate level, as well as the cassation level and, in some instances, even at the discretionary level of the Supreme Arbitrazh Court.

1316. Claimants do not seem to allege any due process violation with respect to the appellate proceedings brought before the Arbitrazh Appellate Court, the Federal Arbitrazh Court or the Supreme Arbitrazh Court. Nor do Claimants seem to suggest that these higher court proceedings were somehow improper. In fact, Claimants take issue only with respect to four first instance court proceedings out of 28 court proceedings in which the complained-of assessments and lower court rulings were scrutinized.[2038] Moreover, Claimants

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2037 *See* ¶¶ 279-296, 992-1002 *supra; see also* Konnov Report, ¶¶ 39-52.

2038 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-17699/07-109-241 (May 26, 2004) (Annex (Merits) C-116), Decision of the Moscow Arbitrazh Court, Case No. A40-21839/04-76-276 (Sept. 2, 2004) (Exhibit RME-1554), Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92/A40-54628/04-143-134 (Nov. 18, 2004) (Exhibit RME-252), Decision of the Moscow Arbitrazh Court, Case No. A40-61058/04-141-151/A40-63472/04-141-162 (Dec. 23, 2004), 3 (Exhibit RME-1563).

The reason Claimants do not raise issues of procedural propriety with respect to many of the court proceedings is likely to be found in Yukos' constant abuses of the judicial process. Thus, for instance, at the hearing for the appeal of Judge Grechishkin's May 26, 2004 decision (which took place between June 21 and June 28), Yukos and Yukos-Moscow presented a large number of dilatory motions, including eight separate motions to adjourn or to stay the proceedings, and a motion to disqualify the entire panel of judges, although Yukos-Moscow had previously objected to the Tax Ministry's challenge to Judge Korotenko. On the penultimate day of the hearing, the Court gave the following warning to Yukos and Yukos-Moscow: "[t]*he court finds that OAO NK YUKOS and OOO YUKOS-Moscow are taking intentional steps designed to delay the proceedings and violate the rules of procedure established by the court in the present case, as well as disturb order in the courtroom, which is to be imposed by the Presiding Judge pursuant to Article 153 of the Arbitrazh Procedure Code of the Russian Federation.* […] *In view of the above, and in the manner envisaged by Article 154 of the Arbitrazh Procedure Code of the Russian Federation, the court of appellate instance issues a warning notice to the interested parties, to be entered in the transcript of the court hearings, and points to their obligation of*

do not seem to raise any specific allegations of due process violations with respect to any of the court proceedings upholding the 2003 tax assessment (which accounts for approximately 25% of the overall tax assessment against Yukos).[2039]

1317. Specifically, Claimants do not allege any procedural improprieties with respect to the following proceedings:

(i) the appellate and the higher instance court proceedings upholding the first instance Arbitrazh Court decisions relating to the 2000 tax assessment[2040] and the respective payment demands issued by the Tax Ministry;[2041]

(ii) the appellate and the higher instance court proceedings upholding the first instance Arbitrazh Court decisions relating to the 2001 tax assessment, the respective payment demands and the executive enforcement proceedings;[2042] and

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conscientious use of their procedural rights." (Transcript of the Court Hearing Held on June 18, 2004 in the Appellate Instance of the Moscow Arbitrazh Court in Case No. A40-17669/04-109-241 (June 29, 2004), 62 (Exhibit RME-342).

2039 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9/A40-7780/05-98-90, (Apr. 28, 2005) (Annex (Merits) C-196), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7979/05-AK (Aug. 16, 2005) (Exhibit RME-251), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KZ-A40/11321-05 (Dec. 5, 2005) (Annex (Merits) C-197), Ruling of the Supreme Arbitrazh Court, No. 12304/05 (Feb. 22, 2006) (Exhibit RME-1565) (all with respect to joint proceedings upon Yukos' challenge of the 2003 tax assessment and the tax authorities' application for the collection of the related fines).

2040 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), (Annex (Merits) C-121), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/6914-I,B (Sept. 17, 2004) (Exhibit RME-1549), Resolution of the Supreme Arbitrazh Court, Case No. 8665/04 (Oct. 4, 2005) (Exhibit RME-1552) (all with respect to tax authorities' application for the collection of the 2000 tax assessment) *See also* Resolution of the Ninth Arbitrazh Appellate Court, No. AP-4078/04-AK (Nov. 23, 2004) (Annex (Merits) C-147), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12571-04 (Dec. 30, 2005) (Exhibit RME-1555) (all with respect to Yukos' challenge of the 2000 tax assessment).

2041 *See* Ruling of the Moscow Arbitrazh Court, Case No. A40-36683/04-80-355 (Sept. 22, 2004) (Exhibit RME-1556), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-4694/04-AK (Dec. 2, 2004) (Exhibit RME-1557), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1612-05 (Mar. 16, 2005) (Exhibit RME-1558).

2042 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP -40/05-AK dated Feb. 16, 2005 (Annex (Merits) C-167), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588), Ruling of the Supreme

(iii) the appellate and the higher instance court proceedings upholding the first instance Arbitrazh Court decisions relating to the 2002 tax assessment and the respective payment demands,[2043] and the court proceedings confirming related executive enforcement procedure.[2044]

6. The Alleged Political Nature Of The Measures Complained Of Does Not Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*" And, In Any Event, No Lack Of Public Interest Has Been Established

1318. As set forth below, the absence of a public interest underlying a measure by itself does not establish "*measures having effect equivalent to nationalization or expropriation*," and in any event, Claimants have utterly failed to prove their central contention of the existence of a politically-driven conspiracy against Mr. Khodorkovsky and to renationalize Yukos, involving the Russian Government at all levels and scores of leading international banks and industrial companies, among others, around the world, as discussed at length in Section III., above.

Arbitrazh Court, Case No. 7801/05 (Feb. 20, 2006) (Exhibit RME-589) (all with respect to Yukos' challenge of the 2001 tax assessment). *See also* Decision of the Moscow Arbitrazh Court, Case No. A40-45410/04-141-34 (Oct. 15, 2004) (Exhibit RME-542), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-4414/04-AK (Nov. 18, 2004) (Exhibit RME-254), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA–A40/13060-04 (Nov. 15, 2005) (Annex (Merits) C-168) (all with respect to the tax authorities' application for collection of 2001 fines).

2043 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-424/05-AK (Mar. 5, 2005) (Exhibit RME-253), Resolution of the Federal Arbitrazh Court of the Moscow District, No. KA-A40/3222-05 (June 30, 2005) (Exhibit RME-1569) (all with respect to joint proceedings upon Yukos' challenge of the 2002 tax assessment and the tax authorities application for the collection of related fines).

2044 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-68502/04-127-742 (Feb. 7, 2005) (Exhibit RME-590), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-2281/05-AK (Apr. 4, 2005) (Exhibit RME-591), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4941-05 (June 15, 2005) (Exhibit RME-592), Ruling of the Supreme Arbitrazh Court, Case No. 11868/05 (Oct. 12, 2005) (Exhibit RME-593).

a) Lack Of Public Interest By Itself Does Not Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1319. As set forth at paragraphs 1096 to 1103 above, Article 13 ECT protects investors from nationalization, expropriation, and "*measures having effect equivalent to nationalization or expropriation*," *i.e.*, measures causing a total or substantial deprivation of an investment. Claimants thus have the burden of showing that the measures complained of that were allegedly not "*for a purpose which is in the public interest*" caused a total or substantial deprivation of their rights as Yukos shareholders.

1320. In the absence of proof of total or substantial deprivation caused by the measures complained of, such measures do not amount to "*measures having effect equivalent to nationalization or expropriation*," whether or not they were "*for a purpose which is in the public interest.*"[2045]

1321. As set forth at paragraphs 1105 above, Claimants have failed to establish that the allegedly politically motivated measures complained of resulted in a total or substantial deprivation of their rights as Yukos shareholders.

1322. In any event, as shown above (*see* ¶ 1105 above), the diminution in the value of Claimants' Yukos shares about which they now complain was caused by Claimants themselves, the Oligarchs, and the Yukos directors and officers they installed and repeatedly reappointed to manage their investment in

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2045 Article 13(1)(a) ECT. *See also Glamis Gold, Ltd. v. United States of America*, UNCITRAL, Award (June 8, 2009), ¶ 356 (Exhibit RME-1107): "There is for all expropriations, however, the foundational threshold inquiry of whether the property or property right was in fact taken"; *Fireman's Fund Insurance Company v. The United Mexican States*, ICSID ARB(AF)/02/01, Award (July 17, 2006), ¶ 174 (Exhibit RME-1141): "Mexico correctly points out that one cannot start an inquiry into whether expropriation has occurred by examining whether the conditions in Article 1110(1) of the NAFTA for avoiding liability in the event of an expropriation have been fulfilled. That would indeed be putting the cart before the horse ('*poner la carreta delante de los caballos*'). Paragraphs (a) through (d) do not bear on the question as whether an expropriation has occurred. Rather, the conditions contained in paragraphs (a) through (d) specify the parameters as to when a State would not be liable under Article 1110."; *Corn Products International, Inc. v. The United Mexican States*, ICSID ARB(AF)/04/01, Decision on Responsibility (Jan. 15, 2008), ¶ 90 (Exhibit RME-1132); *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v. The United Mexican States*, ICSID ARB(AF)/04/05, Award (Nov. 21, 2007), ¶ 251 (Exhibit RME-1108).

Yukos, and not by the Russian Federation, due wholly to conduct that includes the following:

(i) Yukos' illegal "tax optimization" scheme;

(ii) Yukos' failure to avail itself of multiple opportunities to pay its 2000 tax year assessment, stemming from its illegal "tax optimization" scheme;

(iii) Yukos' payment instead of an unprecedented US$ 2 billion "giga-dividend," primarily to Claimants;

(iv) Yukos's pre-payment to the Oligarchs' company of a substantial loan obligation;

(v) Yukos' failure either to amend its tax returns, or pay subsequent assessments, for tax years 2001, 2002 and 2003;

(vi) Yukos' repeated and consistent attempts to mislead Russian tax authorities by making spurious and insincere settlement offers;

(vii) Yukos' decision to file unacceptable amended VAT returns;

(viii) Yukos' failure during this entire period to file a voluntary bankruptcy petition in Russia, despite its admitted insolvency;

(ix) Yukos' sabotaging of the YNG auction;

(x) Yukos' stripping of valuable assets from the company and its segregation of those assets in Dutch Stichtings;

(xi) Yukos' default on its obligations to the SocGen syndicate, leading the syndicate to commence bankruptcy proceedings against Yukos;

(xii) Yukos' and the Oligarchs' repeated and consistent lies to PwC, and through PwC to Yukos' creditors and the investing public.

b) Claimants Have Failed To Establish That The Measures Complained Of Were Not For A "*Purpose Which Is In The Public Interest*"

1323. As set forth at paragraphs 958 to 959 above, an investor and a company in which a foreign investment has been made are obliged to abide by host State laws. Neither an investor nor a local company in which an investor has made an investment may claim a right to non-enforcement of the laws and regulations in force in the host State. Specifically, it is a universally recognized principle that no one has a right to be exempted from the enforcement of applicable laws and regulations by alleging the State's failure to enforce a law or regulation in force in other instances or the State's "improper" motivation in enforcing mandatory laws and regulations.[2046] As confirmed by the tribunal in *Rumeli v. Kazakhstan*, execution of the laws of the host State and, in particular collection of taxes, is necessarily in the public interest.[2047]

1324. Specifically, the purposes justifying imposition and enforcement of taxes, including severe penalties, fines and other sanctions in case of non-compliance of taxpayers with their obligations to pay taxes, are firmly recognized in international law.[2048] Equally, measures to prevent and discourage tax evasion, including selective tax enforcement, are recognized as having a legitimate objective which is in the public interest.[2049]

1325. Given the high measure of deference that international law extends to the right of domestic authorities to enforce a State's laws within its own

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2046 *See* Section VI.C.3.c.4.

2047 *See Rumeli Telekom A.S. and Tesim Mobil Telekoikasyon Hizmetleri A.S. v. Republic of Kazakhstan*, ICSID ARB/05/16, Award (July 29, 2008), ¶ 705 (Annex (Merits) C-992).

2048 *E.g.*, OECD, The Multilateral Agreement on Investment, Draft Consolidated Text (Apr. 22, 1998), 86-87, Article VIII and notes (Exhibit RME-1121); Ian Brownlie, *International Law at the Fiftieth Anniversary of the United Nations: General Course on Public International Law*, 255 Rec. des Cours 9 (1995), 143 (Exhibit RME-1122); George C. Christie, *What Constitutes a Taking of Property under International Law?*, 38 B.Y.I.L. 307 (1962), 331-332 (Annex (Merits) C-1021); JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES (2010), 56 (Exhibit RME-1127); *EnCana Corporation v. Republic of Ecuador*, LCIA UN3481, UNCITRAL, Award (Feb. 3, 2006), ¶ 177 (Annex (Merits) C-976).

2049 *E.g.*, *Case of Hentrich v. France*, ECHR, Application No. 13636/88, Judgment (Sept. 22, 1994), 296-A Publications of the European Court of Human Rights, Series A: Judgments and Decisions 7 (1994), 19, 21 ¶¶ 39, 47 (Exhibit RME-1140).

borders, measures that bear some plausible relationship to law enforcement must be deemed to have been taken for a "*purpose which is in the public interest*":

> "A State's declaration that a particular interference with an alien's enjoyment of his property is justified by the so-called 'police power' does not preclude an international tribunal from making an independent determination of this issue. But, if the reasons given are valid and bear some plausible relationship to the action taken, no attempt may be made to search deeper to see whether the State was activated by some illicit motive."[2050]

1326. Certainly, as recently confirmed by the tribunal in *AES v. Hungary*, the fact that the measures taken become politicized, as they have in this instance as a result of Claimants' and their controlling Oligarchs' massively funded public relations campaign,[2051] does not signal the absence of a public interest.[2052]

1327. In any event, Claimants must meet a high burden of proof to sustain the central theme of their claims, which is that the Russian Federation's actions that allegedly caused a total or substantial deprivation of Claimants' rights as Yukos shareholders, through the coordinated actions of all branches of power, at all levels, and implemented by literally hundreds of officials, including

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2050 George C. Christie, *What Constitutes a Taking of Property under International Law?*, 38 B.Y.I.L. 307 (1962), 338 (Annex (Merits) C-1021). *See also*, *ibid.*, 332: "But it certainly would seem that if the facts are such that the reasons actually given are plausible, search for the unexpressed 'real' reasons is chimerical. No such search is permitted in municipal law, and the extreme deference paid to the honour of States by international tribunals excludes the possibility of supposing that the rule is different in international law."; *Antoine Goetz and others v. Republic of Burundi*, ICSID ARB/95/3, Award (Feb. 10, 1999), 15 ICSID Rev. 513 (2000), 513-514 ¶ 126 (Exhibit RME-1144): "[U]ne mesure telle que celle qui a été prise à l'encontre d'AFFIMET n'est internationalement licite que si 'des impératifs d'utilité publique, de sécurité ou d'intérêt national l'exigent exceptionnellement'. C'est de toute évidence au regard du droit national burundais que cette condition doit s'apprécier. […] En l'absence d'erreur de droit ou de fait, d'erreur manifeste d'appréciation ou de détournement de pouvoir, il n'appartient pas au Tribunal de substituer son propre jugement à l'appréciation faite discrétionnairement par le Gouvernement du Burundi des 'impératifs d'utilité publique… ou d'intérêt national'." "[A] measure such as that taken against AFFIMET is not internationally lawful unless 'exceptionally required by imperatives of public utility, security or national interest.' It is very evidently according to Burundi law that this condition must be assessed. [...] In the absence of legal or factual error, manifest error of assessment or abuse of power, it is not for the Tribunal to substitute its own judgment for the discretionary assessment made by the Government of Burundi of 'imperatives of public utility... or national interest'." [unofficial translation] [emphases added]

2051 *See* Section III. above.

2052 *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Republic of Hungary*, ICSID ARB/07/22, Award (Sept. 23, 2010), ¶¶ 10.3.23-10.3.24 (Exhibit RME-1103).

more than 60 judges, with the collaboration of leading international commercial banks, industrial corporations, accountants, and appraisers around the globe, were all "motivated by the twin desire to remove Mr. Khodorkovsky as a potential political opponent and to appropriate Yukos' assets."[2053] Claimants have entirely failed to meet that burden.

(1) Claimants Must Meet A High Burden Of Proof To Sustain Their Conspiracy Theory

1328. As stated in *Tokios Tokelès v. Ukraine*, Claimants bear the burden of alleging and proving each of the elements necessary to establish a politically motivated, concerted effort by the Russian tax authorities, the Presidential Administration, the Ministry of Justice, the Federal Property Fund, the Prosecutor General, the judiciary at all levels, and State companies, aided by the willful assistance of scores of leading international commercial banks, industrial corporations, and business professionals worldwide, to remove Mr. Khodorkovsky as a political opponent and to appropriate Yukos' assets:

> "Having set forth the arguments of the parties, we return to the central question of this dispute: why did the tax authorities take these actions against Taki spravy? Did the authorities initiate and carry out these actions to punish Taki spravy for producing campaign materials for political opponents of the government, as Claimant alleges? Or did the authorities' investigation of fictitious enterprises with which Taki spravy had business relations naturally and justifiably lead them to investigate Taki spravy, as Respondent maintains?[2054]
>
> Notwithstanding these grounds for skepticism, we might have regarded the issues as very finely balanced, if the existence of a nayizd had been the only feasible explanation of what took place. But this is not so. […] There is thus an entirely plausible alternative to the hypothesis of nayizd. It is not for the State to prove that Taki spravy was guilty of economic offences, and the relevance of this material is simply to show that the Claimant is in error in asserting that the events have no credible alternative explanation other than a concerted, malicious and politically inspired campaign. Once this alternative is on the table it is in our opinion impossible to treat

2053 Claimants' Memorial on the Merits, ¶¶ 65, 496, 871.

2054 *Tokios Tokelès v. Ukraine*, ICSID ARB/02/18, Award (July 26, 2007), ¶ 113 (Annex (Merits) C-985).

> the existence of a nayizd as the most plausible explanation of the events which found the Claimant's case."[2055]

1329. More generally, the standard for proving improper, political motivation is a demanding one, in particular if bad faith is to be established at all levels of different branches of the host State on the basis of circumstantial evidence:

> "The Tribunal further considers that, as argued by the Respondent, the standard for proving bad faith is a demanding one, in particular if bad faith is to be established on the basis of circumstantial evidence."[2056]

1330. The jurisprudence of the International Court of Justice is in accord. While otherwise adopting "*a more liberal recourse to inferences of fact and circumstantial evidence*,"[2057] the Court rejecting the United Kingdom's claim of collusion between Albania and Yugoslavia for lack of proof:

> "The statements attributed by the witness Kovacic to third parties, of which the Court has received no personal and direct confirmation, can be regarded only as allegations falling short of conclusive evidence. A charge of such exceptional gravity against a State would require a degree of certainty that has not been reached here.
>
> Apart from Kovacic's evidence, the United Kingdom Government endeavoured to prove collusion between Albania and Yugoslavia by certain presumptions of fact, or circumstantial evidence, such as the possession, at that time, by Yugoslavia, and by no other neighbouring State, of GY mines, and by the bond of close political and military alliance between Albania and Yugoslavia, resulting from the Treaty of friendship and mutual assistance signed by the those two States on July 9th, 1946.
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> The Court considers that, even in so far as these facts are established, they lead to no firm conclusion. It has not been legally established that Yugoslavia possessed any GY mines, and the

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2055 *Ibid.*, ¶ 136.

2056 *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID ARB/03/29, Award (Aug. 27, 2009), ¶ 143 (Exhibit RME-1146).

2057 *Corfu Channel Case (United Kingdom v. Albania)*, Judgment on the Merits (Apr. 9, 1949), 1949 I.C.J. Rep. 4, 18 (Exhibit RME-1147).

> origin of the mines laid in Albanian territorial waters remains a matter for conjecture."[2058]

The International Court of Justice also underscored that "*proof may by drawn from inferences of fact, provided that they leave no room for reasonable doubt*."[2059]

1331. Similarly, the Iran-U.S. Claims Tribunal repeatedly dismissed claims supported exclusively by witness statements attributing statements to third parties of which the tribunal received no personal and direct confirmation.[2060]

1332. Here, of course, there are more than ample reasons for the Tribunal to conclude that Claimants' grand conspiracy theory is not only devoid of direct evidentiary support, but is also inherently implausible and illogical, particularly when compared to the far more direct, less complex, and thoroughly documented explanation that Yukos engaged in massive tax evasion and then improperly resisted the authorities' efforts to assess and collect what Yukos owed, resulting in fines, penalties, and criminal sentences that doomed Yukos to

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2058 *Ibid*., 16-17.

2059 *Ibid*., 18. [emphasis in original]

2060 *E.g., AHFI Planning Associates, Inc. v. The Government of Iran, et al.*, Iran-U.S. Claims Tribunal, Award (May 8, 1986), 11 Iran-U.S.C.T.R. 168, ¶ 32 (Exhibit RME-1148): "The Claimant, however has failed to produce evidence establishing that the Government of Iran was responsible for the loss of this property in Tehran. The only evidence adduced by the Claimant in support of this claim for expropriation is an affidavit by the International Sales Manager of AHFI that he received a phone call from the Iranian landlord, relating that unidentified persons, styled as 'representatives of a revolutionary committee' had occupied the leased offices and taken possession of AHFI property. The Tribunal considers that this is an inadequate basis upon which to find responsibility by the Government of Iran for the expropriation claim. This claim, therefore, must be dismissed for lack of proof."; *Combustion Engineering, Inc., et al. v. The Islamic Republic of Iran, et al.*, Iran-U.S. Claims Tribunal, Case No. 308, Partial Award (Feb. 18, 1991), 26 Iran-U.S.C.T.R. 60 (1992), 81 ¶¶ 75-76 (Exhibit RME-1149); *Jalal Moin v. The Government of the Islamic Republic of Iran*, Iran-U.S. Claims Tribunal, Award (May 24, 1994), 30 Iran-U.S.C.T.R. 70 (2001), 74-75, ¶ 19 (Exhibit RME-1150): "The Tribunal notes that on the issue of the alleged expropriation Mr. Banayan only testified that in 1986 he had been told that certain properties at issue in this Case, since the beginning of the Islamic Revolution, belonged to the Foundation for the Oppressed. The Tribunal considers this to be hearsay evidence, on which it cannot rely, unless the evidence is substantiated. Such substantiation is missing. The Tribunal is mindful of the difficulties faced by the Claimant in collecting evidence, although the Tribunal would expect that any taking of the properties in question would be indicated in some documentary evidence, for example, in contemporary correspondence. In any event, the Tribunal must base its awards on probative evidence."; *Rockwell International Systems, Inc. v. The Government of the Islamic Republic of Iran (The Ministry of National Defence)*, Iran-U.S. Claims Tribunal, Case No. 430, Award (Sept. 5, 1989), 23 Iran-U.S.C.T.R. 150 (1989), 180 ¶ 118 (Exhibit RME-1151).

a self-inflicted demise. As detailed above in Section III., Claimants' allegations require that the Tribunal conclude that their was a consistent concerted effort among at least hundreds of persons and entities around the globe, all manipulated centrally from Moscow, to cause Yukos' demise, despite the unassailable facts that:

(i) The massive conspiracy Claimants posit could not have succeeded absent Claimants' own consistently self-inflicted injuries;

(ii) The conspiracy necessarily involved precisely coordinated action by literally hundreds of government officials, at all levels, and including more than 60 judges, among them many of the nation's leading legal scholars, all of whom enjoy sterling reputations;

(iii) The conspiracy also necessarily included among its ranks scores of industrial corporations in Russia and elsewhere, leading commercial banks around the globe, a U.S. bankruptcy judge, PwC, and untold other professionals worldwide;

(iv) If the Russian Federation wished to achieve the goal Claimants suggest, it could have done so far more swiftly and certainly than the lengthy and uncertain path Claimants concoct;

(v) Claimants' conspiracy theory rests on the speculation, innuendo, and suppositions of pundits and politicians and the utter mischaracterizations of foreign court rulings that lack precedential effect on their own terms, and stem from proceedings in which the facts presented to this Tribunal were never offered, let alone considered; and

(vi) Likewise, to the extent Claimants' witnesses purport to support this conspiracy theory at all, the Tribunal must discount their views because they are either former Yukos insiders, currently serving the Oligarchs and/or Claimants, for example in managing the Dutch Stichtings, or are former Russian Government officials

who are now opposed to the current Government, obviously misinformed about indisputable facts, severely compromised by their own ties to Yukos and its Oligarch owners, and their own prior misdeeds.

1333. Last, but certainly not least, and as also noted above, the Tribunal must be mindful of the fact that the fantasy scenarios upon which Claimants are relying in these proceedings have achieved some notoriety in public and political forums due only to the massive public relations campaign orchestrated and financed, at a cost of millions of dollars in 2003 and 2004 alone, by Yukos' Oligarch shareholders and senior managers, a campaign that continues to this day. As a result, the Tribunal must exercise particular caution in considering much of what Claimants rely on from the press and the politically-oriented observers, which is scarcely competent evidence at all, let alone credible evidence, including inherently political and invective diatribe. As confirmed by the International Court of Justice, such tracts, as well as press reports that merely repeat their inaccuracies and speculations, are not and cannot substitute for evidence of facts that Claimants must establish:

> "A large number of documents has been supplied in the form of reports in press articles, and some also in the form of extracts from books. Whether these were produced by the applicant State, or by the absent Party before it ceased to appear in the proceedings, the Court has been careful to treat them with great caution ; even if they seem to meet high standards of objectivity, the Court regards them not as evidence capable of proving facts, but as material which can nevertheless contribute, in some circumstances, to corroborating the existence of a fact, *i.e.*, as illustrative material additional to other sources of evidence.
>
> […] The Court has however to show particular caution in this area. Widespread reports of a fact may prove on closer examination to derive from a single source, and such reports, however numerous, will in such case have no greater value as evidence than the original source. It is with this important reservation that the newspaper reports supplied to the Court should be examined in

order to assess the facts of the case, and in particular to ascertain whether such facts were matters of public knowledge."[2061]

(2) Claimants Have Failed To Establish Their Conspiracy Theory

1334. As shown above, Claimants' conspiracy theory is inherently implausible and illogical and unworthy of belief, as well as utterly unsupported by any of the types of evidence upon which the Tribunal must insist before it can consider affording that conspiracy theory any weight at all.

1335. What Claimants proffer are not facts, or even reports of facts, but rather a toxic brew of implausibility, innuendo, and sheer supposition, as well as expressions of personal, subjective, and self-aggrandizing beliefs. As the International Court of Justice confirmed in *Military and Paramilitary Activities in and against Nicaragua*, such statements cannot take the place of evidence:

> "The Court has not treated as evidence any part of the testimony given which was not a statement of fact, but a mere expression of opinion as to the probability or otherwise of the existence of such facts, not directly known to the witness. Testimony of this kind, which may be highly subjective, cannot take the place of evidence. An opinion expressed by a witness is a mere personal and subjective evaluation of a possibility, which has yet to be shown to correspond to a fact; it may, in conjunction with other material, assist the Court in determining a question of fact, but is not proof in itself. Nor is testimony of matters not within the direct knowledge of the witness, but known to him only from hearsay, of much weight […]."[2062]

1336. Accordingly, Claimants cannot be deemed to have met their high burden of proof by relying on circumstancial and other hearsay evidence.

2061 *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, Judgment on the Merits (June 27, 1986), 1986 I.C.J. Reports 14, 40-41 ¶ 62-63 (Annex C-226) (Exhibit RME-1145).

2062 *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America)*, Judgment on the Merits (June 27, 1986), 1986 I.C.J. Rep., 14, 42 ¶ 68 (Annex C-226) (Exhibit RME-1145).

D. The Russian Court Decisions That Confirmed The Related Enforcement Measures Did Not Constitute Or Contribute To "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1337. Claimants' challenge to the YNG auction is patently meritless.[2063] As shown above,[2064] the YNG auction was held because Yukos resisted paying its overdue taxes, obstructed other tax enforcement measures, and raised disingenuous and dilatory "settlement" proposals, all the while continuing to insist on the legality of its fraudulent behavior, such that the tax authorities could not credit any Yukos statement of good intentions and were left with no assurance that the outstanding balances of Yukos' tax obligations would ever be paid, let alone within a reasonable period of time. Compulsory enforcement was therefore necessary and appropriate.

1338. By the time of the YNG auction, Yukos' tax liabilities amounted to US$ 12.4 billion.[2065] Among Yukos' available assets, the YNG shares offered the best prospect of raising at auction funds sufficient to pay a significant portion of Yukos' outstanding tax bill.

1339. When the YNG shares were seized in the summer of 2004, Yukos requested that if they were to be sold, they be sold at a public auction. Under Russian law in effect at the time, the authorities could have sold the YNG shares directly to a recipient of their choice, through a privately-negotiated transaction.[2066] As Yukos requested, however, an auction was organized, providing an open and competitive process, with a view to maximizing the return from the sale.[2067]

2063 Claimants' Memorial on the Merits, ¶¶ 334-410.

2064 *See* Sections II.I, II.J.

2065 RUB 344,222,156,424.22, based on the RUB/US$ exchange rate on December 17, 2004. *See* Notification from the Bailiffs to the Federal Tax Service (Dec. 17, 2004) (Annex (Merits) C-211).

2066 Under Russian law in effect at the time, the YNG shares could have been sold either at public auction or through a privately-negotiated transaction to any willing purchaser, including State-owned companies. *See* Article 54 of the 1997 Enforcement Law (Exhibit RME-615). Russian law is in accord with the laws of numerous other countries.

2067 Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), 9 (Annex (Merits) C-140).

1340. The Russian authorities worked to make the auction a success: they appointed a world-class financial institution, DKW, to evaluate the market value of 100% of the YNG shares; they authorized the posting of an English summary of DKW's valuation on DKW's website so as to render it accessible to a broader public of potential investors; they allowed participation in the auction to any bidder, domestic and foreign; and they publicized the auction well in advance of the date scheduled for the sale.[2068]

1341. The minimum bid price for the auctioned shares was based on the DKW Report. It was consistent with DKW's value range, taking account that DKW valued 100% of the shares, but only 76.79% of the shares were being offered for sale, and the sale was subject to YNG's own substantial outstanding tax liabilities.[2069] The opening price was more taxpayer-friendly than what a taxpayer such as Yukos could have expected in many other countries. And by the start of the auction, four bidders had obtained antitrust clearance and two made the required 20% cash deposit -- approximately US$ 1.77 billion.

1342. But Yukos' management and controlling shareholders -- and not the Russian authorities, as Claimants allege[2070] -- effectively "*depressed the value*" of the auctioned shares by, *inter alia*, foisting upon YNG upstream guarantees up to US$ 5 billion, of which US$ 3 billion was in favor of GML-owned Moravel, and by "bleeding" YNG with US$ 4.1 billion in accounts receivable, chiefly due to Yukos' failure to pay YNG for crude oil that YNG produced and delivered to Yukos or its trading shells.[2071]

1343. Moreover, in yet another example of their repeated and consistently self-destructive behavior, Yukos' management and controlling shareholders set about to sabotage the YNG auction by threatening anyone participating in it with a "*lifetime of litigation,*" on which they promptly made good by filing the spurious Texas bankruptcy proceeding based on jurisdictional

2068 *See* ¶¶ 456-465 *supra*.

2069 *See* ¶¶ 466-478 *supra.*

2070 Claimants' Memorial on the Merits, ¶¶ 365-367.

2071 *See* ¶¶ 479-488 *supra.*

sham, and with its automatic stay and subsequent TRO, which enjoined all known bidders and their financiers, and anyone acting in concert with them, from participating in the auction.[2072]

1344. Yukos' sabotage plan had the predictable result of severely depressing participation and undermining competition at the auction. The first bidder made a bid that was already five bid increments -- about US$ 500 million -- above the minimum starting price, suggesting that competition was expected even in the face of the Texas embargo. Unfortunately, the only other party to appear at the auction was subject to the TRO, so the bidding ended where it began, at approximately US$ 9.4 billion, yet still above fair market value under the DKW analysis.[2073]

1345. While Claimants continue to insist that the price was a "*knock-down,*" they lack any standing to challenge it, because they are responsible for "knocking down" the chance for greater competition at the auction. Moreover, their proffer of the Kaczmarek Report to argue that the "fair" price would have been US$ 28 billion proves precisely the opposite. The Expert Report of Professor James Dow, submitted with this Counter-Memorial, demonstrates that Claimants' hypothetical valuation is based on three evident and substantial errors, which if corrected would lead to an assessment of US$ 12.5 billion for all of YNG, which corroborates that the price actually paid for three-fourths of the shares, under distressed conditions of Claimants' making, was fair.[2074]

1346. As outlined here and shown at greater length in the statement of facts above, Claimants are utterly wrong that the YNG auction was "*organized*"[2075] by the Russian Federation in furtherance of a "'*secret' plan to appraise and sell*" YNG to Rosneft.[2076] It was instead conducted pursuant to a fully transparent process to collect long overdue taxes from Yukos, which Yukos did

2072 *See* ¶¶ 490-506 *supra.*

2073 *See* ¶¶ 507-510, 517-520 *supra.*

2074 Dow Report, ¶¶ 7, 35, 38, 54.

2075 Claimants' Memorial on the Merits, §§ II.F.3 and II.F.4.

2076 Claimants' Memorial on the Merits, ¶¶ 350, 395.

everything it could to frustrate and undermine. Far from being "*the scam of the year*,"[2077] it was conducted in full compliance with Russian law and in accordance with international practice, which, in many respects, is significantly less debtor-friendly. The auction process and results were fully reviewed and upheld by Russian courts. As discussed in Section VI.D.3.(e) below, Claimants have failed to allege or establish that any due process violation took place in the course of those court proceedings.

1347. In short, the facts of the YNG auction, when considered fairly, provide no support for any claim against the Russian Federation under the ECT.

1. The Tribunal Cannot Act As An Appellate Court To Review Russian Court Decisions

1348. As set forth in Section C.1. above, the Tribunal cannot sit as an appellate court to review domestic court decisions. Claimants must show that the court decisions that confirmed the related enforcement measures amounted to a treaty violation, in this case Article 13(1) ECT. It is not sufficient for Claimants to show that the Russian court decisions that confirmed the related enforcement measures, including the YNG auction, have violated the fair and equitable treatment standard or due process requirements.

2. Claimants Must Establish That The Russian Court Decisions That Confirmed The YNG Auction Constitute A Radical Departure From Russian Law And Have Failed To Do So

1349. Claimants have failed to establish that the complained-of actions taken by the Russian authorities in preparation for and in the conduct of the YNG auction constituted a radical departure from Russian law. To the contrary, as shown in Sections II.J.1 and VI.D.3(e)(2), these actions were in compliance with Russian law, as confirmed by Russian courts.

1350. This is true, for example, for: (i) the seizure of the YNG shares on July 14, 2004;[2078] (ii) the bailiff's resolution of August 12, 2004 appointing DKW as

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2077 Claimants' Memorial on the Merits, ¶ 818, quoting a statement from Andrei Illarionov.

2078 *See* ¶¶ 407-409, 451 *supra*.

independent appraiser for the valuation of the YNG shares;[2079] (iii) the bailiff's resolution of November 18, 2004 ordering the sale of the YNG common shares at auction;[2080] (iv) the authorities' determination of the auction starting price;[2081] and (v) the conduct of the auction.[2082]

3. The YNG Auction Confirmed By The Russian Courts Is Not Expropriatory

a) Enforcement Of Taxes Does Not Generally Constitute Expropriation

1351. It is uncontested that a State may take property without compensation in order to enforce its laws. In particular, it is uncontested that property may be seized for non-payment of taxes, fines, or duties. For example, the U.S.-Mexico General Claims Commission dismissed an expropriation claim based on the Mexican authorities' auction of property for non-payment of customs duties, stating:

> "As the customs authorities, then, applied the law, in general, with justice, there was no confiscation in the international meaning of the word. The merchandise was taken and sold pursuant to Mexican law for non-payment of duty, and therefore, the execution of the legislative will cannot inflict injury upon an importer."[2083]

1352. Similarly, the Iran-U.S. Claims Tribunal dismissed an expropriation claim seeking compensation for the auction of a liquor license by the U.S. Internal Revenue Service to satisfy overdue withholding taxes:

> "This claim is dismissed because the Claimant has failed to show that the IRS's action was anything other than a lawful levy for overdue taxes, for which there is no State responsibility."[2084]

2079 *See* ¶ 457 *supra*.

2080 *See* ¶ 463 *supra*.

2081 *See* ¶¶ 463-478 *supra*.

2082 *See* ¶¶ 507-510, 517-527 *supra*.

2083 *Louis Chazen (U.S.A) v. United Mexican States*, U.S.-Mexico General Claims Commission, Decision (Oct. 8, 1930), 4 U.N.R.I.A.A. 564, 571 (Exhibit RME-1152).

2084 *Emmanuel Too v. Greater Modesto Insurance Associates and the United States of America*, Iran-U.S. Claims Tribunal, Case 880, Award (Dec. 29, 1989), 23 Iran-U.S.C.T.R. 378 (1991), 388 ¶ 27 (Exhibit RME-1153).

b) Claimants Have Failed To Establish That The YNG Auction Was A Sham Auction Designed To Appropriate Yugansk To The State

1353. The facts detailed above demonstrate conclusively that Claimants have not shown, because they cannot show, that the YNG auction was, as Claimants now contend, a "sham auction" designed to appropriate YNG to the Russian Federation.[2085] At the threshold, there can be no serious question that (i) the YNG auction was based on properly rendered tax assessments, repeatedly and consistently upheld by the Russian courts over Yukos' objections after extensive judicial review, stemming from Yukos' illegal "tax optimization" scheme, (ii) the auction was made necessary only by Yukos' failure to discharge its tax liabilities despite being afforded multiple opportunities to do so, (iii) the auction was organized so as to maximize bidder participation and the amount of proceeds to be applied to satisfying those liabilities to the greatest possible extent, (iv) the purchase price was paid in full and was then applied fully to reduce Yukos' tax obligations, and (v) all of Yukos' objections to the auction, many of which Claimants repeat here, were rejected by the Russian courts at multiple levels.[2086] Further, the notion that the auction was "a sham" is contradicted by the fact that, under Russian law at the time, the Russian Federation did not need to conduct the auction at all, and instead could have sold YNG through a privately negotiated transaction to any willing purchaser, including State-owned companies.[2087] Accordingly, if the authorities' plan were to renationalize YNG, they could have done so directly.

1354. It is equally incontrovertible that the auction procedures were proper and fair, and fully consistent with governing Russian law, as the courts consistently concluded in rejecting Yukos' challenges. At the outset, the bailiffs hired a world-class independent appraiser to perform a professional market valuation of YNG, which was widely published to maximize interest in the

2085 *See* Claimants' Memorial on the Merits, ¶ 334.

2086 *See* ¶¶ 450-527, 1372-1375.

2087 *See* ¶¶ 452, 454 *supra*.

auction among potential bidders.[2088] Tellingly, in its many challenges to the YNG auction in the Russian courts, YNG never challenged the appointment of this independent appraiser, nor did it ever criticize the appraiser's valuation.[2089]

1355. Further, the parameters for the auction and related information were widely published, both on the internet and elsewhere.[2090] Moreover, the starting price for the auctioned shares was consistent with the professional market valuation to which Yukos never objected, although Claimants purport to make that objection now, based on a fatally flawed analysis that actually supports the auction price that was ultimately achieved.[2091]

1356. But then, in a scenario with which the Tribunal is now fully familiar, the Oligarchs and the Yukos management who they and Claimants installed to manage their investment in Yukos savagely sabotaged the YNG auction, by threatening to cause "*a lifetime of litigation*" for anyone purchasing assets in that auction, and filing a spurious bankruptcy petition in Texas predicated on a jurisdictional sham (one that the U.S. Bankruptcy Court later rejected). That petition enabled Yukos to interfere with the YNG auction based on the automatic stay of proceedings that commenced immediately upon the petition's filing, and created the risk that potential bidders and their bank financiers would be subjected to a severe contempt sanction by the U.S. Bankruptcy Court if they participated in the auction, coupled with the TRO Yukos obtained against potential bidders for YNG assets and their sources of financing, creating yet another risk of a contempt citation.[2092] As Yukos representatives candidly admitted, this was all part of their deliberate and elaborate campaign of intimidating terror that, as Yukos and the Oligarchs intended, deterred potential bidders, diminished competitive bidding for YNG, and limited the Russian Federation's ability to maximize the auction proceeds

2088 *See* ¶¶ 457-458 *supra*.

2089 *See* ¶¶ 457, 460 *supra*.

2090 *See* ¶ 464 *supra*.

2091 *See* ¶¶ 463-478, 517-520 *supra*.

2092 *See* ¶¶ 497-506, 513-514 *supra*.

and thereby reduce Yukos' outstanding tax liabilities to the greatest possible extent.[2093]

1357. Yet as also demonstrated above, even in the face of the extraordinary efforts by Yukos and its controlling shareholders to thwart the YNG auction's success, the purchase price that was ultimately obtained for the auctioned YNG shares exceeded the pre-auction fair market valuation, as adjusted for the percentage of shares being sold and the pending tax claims, by substantial percentages, ranging from 10% to 26%, and likewise exceeded contemporaneous fair market value estimates published by market observers.[2094]

1358. And of course, the entire auction would not have been necessary at all, were it not for Yukos' repeated and consistent failure to avail itself of multiple opportunities to pay its 2000 tax year assessment stemming from its illegal "tax optimization" scheme, despite having ample time and ample resources with which to make that payment, and knowing that its failure to pay its tax debt would result in precisely this type of enforcement proceeding, an auction of a controlling stake in one of Yukos' primary production subsidiaries. The facts that the YNG auction was made necessary due only to Yukos' failure to act responsibly and pay its tax bill, and that Yukos then acted so brazenly to thwart the auction's success, obviously renders Claimants' criticism of the Russian Federation's efforts to get Yukos' tax bills paid, including through the YNG auction, all the more audacious.

c) The Auction Process Was In Accordance With International Practice

1359. The procedures governing the YNG auction are fully consistent with international practice. If anything, Russia's law on forced sales is significantly more demanding than the laws of most other countries.

2093 *See* ¶¶ 508, 516, 522, 527 *supra*.

2094 *See* ¶¶ 517-518 *supra*.

(1) No Requirement That Assets Be Disposed Of At Public Auction

1360. In many jurisdictions, there is no requirement that assets be disposed of at public auction.[2095] In those countries, State authorities are free to sell assets on a negotiated, one-on-one basis, with all the attendant risks of favoritism and below-market pricing. As a legal matter, Russian authorities enjoyed the same freedom, but -- at Yukos' request,[2096] and in the interest of greater transparency -- they opted to sell the YNG shares at public auction, thereby triggering the application of Russia's auction rules, which are significantly more debtor-friendly than those of many other countries.[2097]

(2) In Many Countries, There Is No Requirement For A Prior Appraisal Of The Auctioned Assets Nor For An Auction Starting Price. When Required, Starting Prices At Below Market Are Permitted

1361. The starting price for YNG common shares was set based on their fair market valuation, as determined by an independent appraiser and widely

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2095 For example, in Italy, "*[t]he judge may authorize that the sale of the seized assets is performed without public auction or by means of a broker.*" *See* Article 532 of the Italian Code of Civil Procedure (*Codice di procedura civile*) (Exhibit RME-1603).

In New Zealand, pursuant to section 11.22(1) of the New Zealand 1908 Judicature Act, "*property to be sold because of a direction in a judgment or order must be sold in a way that ensures that the best price is obtained for it, unless the court directs otherwise.*" Under section 11.22(2) of the same statute, sales can be carried out either by private sale or by public auction. *See* § 11.22 of the New Zealand 1908 Judicature Act (Exhibit RME-1608).

In Sweden, pursuant to Chapter 9, section 1 of the Swedish Enforcement Code (*Utsökningsbalk*) (1981:774), sales of seized property can be carried out by public auction or by private sale (Exhibit RME-1609).

In the United Kingdom, if an order for the sale of shares is made (pursuant to the Civil Procedure Rules, Part 73 (Exhibit RME-1642)) or if the shares are sold by a court-appointed receiver (pursuant to the Civil Procedure Rules, Part 69 (Exhibit RME-1642)), the usual way of selling shares would be either through the stock market, if the shares are publicly quoted, or by private sale. In any event, in the United Kingdom, a sale of shares by auction would be "*improbable*." *See Holt & Others v IRC,* Supreme Court of England and Wales, Chancery Division, No. [1953] 1 WLR 1488, 1493 (Exhibit RME-1615).

2096 *See* Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), 9 (Annex (Merits) C-140).

2097 For example, Russian auction rules applicable to the YNG auction required a prior market value appraisal of the auctioned shares, a starting price to be based on the appraised value, an auction notice to be published 30 days in advance of the auction, unrestricted participation in the auction and a minimum number of two participants. Each of these requirements was satisfied. *See* ¶¶ 457-464.

publicized in Russia and abroad.[2098] Unlike Russia, many countries do not even require an appraisal of the market value of the auctioned assets or a minimum starting price. Other countries, even if they do require a minimum starting price, provide that it can be set well below market value.

1362. For example, as explained by Dale Hart, former U.S. Internal Revenue Service Deputy Commissioner,[2099] in the United States the minimum starting price[2100] can be as low as 75% of the market value of the auctioned assets, so as to reflect the forced nature of the sale,[2101] and may be reduced to 60% of market value to take into account other factors, such as "*possible attempts by the taxpayer to disrupt sale*."[2102] In the case of the YNG shares, reductions of this kind would have been justified, because the sale was "*not taking place between a willing seller and a willing buyer*," the sale provided "*no guarantee of clear title,* [the] *property* [was] *sold 'as is, where is,'* [there was] *no warranty on the property*," and Yukos' controlling shareholders and management did in fact attempt to "*disrupt the sale*." Ultimately, "*[i]f no one offers at least the amount of the minimum price for*

2098 *See* ¶¶ 466-467, 458, 464 *supra*.

2099 *See* Hart Report, ¶ 28.

2100 Section 6335(e) of the Internal Revenue Code requires that a "minimum bid price" be established for the seized property offered for sale (Exhibit RME-1627). *See also* Treasury Regulation 301-6335.1(c)(4)(i) (Exhibit RME-1610). The Internal Revenue Manual provides some guidelines to determine the minimum bid: the IRS should start with fair market value, subtract 25% (because the sale is a forced sale), then subtract up to 20% more for other factors (including the possibility that senior lien holders will foreclose and possible attempts by the taxpayer to disrupt the sale). *See* U.S. Internal Revenue Manual, § 5.10.4 (Exhibit RME-1649). *See also BFP v. Resolution Trust Corp*, 511 U.S. 531, 537 (1994) (noting that the fair market value is "*the very antithesis of forced-sale value;*") (Exhibit RME-1611); *Kabakjian v U.S.*, 92 F.Supp. 2d 435 (D.C. P.A. 2000) (finding forced sale price within statutory minimum where price was not "*so low as to shock the conscience*") (Exhibit RME-1612).

2101 More specifically: (i) the "*property value reduction, not to exceed 25%*" is taken "*in order to determine the forced sale value*" and "*to reflect the fact that the sale is a forced sale of the property -- it is not taking place between a willing seller and a willing buyer. The difficulties associated specifically with a forced government sale, such as no guarantee of clear title, property sold 'as is, where is', and no warranty on the property, should also be considered when determining this percentage*." *See* Rule 5.10.4.8 of the Internal Revenue Manual of the Internal Revenue Service, as of Mar. 7, 2009 (Exhibit RME-1649).

2102 A further reduction "*by a maximum of 20%*" is appropriate "*in order to determine the reduced forced sale value*" taking into account any factors that may depress the value of the property at sale, including "*possible attempts by the taxpayer to disrupt sale.*" Rule 5.10.4.8 of the Internal Revenue Manual of the Internal Revenue Service, as of Mar. 7, 2009 (Exhibit RME-1649). Where the unpaid taxes are even less than this amount, the minimum price need not exceed the amount of such unpaid taxes plus costs.

the property and the Secretary has determined that it would be in the best interest of the United States to purchase the property for the minimum price, the property shall be declared to be sold to the United States for the minimum price."[2103]

1363. In Germany, an even lower percentage of fair market value is acceptable. Shares in a joint-stock company that are not traded on a stock exchange (such as the YNG shares) can be auctioned for as little as 50% of their market value.[2104]

1364. Other countries either do not impose a minimum starting price,[2105] or allow such a price to be set far below market value.[2106]

1365. In light of the foregoing, it is clear that the starting price for the YNG auction was, if anything, more taxpayer-friendly than what a taxpayer such as Yukos could have expected in many other countries.

2103 *See* Treasury Regulation 301-6335.1(c)(4)(ii) (Exhibit RME-1610); Section 6343(b) of the U.S. Internal Revenue Code (Exhibit RME-1627).

2104 *See* Section 300 of the German Tax Code (*Abgabenordnung*) and Section 817a of the German Code of Civil Procedure (*Zivilprozessordnung*) (Exhibit RME-1613), according to which "*[o]nly a bid having a value of at least half of the ordinary sale value of the property (minimum offer) may be accepted*."

2105 For example, in France, the public officer in charge of the auction is free to reduce the starting price. *See JCl Procédure Civile*, fasc. 2340, § 41 (Exhibit RME-1605).

In New Zealand, pursuant to section 11.22(2)(c)(i) of the New Zealand 1908 Judicature Act, it is subject to the court's discretion whether to fix a reserve price for auction sale (Exhibit RME-1608). There is no legislative provision requiring such reserve price to be equal to market value.

In Sweden, there is no requirement for a minimum starting price. *See* Swedish Enforcement Code, (*Utsökningsbalk*) (1981:774), Chapter 9, § 4 (Exhibit RME-1609).

In the United Kingdom, the only requirement is that the auctioneer exercises his powers "*in good faith for the purposes of obtaining repayment*." Decision of the Privy Council, *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295, 312F (Exhibit RME-1607) (it is well established that the duties applicable to sales under a charging order or a court appointed receiver are the same as those applicable to a mortgagee or a receiver appointed out of court. *Ibid*., 312G).

2106 For example, in Italy, the starting price of auctioned real estate is equal to three times its cadastral value which is a conventional value, generally far below market value. *See* Article 79 of Presidential Decree No. 602 (Sept. 29, 1973) (Exhibit RME-1606).

In Austria, pursuant to section 45(4) of the Austrian Tax Enforcement Act (*Abgabenexecutionsordnung*), "*[a] bid lower than half of the evaluation price shall not be admitted to the auction.*" (Exhibit RME-1614)

(3) Auctions May Proceed To Repay Additional Tax Liabilities Of A Debtor When That Debtor's Initial Tax Debt Has Been Satisfied

1366. When the YNG auction was held on December 19, 2004, Yukos had finally paid its 2000 tax liabilities, the collection of which was the original purpose of the auction. But Yukos had become delinquent with respect to subsequent tax years, which were consolidated into the original enforcement proceedings for tax year 2000 and were enforced. The YNG auction was thus held to collect the post-2000 tax claims, which amounted to US$ 12.4 billion at the date of the auction.[2107]

1367. This is consistent with the practice in many other countries, where an auction originally scheduled to collect taxes for tax year N can proceed in order to collect the taxes that have subsequently become delinquent for tax year N+1 (and N+2, etc.), even if the taxpayer, prior to the sale, has paid the assessment for year N.[2108]

d) The Alleged Violations Of Due Process Do Not By Themselves Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1368. As shown above, in the absence of proof of total or substantial deprivation caused by alleged due process violations, such violations by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*."[2109]

2107 *See* Notification from the Bailiffs to the Federal Tax Service (Dec. 17, 2004) (Annex (Merits) C-211).

2108 For example, in New Zealand, tax debts are treated as a whole, rather than on a year by year basis. *See* section 156 of the Tax Administration Act 1994 (Exhibit RME-1626). In order to proceed to the sale of the assets in discharge of the debt for subsequent tax years, the tax authorities are required to obtain a court order.

In the Netherlands, if the assessment with respect to tax year N+1 is collectable and enforced, the tax collector can, pursuant to Articles 10-15 of the Tax Collection Act 1990, proceed with the sale scheduled for tax year N in order to collect the tax delinquency for tax year N+1, even if the liability for year N has been discharged in the meantime. *See* Articles 10-15 of the Tax Collection Act 1990 (Exhibit RME-1604).

2109 *See* ¶ 1277 *supra*.

e) In Any Event, Claimants Have Failed To Establish The Alleged Due Process Violations

1369. Claimants generally contend that the YNG auction was "*conducted in breach of the most basic standards of due process*"[2110] and raise a number of specific allegations.[2111] None has any merit.

(1) The Alleged Due Process Violations In The Auction Process Were Subject To Court Review

1370. In the Russian legal system, all of Claimants' allegations regarding the auction process and results were subject to court review. Yukos was entitled to (i) seek judicial review of the authorities' actions,[2112] and (ii) appeal the court decisions upholding the legality of such actions.[2113]

1371. Yukos extensively exercised these rights,[2114] seeking the annulment of actions regarding the auction process as well as of the auction results. All of Yukos' challenges received a full judicial review at first instance level, full *de novo* review at the appellate court level, and legal scrutiny at the cassation court level.

2110 Claimants' Memorial on the Merits, ¶ 594.

2111 Claimants' Memorial on the Merits, ¶¶ 594-600.

2112 *See* ¶ 1286 *supra*. *See also* Russian Arbitrazh Procedure Code, Art. 198 (Exhibit RME-1670), the 1997 Enforcement Law, Art. 90 (Exhibit RME-1671), and the Federal Law No. 135-FZ dated July 29, 1998 "On Appraisal Activity in the Russian Federation," Art. 13 (Exhibit RME-1619). According to this latter provision, "[i]*f there is a dispute regarding the trustworthiness of the market or other value of the object of evaluation provided in the report, including in connection with another available report on the evaluation of the same object, this dispute shall be resolved by court, arbitrazh court in accordance with its jurisdiction, by an arbitral tribunal if the parties to the dispute or to the contract agree, or in accordance with the procedure provided by the legislation of the Russian Federation governing the evaluation activity. The court, arbitrazh court, or the arbitral tribunal, shall be entitled to order the parties to execute the transaction at the price determined during the hearing of the dispute at the court session only if the execution of transaction is compulsory under the legislation of the Russian Federation*."

2113 *See* ¶¶ 1287-1289 *supra*.

2114 Yukos, however, did not challenge: (i) the August 12, 2004 resolution whereby the bailiffs appointed DKW as independent appraiser for the market-value valuation of 100% of the YNG shares (*see* Resolution of Bailiff D.A. Borisov (Aug. 12, 2004) (Annex (Merits) C 270)); and (ii) the DKW Report, which Yukos received on October 13, 2004 (*see* DKW Report, Cover Letter (Annex (Merits) C 274).

1372. With the few exceptions discussed below, all of Claimants' allegations with respect to the YNG auction were also raised by Yukos before Russian courts and were fully reviewed, through various layers of appeals.

1373. Claimants do not allege any procedural improprieties with respect to any of the numerous court proceedings upholding the legality of the auction process and results.

(2) The Alleged Due Process Violations In The Auction Process Were Reviewed By The Russian Courts Or Were Not Raised By Yukos

1374. The following allegations raised by Claimants in this arbitration were also raised by Yukos before Russian courts, and were fully reviewed and rejected at multiple levels of appeal.

(i) The allegation that YNG shares were a "*core asset of Yukos*."[2115] As set forth at paragraphs 407 to 409 and 451 above, the YNG shares were seized and sold in accordance with Russian law and no procedural irregularities in that regard have been alleged by Claimants.[2116]

(ii) The allegation that the auction purchase price was a "*bargain price*."[2117] As set forth at paragraphs 517 to 520 above, the auction price was achieved in accordance with Russian law and, likewise,

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2115 Claimants' Memorial on the Merits, ¶ 600.

2116 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004), 3-5 (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004), 3-6 (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525). *See also* Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004), 7-12 (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005), 4-7 (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005), 2-4 (Annex (Merits) C 292).

2117 Claimants' Memorial on the Merits, ¶ 594.

no procedural irregularities in that regard have been alleged by Claimants.[2118]

1375. The following due process violations alleged by Claimants in this arbitration were also raised by Yukos before Russian courts, and were fully reviewed and rejected at multiple levels of appeal.

(i) The allegation that "*there was effectively a single bidder -- Baikalfinancegroup -- at the auction*"[2119] because "*only Baikal placed a bid*."[2120] Yukos made this allegation when it challenged the results of the YNG auction, arguing that the auction was void because there was only one participant, Baikal Finance, with Gazpromneft having failed to place a bid.[2121] The Russian courts considered Yukos' claim at the first instance, appellate, and cassation court levels, and consistently rejected it, in accordance with Russian law, finding that, under the auction rules, Gazpromneft was a regular participant, even though it did not bid, and that the auction was therefore valid.[2122]

(ii) The allegation that Baikal Finance did not have standing to participate in the auction since it was "*a newly-created front company for Rosneft*,"[2123] which "*had no significant capital with which to*

2118 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007), 5-6 (Exhibit RME-680), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007-GK (May 30, 2007), 5-6 (Exhibit RME-681) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007), 3-4 (Annex (Merits) C 294).

2119 Illarionov Witness Statement, ¶ 50; Claimants' Memorial on the Merits, ¶ 598.

2120 Claimants' Memorial on the Merits, ¶ 595.

2121 *See* Statement of Claim on Invalidation of the Auction, on Invalidation of the Agreement Concluded at the Auction and on Compensation of Losses and Damages ("Statement of Claim on Invalidation of the Auction") (May 25, 2005), 12 (Exhibit RME-1617).

2122 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007), 3-4 (Exhibit RME-680); Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007-GK (May 30, 2007), 3-4 (Exhibit RME-681); and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007), 2-3 (Annex (Merits) C 294).

2123 Claimants' Memorial on the Merits, ¶ 600.

participate in the auction, the funds used to pay the auction price for Yuganskneftegaz were obtained by Rosneft." [2124] When Yukos made this allegation,[2125] the Russian courts held -- at the first instance, appellate, and cassation court levels -- that Baikal Finance had the legal capacity to participate in the auction in compliance with the auction rules, because it was duly incorporated, submitted the required documents, and paid the requisite deposit. Therefore, Baikal Finance was a valid bidder.[2126]

1376. Claimants' allegation that the value of the auctioned shares was "*several times the amount of Yukos' outstanding alleged tax liability at the time*" [2127] was not raised by Yukos before Russian courts.[2128]

1377. The following due process violations now alleged by Claimants were not raised by Yukos before Russian courts,[2129] but are in any event meritless:

(i) The allegation that by the time of the YNG auction, the 2000 tax assessment, for whose satisfaction the YNG auction had been originally scheduled, "*had been paid off in its entirety*." [2130] It is irrelevant, both as a matter of fact and of law, that Yukos' debt for tax year 2000 had been collected in full before the auction. Yukos had become delinquent with respect to subsequent tax years, and these liabilities had been consolidated into the original

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2124 Claimants' Memorial on the Merits, ¶ 596.

2125 *See* Statement of Claim on Invalidation of the Auction (May 25, 2005), 10, 15-18 (Exhibit RME-1617).

2126 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-27259/05-56-27 (Feb. 28, 2007), 3 (Exhibit RME-680); Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-5330/2007-GK (May 30, 2007), 3-4 (Exhibit RME-681); and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/9508-07 (Oct. 12, 2007), 2-3 (Annex (Merits) C 294).

2127 Claimants' Memorial on the Merits, ¶ 600.

2128 *See* Statement of Claim on Invalidation of the Auction (May 25, 2005) (Exhibit RME-1617).

2129 *See* Statement of Claim on Invalidation of the Auction (May 25, 2005) (Exhibit RME-1617).

2130 Claimants' Memorial on the Merits, ¶ 594.

enforcement proceedings for tax year 2000 and were being enforced. The record is clear that Yukos' outstanding tax liabilities at the time of the auction amounted to US$ 12.4 billion,[2131] and therefore exceeded the value of the auctioned shares as appraised by DKW.[2132]

(ii) The allegation that the auction was held on a Sunday and the "*bidding process lasted approximately ten minutes*."[2133] This allegation is equally irrelevant. Russian law does not prohibit the holding of an auction on a Sunday, nor does it mandate a minimum duration of the bidding process at the auction.

(3) Claimants Have Failed To Allege Or Establish Any Due Process Violations In The Court Proceedings That Confirmed The YNG auction

1378. Claimants do not allege, nor do they contend that Yukos alleged, any procedural improprieties with respect to any of the aforementioned court proceedings, including relevant appeal proceedings.

1379. Accordingly, Claimants have failed to prove that any of the Russian court decisions that confirmed the tax enforcement measures against Yukos constitute or contribute to "*measures having effect to nationalization or expropriation*."

4. The Complained Of Security And Enforcement Measures Confirmed By The Russian Courts Are Not Expropriatory

1380. Nor are any of the complained of security and enforcement measures confirmed by the Russian courts expropriatory in any respect.

2131 *See* Notification from the Bailiffs to the Federal Tax Service (Dec. 17, 2004) (Annex (Merits) C 211).

2132 Adjusted for the 76.79% of the YNG shares and YNG's then outstanding tax liabilities. *See* ¶¶ 471-478 *supra*.

2133 Claimants' Memorial on the Merits, ¶ 595.

a) Security and Enforcement Of Taxes Do Not Generally Constitute Expropriation

1381. As shown at paragraphs 1120 to 1128 above, enforcement of taxes does not generally constitute expropriation.

b) The Authorities' Measures To Collect Taxes From Yukos And Their Refusal of Yukos' Settlement Offers Were Entirely Appropriate

1382. According to Claimants, Respondent "*prevented Yukos from satisfying*" its tax liabilities[2134] by (i) giving Yukos "*absurdly short*" deadlines to pay "*enormous sum*[s]," [2135] (ii) "*paralyzing the Company through* […] *a wide-ranging freeze and seizures of assets, thereby engineering the circumstance of non-payment*," [2136] and (iii) "*unreasonabl*[y]" and "*arbitrar*[ily]" rejecting Yukos' settlement proposals.[2137] Those claims are not only unfounded; as shown below, they smack of bad faith. We examine each in turn.

(1) Yukos Had Ample Time To Pay The Tax Assessments, And Its Refusal To Pay Was Inexcusable

1383. Claimants, like Yukos before them, complain that on April 14, 2004, the tax authorities gave Yukos less than one day -- until April 16, 2004 -- to pay its overdue taxes, a period that they describe as "*absurdly short*." [2138] In fact, as Yukos well knew at the time, Russian law did not allow the tax authorities to grant to taxpayers more than ten days within which to pay assessments once the tax payment demands had been issued.[2139] The premise of the Russian system --

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2134 Claimants' Memorial on the Merits, ¶¶ 335-362.

2135 Claimants' Memorial on the Merits, ¶ 582. *See also* ¶¶ 336-338, 590, 682, 809.

2136 Claimants' Memorial on the Merits, ¶¶ 808 *et seq.* *See also* ¶¶ 337-342, 682-683.

2137 Claimants' Memorial on the Merits, ¶¶ 689 *et seq.* *See also* ¶¶ 343-348, 355.

2138 Claimants' Memorial on the Merits, ¶¶ 336, 338, 582.

2139 Russian law at the time did not include a statutory requirement regarding the minimum time limit to be granted to a taxpayer for the voluntary performance of a tax payment demand (*see, e.g.*, Article 69 of the Tax Code; Exhibit RME-579). To the contrary, the standard procedure at the time expressly required that this period would not exceed ten calendar days from the date of the delivery of the demand (*see, e.g.*, Tax Ministry Order No. BG-3-29/159 (Apr. 2, 2003); Exhibit RME-580), and it was in the Tax Ministry's discretion to establish, within this maximum ten day time limit, the deadline for the voluntary performance of any specific payment demand.

which is well understood by taxpayers and authorities alike –- is that a taxpayer is on notice that it will need to pay a specified amount as soon as it receives the audit report for the relevant tax year, which sets forth in detail the basis for the assessments and the amount payable, and always precedes the formal payment demand by a significant period of time. Claimants make similar arguments for the tax year 2001,[2140] 2002,[2141] and 2003.[2142] They are equally meritless, for the same reasons as noted above. For a table showing the actual lead times given to Yukos to pay (*see* ¶ 417 *supra*).

1384. By April 14, 2004, Yukos had known for 107 days[2143] –- not "less than one day"[2144] –- that the amount it would need to pay, in the event that its objections were rejected, would be approximately US$ 3.5 billion.[2145] Rather than "*absurdly short*," this was an entirely reasonable time.

1385. If Yukos' management and controlling shareholders –- namely Claimants –- had intended to pay the company's 2000 tax liabilities, they would not have waited until the Tax Ministry issued the tax assessment on April 14, 2004 to generate and set aside the necessary cash. They would have –- and should have –- done so long before then.

1386. Throughout the foregoing 107 day period, no restrictions whatsoever were in place on either Yukos or its assets, let alone the assets of its

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2140 Claimants' Memorial on the Merits, ¶ 353.

2141 *Ibid.*, ¶¶ 260, 356.

2142 *Ibid.*, ¶¶ 263, 589.

2143 The audit report was issued on December 29, 2003. By the time the 2000 tax assessment and the respective payment demands were issued (Apr. 14, 2004), Yukos had thus had 107 days prior notice. *See* ¶¶ 374-375 *supra*.

2144 Claimants' Memorial on the Merits, ¶ 338.

2145 Indeed, when the tax assessment for the year 2000 was issued on April 14, 2004, it concluded that Yukos owed a total of approximately RUB 99.4 billion, a figure closely corresponding (with minor adjustments) to the still unpaid RUB 98.5 billion assessment in the December 29, 2003 audit report (*see* Decision to Hold the Taxpayer Fiscally Liable for a Tax Offense No. 14-3-05/1609-1 (Apr. 14, 2004) (Annex (Merits) C-104)). Later on, the arbitrazh courts affirmed this assessment in all material respects, while reducing the assessed amounts by RUB 33 million (approximately US$ 1.1 million based on the RUB/US$ exchange rate on June 29, 2004) (*see* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004) (Annex (Merits) C-121)).

subsidiaries. Despite the lack of any such legal impediment, Yukos' management evidently made a conscious decision not to set aside the necessary cash -- an extremely serious mistake for which Claimants, as Yukos' controlling shareholders, must bear responsibility. Neither Claimants nor Yukos has ever provided a credible reason why they could not have assembled the necessary cash in time to pay, if only there had been the will to do so.

1387. Nor can Claimants contend that in April 2004 Yukos was short of cash. Even if, *quod non*, this were true, Claimants would have only themselves to blame, because as Yukos' controlling shareholders, Hulley, VPL and YUL made the ultimate decision to proceed with an unprecedented US$ 2 billion interim cash dividend that involved the payment to themselves of approximately US$ 1.4 billion.[2146]

1388. Further, as will be recalled, that dividend was approved by a vote of Claimants soon after Mr. Khordorkovsky's October 25, 2003 arrest on charges that included tax fraud, and was disbursed in installments through February 2004. In the face of a gathering storm -- with large tax assessments against Yukos in the near future a virtual certainty -- Claimants' decision to strip as much cash as possible out of Yukos was a fraud perpetrated on Yukos' creditors, including the Russian Treasury. Had Claimants only held their greed in check, Yukos would have needed only US$ 1.5 billion more to discharge the totality of its tax liability for the year 2000 in a timely manner. A company of Yukos' size, should have been able to accomplish this readily.[2147]

1389. Yukos also retained ready, unrestricted access to ample resources with which to cover assessments for the other tax years at risk, 2001-2003.[2148]

2146 Lys Report, Exhibit 19. *See* ¶¶ 349-352 *supra*.

2147 Yukos' consolidated turnover for nine months of 2003 was more than US$ 12 billion, an average of US$ 1 billion per month (*See* Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements (Sept. 30, 2003) (Annex (Merits) C-31)).

2148 Yukos and its affiliates had not yet filed their profits tax returns for tax year 2003, which became due only on March 28, 2004. Yukos could, and should, have filed these returns without abusively invoking any low-tax region benefits. Instead, it persisted in doing so -- in the teeth of the authorities' December 29, 2003 audit report –- thus unnecessarily laying the foundation for a further large assessment for tax year 2003. Likewise, Yukos' trading shells

These assets included the huge nest egg that Yukos had hidden away in its opaque Cyprus/British Virgin Islands structure (valued by PwC at US$ 6.8 billion as of June 30, 2004).[2149] Yukos at the time also owned unencumbered Sibneft shares that it could have liquidated, which were worth, by Yukos' estimation, approximately US$ 4.6 billion as of June 30, 2004.[2150] Ample additional resources, in Russia and overseas, were also available to Yukos' management to pay its liabilities for tax years 2001-2003.[2151]

1390. Instead, Yukos simply defied the demand to pay its tax bill for 2000. This refusal to pay constituted a gross violation of Russian law, under which it was clear that the 2000 tax assessment was due and payable as of April 16, 2004, regardless of any pending court proceedings.[2152] In its claims before the Russian courts, Yukos never claimed otherwise. Instead, Yukos again argued its case in the court of public opinion, justifying its failure to pay on the utterly specious grounds, discussed below, that it was prevented from doing so.

(2) The April Injunction Was Appropriate And Did Not Prevent Yukos From Paying Its Overdue Taxes

1391. In these proceedings, Claimants have contended,[2153] as Yukos had claimed previously,[2154] that Yukos was prevented from paying the 2000 tax

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continued through 2004 to pretend that, for VAT purposes, they and not Yukos were the real exporters, thereby guaranteeing that Yukos would be subject to a large VAT assessment for tax year 2004.

2149 *See* E-mail from Chris Santis to Douglas Miller attaching Brittany Trial Balance Sheet for six months of 2004, 8 (Feb. 14, 2005) (Exhibit RME–351).

2150 *See, e.g.*, Petition for voluntary enforcement of the Resolution of June 30, 2004 to initiate enforcement proceedings and the Demand of June 30, 2004 (July 2, 2004), 3 (Annex (Merits) C-126).

2151 *See* ¶ 536 *supra*. As noted at ¶¶ 370-371 *supra*, Yukos could have filed proper amended returns to avoid all VAT assessments for those years, and under Article 81 of the Russian Tax Code (Exhibit RME-344), could also have avoided all fines.

2152 Under Russian law, the tax authorities were required to apply to court only for collection of the assessed fines, while the overdue taxes and default interest were already enforceable before confirmation by a court. *See* Russian Tax Code, Art. 46 (Exhibit RME–541).

2153 Claimants' Memorial on the Merits, ¶ 338.

2154 *See* ¶¶ 393-394 *supra*. *See also* Greg Walters, *Yukos Warns It May Go Bankrupt*, Moscow Times (May 28, 2004) (Exhibit RME–475), citing statement by Yukos that the "*court-ordered freeze on the company's property means Yukos cannot sell assets, including stocks, to help pay the tax bill*" and

assessment by the injunction that the Russian authorities obtained on April 15, 2004 (the "April Injunction").

1392. This has always been a bald fabrication, because that injunction did not interfere in any way with Yukos' ability to pay its taxes, but simply prevented it from selling certain types of assets, in particular its shareholdings in certain Russian subsidiaries.[2155]

1393. The authorities were understandably concerned that Yukos would adopt a scheme to remove Yukos' subsidiaries (including YNG, Samaraneftegaz and Tomskneft) from the perimeter of the Yukos group, and thereby reduce Yukos itself to an empty shell. As discussed above,[2156] the Oligarchs had a track record of abusing their control of Yukos' producing subsidiaries to further their individual interests. In the late 1990s, they had done just that in an attempt to defraud their fellow Yukos shareholders. The authorities could legitimately fear in early 2004 that Yukos' management was contemplating a similar maneuver, this time, to their detriment. Such a fear would have been all the more reasonable because Yukos' recent giga-dividend sent a strong signal that the Oligarchs would not hesitate to take steps to weaken Yukos if it suited their private purposes.[2157] In seeking the April Injunction, the authorities properly exercised their responsibility to take precautionary measures to limit this risk.[2158]

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that, "[u]*nless the court ban is lifted, the sale of assets is impossible*. […] *If the tax authorities continue their actions, we can forecast with high probability that we will go bankrupt before the end of 2004*." *See also, e.g.*, Petition for voluntary enforcement of the Resolution of June 30, 2004 to initiate enforcement proceedings and the Demand of June 30, 2004 (July 2, 2004), 2 (Annex (Merits) C-126).

2155 *See* ¶¶ 377-378 *supra*.

2156 *See* ¶¶ 53 *et seq.*

2157 *See* ¶¶ 349-352 *supra*.

2158 *See* Article 90(1) of the Russian Arbitrazh Procedure Code (Exhibit RME–449). Under Russian law, the Tax Ministry is entitled to file an application seeking enforcement of its payment demand prior to the expiration of the time limit provided for voluntary payment of its demand if there are "*unresolved controversies*" with the taxpayer. *See* Resolution of the Plenum of the Supreme Arbitrazh Court, Case No. 5 (Feb. 28, 2001), ¶ 11 (Exhibit RME–450). *A fortiori*, the Tax Ministry is also entitled to file an application for interim relief for purposes of securing its claim on the merits. Claimants' contention that "*Article 104 of the Russian Tax Code prohibits filing a tax claim with a court before the voluntary payment period has elapsed*" (Claimants Memorial on the Merits, ¶ 247) is contradicted by the very wording of Article 104, which

1394. They did so, however, only to a very limited extent (in fact, too limited, as discussed at ¶¶ 388-394 above). Thus, the April Injunction had no effect on Yukos' bank accounts –- neither those that Yukos ordinarily used to pay its taxes, nor any other ones. In fact, the April Injunction had no impact whatsoever on Yukos' cash flows, either from or to its affiliates or third parties, including proceeds from the sale of oil and oil products. Moreover, because it was limited to the territory of the Russian Federation, the April Injunction did not affect any of Yukos' foreign assets, which included the huge liquid reserve of its British Virgin Islands companies and trusts.[2159]

1395. Equally significant is the fact that the April Injunction encompassed only OAO Yukos NK, the ultimate parent company of the Yukos group. It did not apply to any of Yukos' foreign or domestic affiliates, and therefore did not affect the bank accounts or other assets held in the name of any of those companies (including YNG, Samaraneftegaz and Tomskneft). In fact, the April Injunction did not even apply to any of the trading shells whose abuses had given rise to the tax assessments. The assets of all of these companies –- real and sham –- remained totally unaffected.

1396. All of this was conceded at the time by Yukos' management, which -- while steadfastly insisting that the April Injunction prevented them from paying any taxes relating to their unmasked "tax optimization" scheme -- reassured the public that the injunction "*wouldn't have a significant effect on the company's operations*."[2160] In other words, according to Yukos, the April Injunction

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entitles the tax authorities to apply to court to enforce their claims not only if the "*taxpayer* […] *did not make the payment within the time limit stated in the payment demand*" (in Yukos' case, April 16, 2004), but also "*if the taxpayer refused to pay*" voluntarily in advance of the due date for the payment (Annex (Merits) C-401). As noted, in the circumstances, Yukos had made it crystal clear to the tax authorities before April 16, 2004 that it had no intention of paying its overdue taxes since there were "*unresolved controversies*" with respect thereto. *See* ¶¶ 363, 376 *supra*.

2159 *See* ¶ 378 *supra.*

2160 This was publicly stated by Yukos' Chief Financial Officer, Bruce Misamore, on April 19, 2004, immediately after the issuance of the April Injunction. *See* Gregory L. White, Guy Chazan, *Yukos Is Further Squeezed by Ban - Russian Court Bars Sales of Assets, as Authorities Seek Back Taxes and Fines*, Wall St. J. (Apr. 19, 2004), A8 (Exhibit RME–456).

prevented it from paying taxes that it did not want to pay, but left it free to make any and all other payments.

1397. Even more outrageously, Yukos' managers, while falsely claiming that the April Injunction prevented Yukos from paying even a kopeck of the overdue 2000 tax assessment, continued to divert assets of Yukos and of some of its affiliates into the pockets of Claimants. An example was the payment to Moravel, a Cypriot company wholly owned by the Oligarchs, of US$ 225 million on May 28 and June 28, 2004 -- *i.e.*, at precisely the time when Yukos was claiming that the April Injunction prevented it from paying its overdue taxes.[2161] This transaction cheated not only the Russian treasury, but also Yukos' other shareholders and creditors. The pretext was the contention that Yukos owed money to Moravel pursuant to a "loan," but even the architects of this audacious scheme conceded that at the time Yukos was under no legal requirement to pay anything on that "loan"; the payment of US$ 225 million to Moravel in May and June 2004 was admitted to be a "pre-payment" -- *i.e.*, a voluntary acceleration of the relevant repayment schedule.

1398. Yukos' diversion of corporate assets in favor of Moravel was not limited to the US$ 225 million pre-payment. At the same time -- in May 2004 -- Yukos caused YNG to issue guarantees in the staggering amount of up to US$ 5 billion, of which a majority was for "repayment" of "debts" that Yukos had allegedly incurred vis-à-vis the Oligarchs.[2162] No legitimate business purpose has ever been alleged for this maneuver, which entailed the pledge of the credit of YNG in favor of only the Oligarchs, to the exclusion of Yukos' other shareholders and creditors, under conditions which provided no corresponding benefits to YNG. This is the guarantee that *ex post* was considered by DKW as a contingent liability of YNG when it prepared an evaluation of that company. After Rosneft's acquisition of YNG, YNG successfully challenged this guarantee's validity,

2161 *See* ¶ 390 *supra.*

2162 *See* ¶ 486 *supra.*

confirming that it constituted an improper misuse of YNG by Yukos' management.[2163]

1399. While they were thus diverting Yukos assets in favor of the Oligarchs, Yukos' managers continued to refuse to pay anything at all with respect to the 2000 tax assessment, acting as though payment of this tax bill was optional, and the court decisions upholding the tax assessment for the year 2000 merely hortatory. There was no excuse, legal or otherwise, for this misconduct. Lamentably, however, the false claim that the April Injunction was preventing Yukos from paying its overdue taxes, although preposterous on its face, gained currency among opinion-makers around the world, thanks to Yukos' well-oiled propaganda machine.[2164]

(3) The June 30, 2004 Cash Freeze Orders, The July 2004 Share Seizures And The September 2004 Collection Orders Were Appropriate And Did Not Prevent Yukos From Paying Its Overdue Taxes

1400. Finally, a full 77 days after Yukos had begun its campaign of disobeying the April 14, 2004 tax payment demands, the authorities took an additional, limited step to facilitate collection of the 2000 assessment. On June 30, 2004, they imposed short-term cash freeze orders on some of Yukos' bank accounts (the "Cash Freeze Orders").[2165] These initial orders were followed by

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2163 *See* ¶ 486 *supra.*

2164 *See* ¶¶ 777-779 *supra*.

2165 *See* ¶¶ 399-401 *supra*. Pursuant to Article 9(5) of the 1997 Enforcement Law (Exhibit RME–478), the bailiff had the right to freeze any of the debtor's assets to secure enforcement simultaneously with the initiation of the enforcement proceedings. Article 46(2) of the same law (Exhibit RME–482) provided that "*execution under enforcement documents shall be, in the first priority, levied on the debtor's monetary funds in rubles and in foreign currency, and on other valuables, including those kept in banks and other credit institutions.*" As a matter of practice, bailiffs normally start enforcement by freezing the cash (which is then used to satisfy a creditor's claim if the debtor fails to pay the amounts voluntarily). Russian courts have repeatedly confirmed that this practice complies with the law. *See, e.g.,* Resolution of the Federal Arbitrazh Court of the Far East District, Case No. F03-A73/01-2/1483 (Aug. 7, 2001) ("*When a debtor holds accounts in various banks, a court bailiff may issue resolutions on the attachment of the funds of the debtor in these banks in full. Such actions are not prohibited by legislation on enforcement proceedings.*") (Exhibit RME–483); Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4691-06 (June 5, 2006) ("*Article 9(5) of the Federal Law No. 119-FZ of July 21, 1997 'On Enforcement Proceedings' provides for the possibility to seize a debtor's assets simultaneously with the initiation of the proceedings if there is an application from the creditor to that effect. It has been established that the creditor has submitted such an*

share seizures in July 2004[2166] and collection orders in early September 2004.[2167] None of these measures interfered with Yukos' ability to continue to run its business in the ordinary course. Nor did any of these measures have any impact on any of Yukos' subsidiaries in Russia or overseas.

1401. The Cash Freeze Orders and the subsequent collection orders were aimed at Yukos' bank accounts, and ensured for the first time that Yukos' cash -- rather than being expended in the sole discretion of Yukos' management, as it had been until then -- would instead finally be applied to discharge Yukos' outstanding tax indebtedness.[2168]

1402. The asset seizures secured payment of Yukos' overdue taxes by restricting Yukos' ability to dispose of shares held by it in certain Russian subsidiaries, including YNG, Tomskneft and Samaraneftegaz[2169] (which were previously encumbered by the April Injunction). This restriction in no way harmed Yukos, because they merely prevented Yukos from selling those subsidiaries at a time when there could have been no legitimate reason to do so.

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application to the bailiff, due to which fact a seizure was imposed on the debtor's assets (cash) in the amount to be collected") (Exhibit RME-484); Resolution of the Federal Arbitrazh Court of the Far Eastern District, Case No. F03-A73/06-1/3291 (Oct. 3, 2006) (Exhibit RME-481). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7573-01 (Dec. 25, 2001) (Exhibit RME–485); and Ruling of the Supreme Court, Case No. 5-V02-209 (Nov. 29, 2002) (Exhibit RME–486).

2166 *See* ¶¶ 402 *et seq. supra*.

2167 *See* ¶ 415 *supra*.

2168 The Cash Freeze Orders were only in effect for five business days, following which the freezes were removed and the frozen cash was collected, through collection orders issued by the bailiffs, in discharge of Yukos' tax debt. Under Russian law at the relevant time, measures such as the Cash Freeze Orders only covered cash existing in the bank account as at the date of their initial issuance. As a result, the debtor was free to dispose of any cash subsequently deposited in such accounts, and Yukos was able to take full advantage of this facility notwithstanding the Cash Freeze Orders. *See* Information Letter of the Supreme Arbitrazh Court, No. 6 (July 25, 1996) (Exhibit RME–489); Resolution of the Plenum of the Supreme Arbitrazh Court, No. 11 (Dec. 9, 2002) (Exhibit RME-585); and Letter of 1st Interdistrict Department of the Bailiffs Service for the Central Administrative District of Moscow to Yukos (Aug. 3, 2004) (Exhibit RME–490).

2169 Under Russian law, the bailiffs enjoy full and exclusive discretion to select the debtor's assets upon which to levy enforcement. The 1997 Enforcement Law simply required that execution be levied against the debtor's property "*in such amount and such scope as is required to ensure the satisfaction of claims set out in the enforcement document*," regardless of any proportionality to the amount of the enforced claim. *See* Article 46(6) of the 1997 Enforcement Law (Exhibit RME–482).

In any event, these seizures did not cover all of Yukos' shareholdings in Russian subsidiaries, nor any of Yukos' foreign holdings, or indirect shareholdings in any Russian and foreign subsidiaries' underlying assets.[2170]

1403. These measures did, however, finally convinced Yukos' managers to begin to pay the balance of the company's 2000 tax bill, and to start making payments on the 2001 tax assessments as well.[2171] These belated voluntary payments –- made at a time when the freezes in place were more extensive than under the April Injunction –- confirmed the utter falsity of Yukos' earlier protestations that it could not pay its tax bills because of the April Injunction.[2172]

(4) The Authorities Acted Reasonably In Rejecting Yukos' Tainted Or Otherwise Inadequate Settlement Offers

1404. Claimants complain that the tax authorities were insufficiently generous with Yukos in the exercise of their discretionary right to accept or ignore the latter's settlement offers. These complaints are groundless. In this area too, Yukos' managers attempted to cheat the authorities. Prudently, the authorities declined to fall into Yukos' traps.

1405. The most egregious of Yukos' tricks was repeated at various stages, and consisted of attempts to convince the Russian authorities to accept, as security or partial payment of Yukos' 2000 tax debt, assets –- specifically, Yukos' holdings of Sibneft shares –- that were already subject to court orders securing third party claims or whose title was otherwise disputed by third parties.[2173] Critically, Yukos, when offering these assets, failed to disclose these encumbrances.[2174] Predictably, this attempted fraud ensured that the authorities would look warily at all of Yukos' subsequent proposals.

2170 *See* ¶¶ 405-406 *supra*.

2171 *See* Claimants' Memorial on the Merits, note 380.

2172 *See* ¶¶ 393-394 *supra*.

2173 *See* ¶¶ 417-430, 433-434 *supra*.

2174 For instance, as discussed in greater detail at ¶¶ 417-430, 433-434 *supra*, on April 22, 2004, Yukos offered to the tax authorities 2,724,362,618 Sibneft shares as collateral, in lieu of the April Injunction, without disclosing that those shares were encumbered by a prior court order. Similarly, on July 13, 2004 and again on August 6, September 16, November 24 and

1406. Yukos' managers gave the authorities ample additional reasons for caution. For example, Yukos' requests for payment facilitations were contrary to specific prohibitions of Russian law.[2175] Other proposals were configured in a way that seemed almost to taunt the authorities into rejecting them. For example, Yukos' highly complex offer of August 6, 2004 included in its final sentence a demand that the bailiffs "*respond to this letter prior to August 10, 2004*" -- only the day after the offer was delivered to the authorities -- "*subsequent to which the proposals herein will be considered rejected.*"[2176] Yukos' managers would never have included such an obviously unacceptable condition in their offer if they had intended it to receive serious consideration by the authorities.

1407. By repeatedly attempting to manipulate the authorities, Yukos' managers -- once again, acting too cleverly for their own, their company's, or their shareholders' good -- destroyed any remaining chance that they could regain the authorities' confidence.

1408. In Russia as in most countries, the authorities have essentially unfettered discretion to accept or reject settlement offers.[2177] This is not

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December 16, 2004, Yukos requested the bailiffs to enforce the 2000 assessment on a priority basis against 1,637,633,048 Sibneft shares, which were in part encumbered by another prior court order and whose ownership was claimed by third parties. The same shares were repeatedly offered to the President and Prime Minister of the Russian Federation by the former Canadian Prime Minister, Jean Chrétien, as collateral for, or in partial payment of, the settlement amount proposed by Yukos.

2175 As discussed in greater detail at ¶¶ 431-432 *supra*, Yukos asked the Moscow Arbitrazh Court and the Ministry of Finance, respectively, for authorization to defer its obligation to pay the 2000 tax debts or to pay in installments. The first application was rejected because Yukos failed to prove any "*extraordinary circumstances*" that would justify payment in installments, as required under Russian law. The second application was dismissed because it was beyond the authority of the tax authorities to grant it.

2176 Letter of Yukos' counsel D.V. Gololobov to Chief Bailiff of the Russian Federation A.T. Melnikov (Aug. 6, 2004) (stamped received Aug. 9, 2004), 9 (Annex (Merits) C-140).

2177 Russian law reserved to the authorities exclusive discretion to accept or reject any of Yukos' "settlement" proposals, none of which suspended the company's obligation to pay the overdue amounts. Under Russian law, it is well-settled that while the debtor is entitled to propose to the bailiffs the assets upon which to levy execution on first priority, the ultimate decision rests entirely within the full discretion of the bailiffs. Pursuant to Article 46(5) of the 1997 Enforcement Law (Exhibit RME–482), "[t]*he debtor may suggest property upon which execution may be levied first. The final order of priority in levying execution against the debtor's monetary funds and other property shall be determined by the court bailiff.*" Court practice is in full accord. *See e.g.,* Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-3056/03-GK (Oct. 28, 2003) (Exhibit RME–560) and Resolution of the Federal Arbitrazh Court

surprising. State revenues need to be collected, and in any well-ordered system, tax assessments are expected to be paid when due. In Russia and elsewhere, tax assessments, subject only to judicial review, are the end of the matter, not the opening round in a protracted series of negotiations between the State and the taxpayer. The *Saluka* decision, relied upon by Claimants,[2178] is inapposite. In that case, the Tribunal held that "[a] *Government that is bound by the standard of fair and equitable treatment of foreign investors* […] *cannot avoid paying due regard to the good faith efforts of a foreign investor*" to "*overcome a critical financial situation like that faced by IPB*," the target of the investment.[2179] The facts here are clearly distinguishable. Far from being the result of "*good faith efforts*," Yukos' proposals to the Russian authorities displayed fraud and bad faith. Far from facing "*a critical financial situation*," Yukos had ample resources which it could have used to pay its tax debts, had it wished to do so. Far from trying to "*overcome*" Yukos' self-inflicted crisis, the "*foreign investor*"(*i.e.*, Claimants) systematically adopted actions that caused the destruction of the company, while safeguarding their own self-interest.

(5) Conclusion Regarding Collection Measures

1409. Any fair-minded assessment of the Russian authorities' reactions to Yukos' failure to pay its taxes when due would necessarily lead to the conclusion that the authorities acted with remarkable restraint. The April Injunction did not interfere with Yukos' ability to pay its tax bill, and claims to the contrary -- however oft-repeated -- are gross distortions. During the period when only the April Injunction was in force, Yukos' management, instead of paying the company's taxes, wrongfully diverted corporate assets. It was only 77 days after the April Injunction that the authorities began to collect the 2000 tax bill out of Yukos' bank accounts (starting with the Cash Freeze Orders). The freezes and

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of the North-Caucasian District, Case No. F08-731/04 (Mar. 24, 2004) (Exhibit RME–561). *See also* Article 324 of the Arbitrazh Procedure Code (Exhibit RME–556).

2178 Claimants' Memorial on the Merits, ¶ 650.

2179 *Saluka v. Czech Republic*, ¶¶ 411, 363 [emphasis added]. *See also Ibid.*, ¶ 407 (Annex (Merits) C-977). The *Saluka* tribunal also noted that "[a] *host State's government is not under an obligation to accept whatever proposal an investor makes in order to overcome a critical financial situation* […]." *Ibid.*, ¶ 363.

collection measures that the authorities put in place did not interfere with Yukos' business, as Yukos' own management recognized at the time. Far from being excessive, those freezes proved far too porous, allowing Claimants and their accomplices not only to divert hundreds of millions of dollars, but also in due course to abscond with virtually all of Yukos' non-Russian assets –- a lamentable result that persists to this date.

1410. Further, the freezes and collection measures taken by the authorities were well within the bounds imposed by Russian law.[2180] They were also less swift and less severe than the measures that would have been taken by tax authorities in other countries, especially if they had been confronted with such provocative behavior. As described in greater detail in paragraphs 1414 to 1421, tax authorities around the world do not hesitate to take aggressive action to assess and collect taxes, especially in cases -- such as this one –- where the tax evasion scheme was extensive and tainted by fraud, the taxpayer had refused, without valid reason, to pay taxes when due, and it had attempted to put assets beyond the tax collector's reach. To cite but one example, the authorities in the United States would in all likelihood have exercised their "jeopardy assessment" powers if they had been confronted with a case similar to the one at issue here, allowing them to seize assets with fewer formalities and considerably greater speed (and no doubt much greater disruption) than what the Russian authorities did with respect to Yukos.[2181] Claimants have never articulated a rationale why Russia, in this and other respects, should be held by this Tribunal to a higher standard than the ones that prevailed in other countries.

c) Claimants Have Failed To Establish That The Russian Court Decisions That Confirmed The Other Security And Enforcement Measures Constitute A Radical Departure From Russian Law

1411. Claimants have failed to establish that the complained-of actions taken by the Russian authorities to secure collection of or collect Yukos' tax liabilities constituted a radical departure from Russian law. To the contrary, as

2180 *See* ¶¶ 377, 380, 399, 407-409, 415 *supra*.

2181 *See* Hart Report, ¶¶ 29-33.

shown in Section II.I, those actions, far from constituting a radical departure from, were in complete compliance with Russian law.

1412. This is true, for example, of: (i) the April Injunction that prohibited Yukos from disposing of specified types of assets (in particular, shares in its subsidiaries) as a security measure to prevent further asset dissipation;[2182] (ii) the time limits set by the tax authorities, and thereafter by the bailiffs, for the voluntary payment of the tax assessments;[2183] (iii) the enforcement fees levied by the bailiffs following Yukos' failure to timely pay the tax claims being enforced;[2184] (iv) the Cash Freeze Orders and collection orders imposed in 2004 on a number of Yukos' bank accounts, as well as the share seizures imposed in July 2004 on Yukos' Russian shareholdings, all with a view to securing collection of Yukos' overdue taxes;[2185] (v) the treatment accorded by the bailiffs to Yukos' tainted settlement offers of its Sibneft shares;[2186] and (vi) the treatment accorded by the tax authorities and the Russian courts to Yukos' requests seeking payment facilitations.[2187]

(1) The Complained Of Security And Enforcement Measures Were In Accordance With International Practice

1413. The following survey clearly shows that the time given to Yukos to pay its tax liabilities and the measures imposed by the Russian authorities to secure collection of these liabilities were fully consistent with international practice.

(a) Time To Pay Assessed Taxes

1414. Claimants complain, insistently, that Yukos was given an unreasonably short time to pay the contested assessments.[2188] As explained

2182 *See* §§ II.I.2.; VI.D.4.b.2.

2183 *See* Sections II.I.1, II.I.4, II.I.5; VI.D.4.b.1.

2184 *See* Sections II.I.4.b, II.I.5; VI.D.4.e.2-3.

2185 *See* Sections II.I.4.c-d, II.I.5 and VI.D.4.b.3.

2186 *See* Sections II.I.6.a; VI.D.4.b.4.

2187 *See* Section II.I.6.b.

2188 *See* Claimants' Memorial on the Merits, ¶¶ 336, 338.

above,[2189] the notice periods -- measured, consistently with Russian practice, from the date when the audit report was issued to the deadline for payment -- were actually lengthy, ranging up to 109 days in the case of the first of the assessments relating to tax year 2000.

1415. Comparable minimum notice periods allowed by other countries do not differ significantly from the ones granted to Yukos.[2190] In cases where fraud is present or collection may be impaired (including by means of the type of last-minute dividend distributions Yukos made here[2191]), a number of countries -- such as Canada,[2192] New Zealand,[2193] the Netherlands,[2194] the United Kingdom,[2195] and the United States[2196] -- have mechanisms allowing the

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2189 *See* ¶¶ 374-375, 414.

2190 For example, in the United Kingdom, taxes become due and payable within 60 days of the date of the inquiry (*see* ¶¶ 34 and 48, Schedule 18 of the Finance Act 1998 in the corporation tax context (Exhibit RME-1624), and Regulation 4(1) Value Added Tax Tribunal Rules 1986 SI 1986/590 in the VAT context (Exhibit RME-1625)). In Canada, payment is due "*forthwith*" upon notice of the assessment (*see* § 158 of the Canadian Income Tax Act, RSC, 1985 c.1 (5th suppl.) as amended (Exhibit RME-1623).

2191 *See* section 6851 of the U.S. Internal Revenue Code (contemplating also "*the case of a corporation distributing all or a part of its assets in liquidation or otherwise*") (Exhibit RME-1627).

2192 In Canada, pursuant to section 225.2 of the Income Tax Act, RSC, 1985 c.1 (5th suppl.) as amended, if the tax authorities reasonably believe that the collection of an amount would be put in jeopardy by a delay, they may assess and take immediate collection action, after having applied, on an *ex parte* basis, to a judge, showing that collection is in jeopardy (Exhibit RME-1623).

2193 Pursuant to sections 89C(e), (eb) and 142A of the New Zealand Tax Administration Act 1994 (Exhibit RME-1626), if the tax authorities believe that a taxpayer is trying to move assets to impair tax collection or has been involved in fraudulent activity, they may issue an assessment which is immediately due.

2194 Pursuant to Article 10 of the Dutch Tax Collection Act 1990, "*a tax assessment of the taxable person, concerning an amount receivable, is immediately collectable for its full amount if* […] *the tax collector can credibly establish that it may be reasonably feared that goods owned by the taxable person will be diverted.*" *See* Articles 10-15 of the Tax Collection Act 1990 (Exhibit RME-1604).

2195 In the United Kingdom, if the taxpayer refuses to cooperate or there is a risk of asset dissipation, HM Revenue and Customs can issue a "jeopardy amendment," requiring immediate payment of the taxes ("*any tax shown is due NOW*"). *See* ¶ 30, Schedule 18, Finance Act 1998 (Exhibit RME-1624) and COTAX output to the taxpayer (Exhibits RME-2782). *See also* Expert Report of Felicity Cullen, ¶¶ 23 *et seq*.

2196 As explained by Dale Hart, a former IRS Deputy Commissioner with responsibility for civil enforcement activities, whose expert report is submitted with this Counter-Memorial, if the IRS reasonably believes that the delays associated with the ordinary assessment and collection procedures would jeopardize the effective collection of the tax (because, for instance, the taxpayer could place the assets beyond the reach of the government or become insolvent), the IRS can make a "jeopardy assessment," without prior notice to the taxpayer,

authorities to make "jeopardy assessments" or to take similar measures that effectively require immediate payment of the taxes due.

1416. In many countries, moreover, a taxpayer's obligation to pay taxes is not automatically suspended while challenges to the assessment are pending before courts.[2197] Thus, the enforcement by the Russian authorities of the

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and request immediate payment of the taxes. *See* Hart Report, ¶¶ 29 *et seq*. *See also* § 6861 of the U.S. Internal Revenue Code (Exhibit RME-1627), pursuant to which "*[i]f the Secretary believes that the assessment or collection of a deficiency* […] *will be jeopardized by delay, he shall* […] *immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the secretary for the payment thereof.*" Similarly, if the IRS reasonably believes that the taxpayer will depart or remove property from the United States or conceal himself or his property and in so doing will defeat normal administrative assessment procedures to collect the tax, the IRS will issue a "termination assessment," without prior notice to the taxpayer, and request immediate payment of the taxes. *See also* § 6851 of the U.S. Internal Revenue Code (Exhibit RME-1627), pursuant to which: "*[i]f the Secretary finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act (including in the case of a corporation distributing all or a part of its assets in liquidation or otherwise) tending to prejudice or to render wholly or partially ineffectual proceedings to collect the income tax for the current or the immediately preceding taxable year unless such proceeding be brought without delay, the Secretary shall immediately make a determination of tax for the current taxable year or for the preceding taxable year, or both, as the case may be, and notwithstanding any other provision of law, such tax shall become immediately due and payable.*" In these cases, the IRS may immediately proceed to collect without waiting the otherwise applicable 10-day period after notice and demand or the 30-day period after notice of intent to levy is made to expire. *See also* § 6331 of the U.S. Internal Revenue Code (Exhibit RME-1627).

[2197] *See e.g.*, Austria (pursuant to section 254 of the Austrian Federal Tax Code (*Bundesabgabenordnung*), filing of an appeal does not affect the effectiveness of a tax assessment and especially does not affect or limit the collection of taxes (Exhibit RME-1628)); Canada (collection proceedings are normally postponed until the ultimate determination of a taxpayer's liability by virtue of section 225.1(1) of the Income Tax Act. However, this delay does not apply to limit the tax authorities' action to collect ½ of the amount in dispute where the taxpayer is a large corporation. *See* § 225.1(7) of the Income Tax Act, RSC 1985 c.1 (5th suppl.) as amended (Exhibit RME-1623). A "large corporation" is defined in subsection 225.1(8) as a corporation whose taxable capital employed in Canada and that of related corporations exceeds $10 million (Exhibit RME-1623)); Cyprus (pursuant to Article 42 of the Assessment and Collection of Taxes Law, the tax authorities have the right to collect the contested taxes before a judicial review takes place in cases where they have reason to believe that the tax may not be collected otherwise (Exhibit RME-1629)); France (pursuant to Article L277 of the French Tax Procedure Code, to avoid payment while the case is pending, the taxpayer "*must give guarantees relating to the amount of the disputed amounts*" (Exhibit RME-1637)); Germany (suspension of execution of the contested tax assessment is granted only if payment would impose on the taxpayer an unreasonable hardship; *see* section 361 of the German Tax Code (Exhibit RME-1630)); New Zealand (pursuant to § 138I(2B) of the Tax Administration Act, tax authorities "*may require a disputant to pay all tax in dispute that is the subject of a challenge if* [they] *consider that there is a significant risk that the tax in dispute will not be paid should the disputant's challenge not be successful*" (Exhibit RME-1626); *see also Allen & Anor v Commissioner of Inland Revenue,* Court of Appeal, Case No. (2004) 21 NZTC 18,7, ¶ 73 (Exhibit RME-1631)); and Spain (suspension of execution of tax assessments is granted upon provision

assessments with respect to years subsequent to tax year 2000 by "executive enforcement" (*i.e.*, prior to judicial review) was not inconsistent with international practice. Moreover, all such "executive enforcements" occurred only after the judicial review of the assessment for tax year 2000, which had confirmed the illegality of Yukos' tax scheme. While the judicial review of the 2000 tax assessment was pending, the tax authorities did not seek to enforce payment of any of the assessments for subsequent tax years.

(b) Security Measures And Collection Techniques

1417. Russia's laws on security, collection and enforcement measures of unpaid taxes are also consistent with international practice.

1418. In many countries, the tax authorities are able to take protective measures to ensure collection of tax liabilities even before taxes actually become due and payable. Examples include Austria,[2198] France,[2199] Germany,[2200] Italy,[2201] and New Zealand.[2202]

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of a guarantee for payment of the contested amount; *see* Article 224 and Article 233 of the Spanish General Tax Law 58/2003 (Exhibit RME-1632)).

2198 Under section 232 of the Austrian Federal Tax Code (*Bundesabgabenordnung*), the tax authorities may issue a seizure notification (*Sicherstellungsauftrag*), which is the basis for execution, with a view to preventing jeopardy or material complication of tax collection (Exhibit RME-1628). Such action can be taken even before the final amount of tax is known.

2199 In France, tax authorities may ask the court for authorization to initiate conservatory measures. *See* Article 67 of Law No. 91-650 (July 9, 1991) (Exhibit RME-1635). Pursuant to Article L252 B of the French Tax Procedure Code (Exhibit RME-1637), if the tax authorities suspect a tax fraud, they can perform a precautionary seizure of the taxpayer's assets.

2200 In Germany, a taxpayer's property is subject to preliminary attachment if there is a concern that enforcement could be impaired, even if the tax claim has not yet been assessed, or it is contingent or not yet due. *See* §§ 324 *et seq.* of the German Tax Code (Exhibit RME-1630). For example, in BFH IV 429/51 U (Feb. 21, 1952), the court held that a preliminary attachment may be obtained in case of tax fraud (Exhibit RME-1638). If the tax debt, following the formal assessment and the enforcement through administrative procedure, is not discharged by the due date, the enforcement authorities may satisfy it from the collateral secured by means of the preliminary attachment. *See* § 327 of the German Tax Code (Exhibit RME-1630).

2201 In Italy, tax authorities may secure their claims with mortgages and other interim measures (*sequestro conservativo*) over the taxpayer's assets, including business assets, if they fear inability to collect their claim. *See* Article 22 of Legislative Decree No. 472 (Dec. 18, 1997) (Exhibit RME-1639).

2202 In New Zealand, in case of fraud or risk of asset dissipation, tax authorities can ask the court to issue a charging order on the taxpayer's property, even before judgment adjudicating the tax liability is rendered. *See* Rule 567 of the High Court Rules referred to in *Allen & Anor v*

1419. Often protective measures can be taken without prior intervention by the courts.[2203] Where judicial intervention is required, relief is often granted *ex parte,*[2204] as in the case of the April Injunction obtained by the Russian tax authorities on April 15, 2004.

Commissioner of Inland Revenue, Court of Appeal, No. (2004) 21 NZTC 18,7, ¶ 65 (Exhibit RME-1631).

2203 In France, from the date that a request for payment is issued, tax authorities are entitled to adopt *ex* parte interm measures without seeking court authorization. *See* Article 68 of Law No. 91-650 (July 9, 1991) (Exhibit RME-1635) and Article L252 A of the French Tax Procedure Code (Exhibit RME-1637).

In the United Kingdom, pursuant to section 127 of the Finance Act 2008, the enforcement procedures described in Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (which include the ability to enter premises and seize goods) (Exhibit RME-1647) apply without the need to apply to a court whenever a person does not pay taxes due to HM Revenue and Customs (Exhibit RME-1648). *See also* Expert Report of Felicity Cullen, ¶¶ [113-116.

In the United States when the taxpayer fails to pay any tax for which he is liable, a lien, generally encompassing all of the taxpayer's property or rights to property, automatically arises. *See* § 6321 of the U.S. Internal Revenue Code (Exhibit RME-1627) and § 5.17.2 of the Internal Revenue Manual (Exhibit RME-1649). *See also* Hart Report, ¶ 28. To effect actual collection, the IRS can execute a "levy." *See* § 6331 of the U.S. Internal Revenue Code (Exhibit RME-1627). Judicial intervention is not a precondition in either case (except for property where the taxpayer would have a reasonable expectation of privacy, whose seizure the court can authorize *ex parte*. *See* Hart Report at ¶ 28(ii).

2204 For instance, in Canada, "*where on ex parte application by the Minister, a judge is satisfied that there are reasonable grounds to believe that the collection of all or any part of an amount assessed in respect of a taxpayer would be jeopardize by a delay in the collection of that amount, the judge shall, on such terms as the judge considers reasonable in the circumstances, authorize the Minister to take forthwith any*" enforcement measure. *See* § 225.2(2) of the Income Tax Act, RSC, 1985 c.1 (5th suppl.) as amended (Exhibit RME-1623). *See also* § 223(5) *Ibid*. The enforcement measures are listed in section 225.1(1)(a) to (g) and include the certification of the amount under section 223, (which can be used to enforce the debt in Canada); to require a third person to make a payment under section 224(1) (garnishment procedure); to require an institution or person to make a payment under section 224(1.1) (garnishment procedure for banks and other institutions lending or advancing funds); to require a person to turn over moneys under section 224.3(1) (where the funds have been seized from the tax debtor); or to give a notice, issue a certificate or make a direction under section 225(1) (seizure of chattels).

In France, interim measures may be issued *ex parte* (*see* Article 210 and Article 32 of Decree No. 92-755, of July 31, 1992 (Exhibit RME-1640).

In Germany, a court may grant an application for interim relief *ex parte*. *See* Article 922, Article 937(2)a and Article 944 of the German Code of Civil Procedure (Exhibit RME-1658).

In Italy, *ex parte* interim measures may be issued pursuant to Article 700 and Article 669-*sexies* of the Italian Code of Civil Procedure (Exhibit RME-1641).

In the United Kingdom, courts may grant *ex parte* interim injunctive relief pursuant to Rules 23.4(2) and 25.3(1) of the Civil Procedure Rules (Exhibit RME-1642), and Practice Directive 23.3 (Exhibit RME-1643). *See also,* Cullen Report, ¶ 112.

1420. Numerous countries allow tax authorities to impose cash freezes and asset seizures for the collection of the amounts due.[2205] The authorities are not required to accommodate taxpayer suggestions as to which assets to seize.[2206] Such freezes and seizures sometimes extend to assets with an aggregate value in excess of the amount actually due.[2207]

1421. Several countries allow higher accelerated assessments, freezes, seizures, and even asset sales, when the authorities believe that collection is in "jeopardy."[2208] In this connection, as openly acknowledged by a U.S. court, even in cases not involving any "jeopardy" risk, "*the IRS has much greater latitude and*

2205 In France, upon issuance of a tax notice, the authorities may register a certificate of debt over the taxpayer's movable assets or record a mortgage over the taxpayer's real estate to secure payment of the taxes. *See* Article 1920, Article 1926, and Article 1929 *ter* of the French Tax Code (Exhibit RME-1636). They are also empowered to freeze cash and accounts receivable held by taxpayers with third parties. *See* Article L258 and Article L262 *et seq.* of the French Tax Procedure Code (Exhibit RME-1637).

In the United Kingdom, the tax collector may distrain the goods and chattels of a taxpayer if the taxpayer refuses or neglects to pay an amount of tax due and payable upon demand by the tax collector. *See* Cullen Report, ¶¶ 106 *et seq.* *See also* § 61(1) of the Taxes Management Act 1970 (Exhibit RME-1645) and Regulation 4(1) of the Distress for Customs and Excise Duties and Other Indirect Taxes Regulations 1997/1431 (Exhibit RME-1646); DMBM595020 of the HMRC Manual (Pre-enforcement: Limits in enforcement proceedings: Distraint (England & Wales and Northern Island)) (Exhibit RME-2811) and Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (Exhibit RME-1647). Distraint does not require prior judicial intervention. *See* Cullen Report, ¶¶ 107, 110.

In the United States, as explained by Dale Hart (*see* Hart Report, ¶ 28), the IRS has a strong arsenal of administrative enforcement collection measures at its disposal. These include filing a lien, service of a levy, and seizure of the taxpayer's assets. *See* § 6321 and 6331 of the U.S. Internal Revenue Code (Exhibit RME-1627) and § 5.17.2 of the Internal Revenue Manual (Exhibit RME-1649). In taking action, the IRS will weigh collection alternatives by considering several factors, including: the taxpayer's past compliance history; current level of compliance; current and future financial condition; protection of government's interest in the asset; impact on third parties; and potential yield. *See* § 6331(f) of the U.S. Internal Revenue Code (Exhibit RME-1627), § 301.6331-2(b)(1) and (2) of the Treasury Regulation (Exhibit RME-2663), and Policy Statement 5-34 (May 28, 1999) (Exhibits RME-2668).

2206 *See* Hart Report, ¶ 28(ii); Cullen Report, ¶ 113.

2207 In the United Kingdom, there is no upper limit to the value of the assets that may be frozen or seized in enforcement proceedings. *See* Cullen Report, ¶ 108. *See also* MBM595020 of the HMRC Manual (Pre-enforcement: Limits in enforcement proceedings: Distraint (England & Wales and Northern Island) (Exhibit RME-2811) and Schedule 12 of the Tribunals, Courts and Enforcement Act 2007 (Exhibit RME-1647).

2208 *See, e.g.*, for the United States, Hart Report, ¶¶ 29 *et seq.* For the United Kingdom, *see* Cullen Report, ¶¶ 23-32 (jeopardy amendments), ¶¶ 107 *et seq.* (distraint).

leeway than a normal creditor"[2209] and "*the notion of due process in tax collection is not the same as in other areas of the law*"; because of the State's overriding interest in revenue collection, the taxpayer is afforded much less protection than in other contexts.[2210]

(c) Settlement Offers

1422. As just discussed, in Russia as elsewhere, tax assessments create unconditional obligations to pay, not invitations to negotiations, and tax and enforcement authorities therefore have great discretion whether to accept or reject taxpayers' proposals seeking relaxation of payment terms or other relief from their obligations. In exercising their discretion, the tax authorities naturally take into account, *inter alia*, the prior conduct of the taxpayer.[2211] Yukos acted in

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2209 *Living Care Alternatives of Utica Inc. v. United States,* 411 F.3d 621, 624 (6th Cir. 2005) (Exhibit RME-2726).

2210 *Ibid.* at 629.

2211 This is true, for example, in Australia, where the factors that the Commissioner will take into account in determining whether to exercise his discretion include "*the information provided by the taxpayer and other information that may be held (or obtained) by the Commissioner;* […] *the circumstances that led to the inability to pay;* […] *the taxpayer's current financial position, including other current payment obligations and action taken by the taxpayer to rearrange finances or borrow to meet the debt;* […] *the offer made and the ability to meet payment of the debt (and the additional charges for late payment imposed by legislation) on those terms without seriously impacting on the taxpayer's ability to meet other obligations;* […] *compliance with other taxation obligations or commitments (for example whether all lodgment obligations including activity statements* […] *and the history of the taxpayer's prior dealing with the Commissioner).*" *See* Australian Taxation Office Receivables Policy, Chapter 10, ¶ 11 (Exhibit RME-1633). Australian tax authorities in appropriate circumstances deliberately refuse to settle cases where litigating "*the matter through the courts could have a significant flow-on compliance effect,*" meaning where litigating would send a stronger deterrent signal than a settlement. *See* Australian Taxation Office, Code of Settlement Practice Re-released on Feb. 21, 2007, ¶ 25 (Exhibit RME-1634).

In France authorities may -- but are not required to -- accept a taxpayer's settlement proposals. *See* Administrative Guideline 12-C-2-98 (Exhibit RME-1652).

In Canada, the Federal Court of Appeal held that the Minister as a creditor "*has the right to arrange payment for a tax indebtedness in such a manner that best ensures that the whole will ultimately be paid,*" adding that "*in his discretion the Minister might arrange for payment in installments* […] *as he deems necessary.*" *See The Queen v Optical Recording Laboratories Inc.*, Federal Court of Appeal [1990] 2CTC 524,90 DTC6647(FCA) (Exhibit RME-1653).

In New Zealand, the decision not to enter into an installment arrangement cannot be disputed or challenged in court. *See* Raynel & Anorv CIR (2004) 21 NZTC 18,583 (Exhibit RME-1655).

In Switzerland, the Federal Court held an authorization of the tax authorities to grant payment arrangements is a simple administrative action in the discretion of the authorities, which is not subject to any judicial review. *See* Swiss Federal Court Decision No. 122 I 373 of (December 20, 1996) and No. 2A.344/2002 (Dec. 23, 2002) (Exhibit RME-1662).

ways that virtually ensured that it would not be trusted by the Russian authorities, including by dissipating corporate assets, misrepresenting the true scope of the April Injunction, and trying to convince the authorities to accept assets encumbered by undisclosed third party claims.

1423. Yukos also submitted requests to defer payment of its tax liabilities, or to pay in installments, even though it had ample resources inside and outside Russia to discharge its debts in a timely manner. Yukos' requests would in all likelihood have been rejected in most other countries -- including Austria,[2212] Australia,[2213] Canada,[2214] Germany,[2215] New Zealand,[2216] Spain,[2217]

In the United States, "*the discretion vested in the IRS to settle tax cases is by its very nature a discretion to treat similarly situated taxpayers differently. Within the constraints imposed by regulation and the equal protection or abuse of discretion doctrine, the authority of the IRS to compromise cases of disputed liability has long been absolute*". *See Bunce v United States*, 28 Fed. Cl. 500,510 (1993). (Exhibit RME-2678) *See also Slovacek v Untied States* 40 Fed. Cl. 828 (1998) (Exhibit RME-2750) and Hart Report, ¶ 21.

[2212] In Austria, pursuant to section 212 of the Austrian Federal Tax Code (*Bundesabgabenordnung*) (Exhibit RME-1628), the tax authorities may -- but are not required to -- agree to a deferral of payment of the taxes due, or agree to payment in installments, provided that: (i) immediate payment would lead to a material difficulty for the taxpayer; and (ii) the possibility to collect taxes is not impaired. The maximum term for payment deferral and payment in installments shall not exceed 12 months. *See* § 265 of the *Guidelines for tax Collection* (Exhibit RME-1656).

[2213] In Australia, the tax authorities may accept a request for payment in installments provided that the taxpayer shows that: (i) it is unable to pay the debt by the due date; (ii) the taxpayer has *bona fide* reasons for its inability to pay; (iii) the taxpayer has an acceptable payment plan in the shortest possible timeframe; (v) the first installment is payable at the time of the application; (vi) interest charges will be factored into the payment plan; and (vii) the Commissioner will be reimbursed for any costs incurred in any recovery action for the debt. *See* Chapter 10 of the Australian Taxation Office Receivables Policy (Exhibit RME-1633). Even if these conditions are met, the authorities have discretion whether or not to accept the taxpayer's request.

[2214] *See Burkes v M.N.R.*, 2011 FC 166, citing the CRA's Information Circular No. 98-1R3, (Feb. 12, 2008): "*We* [collection authorities] *will consider payment arrangements when you have tried all reasonable ways of getting the necessary funds, either by borrowing or rearranging your financial affairs, and you still cannot pay the balance in full. To help us determine your ability to pay, you will have to make full disclosure and give evidence of your income, expenses, assets, and liabilities. Collection officers may verify the information you provide before accepting an arrangement.*" (Exhibit RME-1654). [emphasis added]

[2215] In Germany, pursuant to section 222 of the German Tax Code (Exhibit RME-1630), a payment deferral may be granted only if payment by the due date would result in considerable hardships for the taxpayer and if the taxpayer is not to blame for its inability to pay in a timely manner. Whether or not to grant the request is within the discretion of the authorities.

[2216] In New Zealand, the tax authorities may decline to enter into an installment arrangement if they consider that the taxpayer is in a position to pay all of the outstanding tax immediately, or the taxpayer is being frivolous or vexatious. *See* § 177B of the Tax Administration Act (Exhibit RME-1626).

Switzerland,[2218] and the United States.[2219] The same holds true for Yukos' proposals that its liabilities be discharged by means other than cash.[2220]

1424. In light of the foregoing, the time given to Yukos to pay its tax liabilities and the measures that the Russian authorities imposed to secure the collection of those liabilities were fully consistent with international practice.

d) The Alleged Violations Of Due Process Do Not By Themselves Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1425. As shown at Section C.5.a above, in the absence of proof of total or substantial deprivation caused by alleged due process violations, such violations by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*."

2217 In Spain, a taxpayer can request the authorities to authorize payment in installments when its current economic and financial situation temporarily prevents it from paying the overdue taxes when due. *See* Article 65 of the Spanish General Tax Law No. 58/2003 and Article 46 of the Spanish General Collection Regulations Royal Decree No. 939/2005 (Exhibits RME-1657). The taxpayer is required to prove that it will be able to generate sufficient economic resources to pay the tax debt in the immediate future as well as to offer a guarantee covering the amount of the debt plus interest. *See* Resolution of the Central Economic and Administrative Court, Case No. 4076/2006 (July 11, 2007) (Exhibit RME-1660).

2218 In Switzerland, the tax authorities may authorize deferral or payment in installments if the taxpayer proves that it is unable to pay the taxes when due as the result of exceptional circumstances. Even if these conditions are met, the tax authorities remain free to grant or refuse the requested payment facilitation. *See* Article 166 of the Swiss Federal Tax Act. *See also,* Decision of the Administrative Court 3rd Chamber (Mar. 20, 2007) (Exhibit RME-1664) and Federal Court Decision 122/373, 374 (Exhibits RME-1661).

2219 As Dale Hart explains, a deferred payment arrangement is only considered when the taxpayer is unable to pay in full. But if financial analysis reveals an ability to pay but the taxpayer is unwilling to pay, the IRS will initiate enforcement action. *See* Hart Report, ¶ 27. *See also* § 5.14.1.1 of the Internal Revenue Manual, pursuant to which "*If full payment cannot be achieved by the Collection Statute Expiration Date, and taxpayers have some ability to pay, Partial Payment Installment Agreements may be granted*" (Exhibit RME-1649). [emphasis added]

2220 In a number of countries, assessed taxes can be discharged only in cash and no alternative assets can be accepted. For example, in Italy, pursuant to Article 61 of Presidential Decree 602/1973 (Exhibit RME-1650), when the enforcement procedure is started the only way to settle the claim is to pay cash in the amount due before a compulsory of assets takes place. The same is true for the Netherlands. *See* Article 6:111 of the Dutch Civil Code (Exhibit RME-1651): "*An obligation to pay an amount of money shall be performed at its nominal value unless otherwise required by law, customary law or legal act*."

e) In Any Event, Claimants Have Failed To Establish The Alleged Due Process Violations

1426. Claimants generally contend that the enforcement proceedings against Yukos "*were tainted with lack of due process,*"[2221] and raise a number of specific allegations in support of that accusation.[2222] None has any merit.

(1) The Alleged Due Process Violations In The Enforcement Proceedings Were Subject To Court Review

1427. In the Russian legal system, all of Claimants' allegations with respect to the measures adopted by the Russian authorities to secure the collection of, or to collect, Yukos' tax liabilities were subject to court review. Pursuant to Article 198 of the Russian Arbitrazh Procedure Code, Yukos was entitled to seek judicial review of "*non-regulatory acts, or* [...] *decisions, actions (failure to act) by government bodies, bodies of local administration, other bodies, officials.*"[2223] In addition, Yukos was entitled to appeal the court decisions confirming the authorities' actions and measures at the appellate, cassation, and supervisory court level, as discussed in detail in ¶¶ 1287 to 1289 above.[2224]

1428. Yukos pursued this judicial review, and sought the annulment of virtually all[2225] of the specific security and enforcement measures about which

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2221 Claimants' Memorial on the Merits, ¶ 590.

2222 *Ibid.*

2223 *See* Russian Arbitrazh Procedure Code, Art. 198 (Exhibit RME-1670) ("*Citizens, organizations and other persons have a right to submit to an arbitrazh court an application for declaring invalid non-regulatory acts, or declaring illegal decisions, actions (failure to act) by government bodies, bodies of local administration, other bodies, officials, if they believe that the non-regulatory act being challenged, decision and action (failure to act) do not comply with the law or other regulatory act and violate their rights and lawful interests in the sphere of business and other economic activity, unlawfully impose any obligations on them, create other obstacles for business and other economic activity.*" [emphasis added]). *See also* the 1997 Enforcement Law, Art. 90 (Exhibit RME-1671), Russian Arbitrazh Procedure Code, Art. 329 (Exhibit RME-1672), Russian Tax Code, Art. 138 (Annex (Merits) C-401), and Russian Arbitrazh Procedure Code, Art. 324(4) (Exhibit RME-556).

2224 *See also* Russian Arbitrazh Procedure Code, Art. 180, 257(1), 259, 268(1), 271(5), 273, 276(1), 286(1) and (3), 289(5), 292, 294, 299, 304 (Exhibits RME-1679, RME-1677, RME-1678, RME-1695, RME-1570, RME-1681, RME-1684, RME-1686, RME-1687, RME-1682, RME-1685, RME-1688, RME-1689).

2225 Out of the dozens of measures and decisions taken by the Russian authorities in the process of collecting or securing collection of Yukos' tax liabilities, Yukos appears not to have challenged only the following: (i) the Cash Freeze Orders; (ii) a number of complained of shares seizures; (iii) the first instance court decision confirming the bailiffs' denial of Yukos

Claimants now complain. All of Yukos' challenges received full judicial review at the first instance level, full review at the appellate court level (in some cases, *de novo*), and/or legal scrutiny at the cassation court level and, in some instances, even discretionary supervisory review at the Supreme Arbitrazh Court level.

1429. Further, with the single exception discussed below, Yukos raised before the Russian courts all of the allegations with respect to these security and enforcement measures that Claimants now raise again, and those allegations were fully reviewed, through various layers of appeals. The Russian courts consistently dismissed Yukos' allegations as groundless.

(2) Claimants Have Failed To Allege Or Establish Any Due Process Violations In The Court Proceedings That Confirmed The Enforcement Measures

1430. From the nearly 40 court proceedings that confirmed the legality of the security and enforcement measures in question, Claimants allege procedural improprieties with respect only to one: the proceedings in the first instance court initiated upon Yukos' challenge of the 2001 tax assessment, the related payment demand and the collection orders of September 6, 2004.[2226] As shown at ¶¶ 1303 to 1317 above, this allegation is without merit.

1431. Conversely, Claimants do not allege, nor do they contend that Yukos alleged, any procedural improprieties with respect to any of the following court proceedings:

(i) the court proceedings confirming the April Injunction (appellate level);[2227]

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offers of Sibneft shares; (iv) the Tax Ministry's rejection of Yukos' request for a respite or deferral of payment (*see* Letter from the Russian Tax Ministry to Yukos (Aug. 30, 2004) (Annex (Merits) C-145)); and (v) the Moscow Arbitrazh Court's rejection of Yukos' request for an authorization to pay the 2000 tax assessment in installments (*see* Decision of the Moscow Arbitrazh Court, Case No. A40-1397/04ip-109 (Aug. 12, 2004) (Annex (Merits) C-142)).

2226 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92 / A40-54628/04-143-134 (Nov. 18, 2004), 15 (Exhibit RME-252). Claimants do not allege any procedural improprieties with respect to the appeal proceedings in this case.

2227 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (July 2, 2004) on Yukos' challenge of the April Injunction (Exhibit RME-451).

(ii) the court proceedings confirming the legality of the tax authorities' application to collect the 2000 tax assessment (appellate, cassation, and supervisory level);[2228]

(iii) the court proceedings rejecting Yukos' bad faith attempt to substitute the April Injunction with an impaired 57.5% stake in Sibneft (first instance and appellate level);[2229]

(iv) the court proceedings confirming the legality of the 5-day deadlines established in the bailiffs' resolutions initiating tax enforcement proceedings (first instance and cassation level);[2230]

(v) the court proceedings confirming the bailiffs' resolutions levying 7% enforcement fees (up to the cassation level);[2231]

2228 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121); upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/6914-I,B (Sept. 17, 2004) (Exhibit RME-1549) and Resolution of the Supreme Arbitrazh Court, Case No. 8665/04 (Oct. 4, 2005) (Exhibit RME-1552).

2229 *See* Ruling of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (Apr. 23, 2004) (Exhibit RME-452) and Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (July 2, 2004) on Yukos' application for substitution of the April Injunction with Sibneft shares (Exhibit RME-453).

2230 *See* (i) Decision of the Moscow Arbitrazh Court, Case No. A40-33821/04-92-266 (July 30, 2004), 2 (Exhibit RME-487), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-33821/04-92-266 (Nov. 10, 2004) (Exhibit RME-488); (ii) Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004), 3 (Exhibit RME-543), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005) (Exhibit RME-544); (iii) Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005), 7 (Exhibit RME-496), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-4904-05 (June 16, 2005) (Exhibit RME-545); and (iv) Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-698 (Feb. 10, 2005), 4 (Exhibit RME-546), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4816-05 (June 14, 2005) (Exhibit RME-547).

2231 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09-AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-11135-04 (Dec. 6, 2004) (Annex (Merits) C-148), confirming the legality of the enforcement fee resulting from Yukos' failure to pay the 2000 tax assessment; Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004) (Exhibit RME-543) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005) (Exhibit RME-544), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005)

(vi) the court proceedings confirming that the Cash Freeze Orders of June 30, 2004[2232] did not prevent Yukos from paying its tax debts (up to the cassation level);[2233]

(vii) the court proceedings confirming the shares seizures of July 2004 (up to the cassation level);[2234]

(Exhibit RME-496) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-4904-05 (June 16, 2005) (Exhibit RME-545), confirming the legality of the enforcement fee resulting from Yukos' failure to pay fines for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-698 (Feb. 10, 2005) (Exhibit RME-546) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4816-05 (June 14, 2005) (Exhibit RME-547), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2002.

2232 Yukos did not challenge the Cash Freeze Orders as such, but in various court proceedings, raised the argument that these orders prevented it from paying its tax debts.

2233 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-33821/04-92-266 (July 30, 2004), 3 (Exhibit RME-487), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-33821/04-92-266 (Nov. 10, 2004) (Exhibit RME-488). *See also* Resolution of the Ninth Appellate Arbitrazh Court, Case No. 09-AP-1595/04-AK (Aug. 27, 2004), 6 (Exhibit RME-479), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-11135-04 (Dec. 6, 2004) (Annex (Merits) C-148); Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004), 2 (Exhibit RME-543), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005), 3 (Exhibit RME-544).

2234 Specifically:

(i) The July 1, 2004 seizure of Yukos' shares in 24 subsidiaries (Annex (Merits) C-125) was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37946/04-12-398 (Sept. 20, 2004) (Exhibit RME-520) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521). Yukos did not challenge the seizures of shares in 12 other subsidiaries under the July 1, 2004 bailiff's resolution.

(ii) The July 5, 2004 seizure of Yukos' shares in three subsidiaries (NPF Geofit, Tomskneftegeofizika, and Khantymansiysknefteproduct (Annex C (Merits) C-127)) and the July 8, 2004 seizure of Yukos' shares in an oil products retailer OAO Novosibirsk Entity for the Provision of Oil Products of the Eastern Oil Company (Annex (Merits) C-131) were upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12602-04 (Jan. 20, 2005) (Exhibit RME-523). Yukos did not challenge the seizures of shares in 17 other subsidiaries under the July 5, 2004 bailiff's resolution.

(iii) The July 14, 2004 seizure of Yukos' shares in YNG was upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525).

(iv) The July 14, 2004 seizure of Yukos' shares in Samaraneftegaz was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526)

(viii) the court proceedings confirming the bailiffs' denial of Yukos' offers of its Sibneft shares (up to the cassation level);[2235]

(ix) the court proceedings denying Yukos' request to pay the 2000 tax assessments in installments (first instance; this decision was not appealed by Yukos);[2236] and

(x) the appeal proceedings confirming the tax authorities' collection orders of September 6, 2004.[2237]

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and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527).

(v) The July 14, 2004 seizure of Yukos' shares in Tomskneft was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529).

2235 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-34962/04-94-425 (Aug. 17, 2004) (Annex (Merits) C-143). *See also, e.g.*, (i) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525), all regarding Yukos' challenge of the seizure of the YNG shares; (ii) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479), regarding Yukos' challenge of the 7% enforcement fee for non-payment of the tax assessment for year 2000; (iii) Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529), both regarding Yukos' challenge of the seizure of shares in Tomskneft; (iv) Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527), both regarding Yukos' challenge of the seizure of shares in Samaraneftegaz; (v) Decision of the Moscow Arbitrazh Court, Case No. A40-37946/04-12-398 (Sept. 20, 2004) (Exhibit RME-520) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521), both regarding Yukos' challenge of the seizure of shares in 24 other subsidiaries; (vi) Decision of the Moscow Arbitrazh Court, Case No. A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12602-04 (Jan. 20, 2005) (Exhibit RME-523), both regarding Yukos' challenge of the seizures of shares in four other Yukos subsidiaries; and (vii) Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004), 6 (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05 (May 3, 2005) (Annex (Merits) C-292), all regarding Yukos' challenge of the bailiff's decision to sell the YNG common shares and dismissing, *inter alia*, Yukos' argument that the bailiff should have accepted its offer of Sibneft shares of August 6, 2004.

2236 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-1397/04ip-109 (Aug. 12, 2004) (Annex (Merits) C-142).

(3) The Remaining Alleged Due Process Violations In the Enforcement Proceedings Were Reviewed By The Russian Courts Or Were Not Raised By Yukos At The Time

1432. Claimants (like Yukos at the time) allege that the bailiffs prevented Yukos from paying its tax bills by seizing "*Yukos' most valuable assets*."[2238] As set forth at paragraphs 402 to 409 above, the July 2004 seizures of Yukos' shares in its main production subsidiaries (YNG, Tomskneft and Samaraneftegaz) were levied in accordance with Russian law and no procedural irregularities have been alleged.[2239]

1433. The following alleged due process violations were also raised by Yukos before the Russian courts, and were fully reviewed at multiple levels of appeal:

(i) The allegation that the periods for the voluntary payment of each payment demand granted to Yukos were "*incredibly short*."[2240] Yukos raised this objection before the Moscow Arbitrazh Court,[2241]

2237 Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-40/05-AK (Feb. 16, 2005) (Annex (Merits) C-167), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588), and Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb. 20, 2006) (Exhibit RME-589). As noted, Claimants allege procedural improprieties with respect to the first instance proceedings on this case, but not to the appellate and cassation proceedings.

2238 Claimants' Memorial on the Merits, ¶ 590.

2239 Specifically:

(i) The July 14, 2004 seizure of Yukos' shares in YNG was upheld by Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525).

(ii) The July 14, 2004 seizure of Yukos' shares in Samaraneftegaz was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527).

(iii) The July 14, 2004 seizure of Yukos' shares in Tomskneft was upheld by Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529).

2240 Claimants' Memorial on the Merits, ¶ 590.

2241 Namely, Yukos raised this objection when it challenged the legality of the 2001 tax assessment, the related tax payment demands and the collection orders of September 6, 2004.

which dismissed it.[2242] This ruling was upheld at the appellate, cassation, and supervisory court level.[2243] In accordance with Russian law,[2244] the courts confirmed the legality of the time limits set forth in the payment demands, holding that Russian law at the time did not include a statutory minimum time limit for the voluntary performance of a tax payment demand, and that it was in the Tax Ministry's discretion to establish the payment deadline within the maximum ten-day limit provided under the law.[2245]

(ii) The allegation that the Moscow Arbitrazh Court improperly accepted the application filed by the tax authorities on April 15, 2004 to collect the 2000 tax assessment "in direct violation of Art. 104 of the Russian Tax Code."[2246] Yukos raised this objection before the Moscow Arbitrazh Court, which confirmed the legality of the tax authorities' application at the appellate level.[2247] This

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2242 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92 / A40-54628/04-143-134 (Nov. 18, 2004), 15 (Exhibit RME-252).

2243 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-40/05-AK (Feb. 16, 2005) (Annex (Merits) C-167), Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3573-05 (Dec. 9, 2005) (Exhibit RME-588) and Ruling of the Supreme Arbitrazh Court, Case No. 7801/05 (Feb 20, 2006) (Exhibit RME-589).

2244 *See, e.g.,* Article 69 of the Tax Code (Exhibit RME-579). The standard procedure at the time expressly required that the time-limit for performance of a tax payment demand would not exceed ten calendar days from the date of the delivery of the demand. *See* Tax Ministry Order No. BG-3-29/159 (Apr. 2, 2003) (Exhibit RME-580). In many cases unrelated to Yukos' tax authorities have demanded payment within a one or two-day period, regardless of the amount of back taxes, and the legality of such period has not been questioned by the Russian courts. *See, e.g.,* Resolution of Federal Arbitrazh Court of East-Siberian District, Case No. A33-16983/01-S3a-F02-1862/02-S1 (July 16, 2002) (Exhibit RME-1691); Resolution of Federal Arbitrazh Court of Volgo-Vyatsky District, Case No. A82-11/2003-A/6 (Jan. 19, 2004) (Exhibit RME-1692); Resolution of Federal Arbitrazh Court of West-Siberian District, Case No. F04-2648/2005(10969-A61-37) (May 4, 2005) (Exhibit RME-1693).

2245 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-51085/04-143-92 / A40-54628/04-143-134 (Nov. 18, 2004), 15 (Exhibit RME-252) holding: "[i]*n accordance with paragraph 4 Article 69 of the Tax Code of the Russian Federation, a demand to pay a tax shall contain information concerning the deadline for the fulfillment of the demand. The tax legislation does not stipulate any deadline for voluntary fulfillment by the taxpayer of the demand to pay taxes. Upon issue of the Claim, the Inspectorate is entitled to stipulate a time period for its voluntary execution*."

2246 Claimants Memorial on the Merits, ¶ 582. *See also ibid.*, ¶ 247.

2247 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121).

ruling was upheld at cassation and supervisory court level.[2248] In accordance with Russian law,[2249] the court held that the tax authorities were authorized to apply to the court prior to the expiration of the deadline for voluntary payment given Yukos' stated refusal to pay the assessed amounts and the existence of "*unresolved controversies*" with Yukos.[2250]

(iii) The allegation that bailiffs "consistently prevented Yukos from satisfying the payment demands imposed on it […] by rejecting the Company's numerous settlement proposals."[2251] Yukos challenged before Russian courts the bailiffs' denial of Yukos' requests to enforce against its Sibneft shares. The Moscow Arbitrazh Court dismissed Yukos' challenge, holding -- in accordance with Russian

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2248 *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/6914-I,B (Sept. 17, 2004) (Exhibit RME-1549) and Resolution of the Supreme Arbitrazh Court, Case No. 8665/04 (Oct. 4, 2005) (Exhibit RME-1552).

2249 Article 104 of the Russian Tax Code entitles the tax authorities to apply to court to enforce their claims not only if the "*taxpayer* […] *did not make the payment within the time limit stated in the payment demand*" (in Yukos' case, April 16, 2004), but also "*if the taxpayer refused to pay*" voluntarily in advance of the due date for the payment. *See* Article 104 of the Russian Tax Code (Annex (Merits) C-401). As noted, in the circumstances, Yukos had made it crystal clear to the tax authorities already before April 16, 2004 that it had no intention to pay its overdue taxes since it asserted there remained "*unresolved controversies.*" Claimants also allege that the Tax Ministry filed its application with respect to fines for tax year 2001 before the expiration of the deadline for voluntary payment (Claimants' Memorial on the Merits, ¶ 256). This allegation is false. The Tax Ministry applied to the court on September 7, 2004 (*i.e.* after the expiration of the due date), and not on September 3, 2004, as alleged by Claimants. *See* Tax Ministry's petition to collect tax penalties (Exhibit RME-1694). *See also* Tax Ministry's petition to collect tax penalties (Annex (Merits) C-158).

2250 *See* Resolution of the Appellate Division of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241 (June 29, 2004), 5 (Annex (Merits) C-121) ("*Given that failure to meet the Applicant's demand for voluntary payment of the amount due is one of the independent conditions for filing a claim with a court together with the failure to meet the deadline for payment, the RF Tax Ministry had the right to file its application with the Court prior to the due date indicated in the demand, provided that the taxpayer did not meet the demand by the time the claim was submitted. The case file also confirms the existence of unresolved disagreements between the tax authority and the taxpayer with respect to the justness of the Applicant's demands (OAO Yukos Oil Company letters No. 243/2-27 of 12.01.2004, No. 220-24 of 12.01.2004, No. 243/2-130 of 26.01.2004, telegram of 12.01.2004, objections to the field tax audit report No. 243/2-28 of 12.04.2004, protocol of review of objections to the field tax audit report dated 27.01.2004, letter No. 243/2-435 of 08.04.2004), which confirms the Applicant's right to file an application for collection with the Court prior to the expiry of the established deadlines* […]. *Furthermore, the RF Tax Ministry's demands have not yet been fulfilled by the Respondent.*").

2251 Claimants' Memorial on the Merits, ¶ 590.

law[2252] -- that: (i) it was within the exclusive discretion of the bailiffs to determine the assets upon which to levy enforcement; and (ii) in the circumstances, the bailiffs had properly exercised their discretion, given that Yukos' ownership of the proffered shares was disputed.[2253] This decision was not appealed by Yukos. Thereafter, the courts repeatedly -- and quite reasonably -- upheld the bailiffs' treatment of Yukos' offers of the Sibneft shares.[2254]

2252 Under Russian law, it is well-settled that while the debtor is entitled to propose to the bailiffs the assets upon which they could levy execution on first priority, the ultimate decision rests entirely within the discretion of the bailiffs. Pursuant to Article 46(5) of the 1997 Enforcement Law (Exhibit RME-482), "[t]*he debtor may suggest property upon which execution may be levied first. The final order of priority in levying execution against the debtor's monetary funds and other property shall be determined by the court bailiff.*" [emphasis added]. Court practice is in full accord. *See, e.g.*, Resolution of the Federal Arbitrazh Court of the Urals District, Case No. F09-3056/03-GK (Oct. 28, 2003) (Exhibit RME-560) and Resolution of the Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-731/04 (Mar. 24, 2004) (Exhibit RME-561).

2253 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-34962/04-94-425 (Aug. 17, 2004). (Annex (Merits) C-143). In particular, the court held that: "*the Bailiff was not obliged to uphold the petition of* [...] *Yukos* [...] *to enforce against the* [...] *Sibneft shares, obtained by* [...] *Yukos* [...] *in violation of current legislation, the acquisition of which is disputed by the shareholders of* [...] *Yukos* [...] *itself and by the entities from which the shares have been received and upon which a seizure has been imposed by the Arbitrazh Court of the Chukotka Autonomous District and the Moscow Arbitrazh Court*."

2254 *See, e.g.*, (i) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1554/04-AK (Aug. 23, 2004) (Annex (Merits) C-144), upheld by Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/9599-04 (Oct. 25, 2004) (Exhibit RME-612) and Ruling of the Supreme Arbitrazh Court No. 14969/04 (Dec. 17, 2004) (Exhibit RME-525) all regarding Yukos' challenge of the seizure of the YNG shares; (ii) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479), regarding Yukos' challenge of the 7% enforcement fee for non-payment of the tax assessment for year 2000; (iii) Decision of the Moscow Arbitrazh Court, Case No. A40-37418/04-92-324 (Aug. 13, 2004) (Exhibit RME-528) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/10166-04 (Nov. 5, 2004) (Exhibit RME-529), both regarding Yukos' challenge of the seizure of shares in Tomskneft; (iv) Decision of the Moscow Arbitrazh Court, Case No. A40-37414/04-119-463 (Sept. 6, 2004) (Exhibit RME-526) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12561-04 (Jan. 18, 2005) (Exhibit RME-527), both regarding Yukos' challenge of the seizure of shares in Samaraneftegaz; (v) Decision of the Moscow Arbitrazh Court, Case No. A40-37946/04-12-398 (Sept. 20, 2004) (Exhibit RME-520) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/13379-04 (Feb. 2, 2005) (Exhibit RME-521), both regarding Yukos' challenge of the seizure of shares in 24 other subsidiaries; (vi) Decision of the Moscow Arbitrazh Court, Case No.A40-36167/04-121-295 (Sept. 2, 2004) (Exhibit RME-522) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12602-04 (Jan. 20, 2005) (Exhibit RME-523), both regarding Yukos' challenge of the seizures of shares in four other Yukos subsidiaries; and (vii) Decision of the Moscow Arbitrazh Court, Case No. A40-62215/04-144-87 (Dec. 10, 2004), 6 (Exhibit RME-562), Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7284/04-AK (Jan. 27, 2005) (Exhibit RME-563) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/3276-05

(iv) The allegation that the bailiffs "consistently prevented Yukos from satisfying the payment demands imposed on it […] by imposing huge enforcement fees."[2255] Upon Yukos' challenge, Russian courts also confirmed -- up to the cassation court level, and in accordance with Russian law[2256] -- the legality of the enforcement fees, finding that in the circumstances, Yukos had failed to prove that "*exceptional circumstances*" beyond its control prevented it from voluntarily satisfying the enforced claims and could therefore exempt it from the imposition of the enforcement fee.[2257]

1434. Claimants further allege that the bailiffs "overlook[ed] the payments made by Yukos […] to discharge its alleged tax debt."[2258] This allegation does not appear to have been raised by Yukos before any courts. It is not clear, however, to what conduct of the bailiffs Claimants are referring, because they fail to point to any specific factual circumstances.

(May 3, 2005) (Annex (Merits) C-292), all regarding Yukos' challenge of the bailiff's decision to sell the YNG common shares and dismissing, *inter alia*, Yukos' argument that the bailiff should have accepted its offer of Sibneft shares of August 6, 2004.

2255 Claimants' Memorial on the Merits, ¶ 590.

2256 Pursuant to Article 81(1) of the 1997 Enforcement Law, "[i]*f the enforcement document is not executed without any valid reasons within the term fixed for the voluntary performance of the document, the bailiff issues a resolution, under which an enforcement fee shall be imposed on the debtor, in the amount of seven per cent of the claimed amount or the value of the debtor's assets.*" (Exhibit RME-478).

2257 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09-AP-1595/04-AK (Aug. 27, 2004) (Exhibit RME-479) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-11135-04 (Dec. 6, 2004) (Annex (Merits) C-148), confirming the legality of the enforcement fee resulting from Yukos' failure to pay the 2000 tax assessment; Decision of the Moscow Arbitrazh Court, Case No. A40-52837/04-125-533 (Nov. 1, 2004) (Exhibit RME-543) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/1192-05 (Mar. 11, 2005) (Exhibit RME-544), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69460/04-125-697 (Feb. 10, 2005) (Exhibit RME-496) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40-4904-05 (June 16, 2005) (Exhibit RME-545), confirming the legality of the enforcement fee resulting from Yukos' failure to pay fines for the year 2001; Decision of the Moscow Arbitrazh Court, Case No. A40-69459/04-125-698 (Feb. 10, 2005) (Exhibit RME-546) and Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/4816-05 (June 14, 2005) (Exhibit RME-547), confirming the legality of the enforcement fee resulting from Yukos' failure to pay taxes and default interest for the year 2002.

2258 Claimants' Memorial on the Merits, ¶ 590.

E. The Russian Court Decisions That Granted The Claims Brought By NP Gemini Holdings Limited and Nimegan Trading Limited Did Not Constitute Or Contribute To "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1435. As set forth at length at ¶¶ 322-330 above, the failure of the Yukos-Sibneft merger project was the result of legitimate business concerns raised by Sibneft management and shareholders. Claimants have utterly failed to establish that Sibneft and its shareholders acted on the instructions or under the direction or control of the Russian Federation. When Yukos and the Oligarchs before this Tribunal proved unwilling to change the management proposed for the future Yukos-Sibneft, Sibneft and its shareholders pulled back while there was still time to do so.

1436. The Russian court decisions, which the Tribunal cannot review as if it were an appellate court, were taken in accordance with Russian law and cannot give rise to a violation of Article 13 ECT. As shown at ¶¶ 331 to 345 above, in the context of a merger, minority shareholders' court actions such as the ones brought by Gemini Holdings and Nimegan Trading before the Moscow and Chukotka courts were not only allowed in Russian law but were common, and the determinations of the Russian courts at the time were well-founded and in accordance with Russian law.

1437. Finally, Claimants have failed to allege or establish any other facts that could amount to a violation of Article 13 ECT.

1. Claimants Have Failed To Allege Or Establish That The Conduct Of Sibneft, Sibneft Management, And Sibneft Shareholders Is Attributable To The Russian Federation

1438. Claimants have failed to allege or establish that the conduct of Sibneft, its management, and its shareholders is attributable to the Russian Federation.

1439. Under applicable customary international law rules of State responsibility codified in the ILC Articles on State Responsibility,[2259] as a general principle, the conduct of private persons or entities is not attributable to the State. By way of exception, such conduct may be considered an act of a State under international law if such conduct is directed or controlled by the State or is an exercise of elements of governmental authority.

1440. Article 5 provides:

> "*Conduct of persons or entities exercising elements of governmental authority*
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> The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance."[2260]

1441. The exercise of governmental authority in carrying out acts is a *sine qua non* for attribution under Article 5. The commentary to Article 5 states "[i]*f it is to be regarded as an act of the State for purposes of international responsibility, the conduct of an entity must accordingly concern governmental activity and not other private or commercial activity in which the entity may engage*."[2261]

1442. Obviously Sibneft, Gemini Holdings, and Nimegan Trading did not exercise governmental authority in relation to the acts complained of, and Claimants do not allege that they did. The acts complained of in the demerger process are manifestly acts of private parties that any private party could have carried out in similar circumstances.

1443. Article 8 provides:

"*Conduct directed or controlled by a State*

2259 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 26-30 (Exhibit RME-1031).

2260 *Ibid.*, 26.

2261 *Ibid.*, 43 ¶ 5.

> The conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct."[2262]

1444. The commentary to Article 8 of the ILC Articles on State Responsibility notes that "it is made clear that the instructions, direction or control must relate to the conduct which is said to have amounted to an internationally wrongful act."[2263] As regards "direction or control," the commentary states that "[s]uch conduct will be attributable to the State only if it directed or controlled the specific operation and the conduct complained of was an integral part of that operation."[2264]

1445. Investment treaty tribunals have invariably dismissed claims seeking to establish State responsibility under Article 8 of the ILC Articles on State Responsibility unless it could be clearly demonstrated that the specific acts complained of were carried out under the instructions, direction or control of the State. For example, in interpreting Article 8, the tribunal stated in *Jan De Nul v. Egypt*:

> "International jurisprudence is very demanding in order to attribute the act of a person or entity to a State, as it requires both a general control of the State over the person or entity and a specific control of the State over the act the attribution of which is at stake; this is known as the 'effective control' test."[2265]

1446. Claimants content themselves with a statement: "Sibneft brings the merger process to a sudden halt, reportedly at the behest of the Kremlin."[2266] As discussed above, this constitutes speculation based on speculation and is not supported by the facts. Claimants have utterly failed to meet their burden of establishing that Sibneft, Gemini Holdings,l or Nimegan Trading were in fact

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2262 *Ibid.*, 26.

2263 *Ibid.*, 48 ¶ 7.

2264 *Ibid.*, 47 ¶ 3.

2265 *Jan de Nul N.V. and Dredging International N.V. v. Arab Republic of Egypt*, ICSID ARB/04/13, Award (Nov. 6, 2008), ¶ 173 (Annex (Merits) C-997).

2266 Claimants' Memorial on the Merits, 83.

acting under the instructions of, or under the direction or control, of the Russian Federation.

2. The Tribunal Cannot Act As An Appellate Court To Review Russian Court Decisions

1447. As set forth at Section VI.C.1 above, the Tribunal cannot sit as an appellate court reviewing Russian court decisions, including those concerning the Yukos-Sibneft merger project.

3. Claimants Must Establish That The Russian Court Decisions That Granted Gemini Holdings' And Nimegan Trading's Claims Constitute A Radical Departure From Russian Law And Have Failed To Do So

1448. As shown in Section II.H.2.m.(2) above, Claimants have failed to establish that the Moscow and Chukotka courts that granted Gemini Holdings and Nimegan Trading's claims constitute a radical departure from Russian law or were the result of "collusion" between the courts and the shareholders. To the contrary, these court decisions were entirely proper. It cannot have been a surprise that the courts held that the transactions surrounding the Yukos-Sibneft merger project were between interested parties and violated minority shareholders' rights.

4. In Any Event, Claimants Have Failed To Allege Or Establish Facts That Could Amount To A Violation Of Article 13 ECT

1449. Claimants have thus failed to establish any conduct attributable to the Russian Federation except for the court decisions relating to the de-merger. Conduct of Sibneft management and shareholders is clearly not attributable to the Russian Federation. Claimants acknowledge that Yukos -- indeed, "Yukos and its majority shareholders," *i.e.*, Claimants[2267] -- engaged in private negotiations concerning the de-merger and, according to Claimants, alternatively who would "control the management of the merged company."[2268] Claimants

2267 Claimants' Memorial on the Merits, ¶ 212.

2268 *Ibid.*, ¶ 213. An analyst report suggested that the negotiations in fact may have excluded Yukos' management and been solely between the majority shareholders of the two companies. Troika Dialog, Yukos/Sibneft Corporate Governance Risk Increase (Apr. 2, 2004), 4 (Exhibit RME-703): "*Menatep appeared to have sidelined board and management already at this*

allege no more than that "reportedly" upon a meeting with Vladimir Putin, the Sibneft management and shareholders changed their mind, but the report to which they refer contained no suggestion that Mr. Putin urged Sibneft's shareholders not to proceed to conclude the merger, or even that Sibneft's majority shareholders had yet concluded that they should pursue that course. To the contrary, the report suggests that the Sibneft side was considering changing the management team for a merged Yukos-Sibneft, which Mr. Putin reportedly endorsed. It was only the Yukos side, represented by Mr. Nevzlin, that refused to consider a change in management (not economics), which scuttled the deal. Reliance on such flimsy speculation offers no basis for a claim under Article 13(1) ECT.

1450. That Sibneft was later acquired by Gazprom -- whose conduct has not been shown by Claimants to be attributable to the Russian Federation either -- does not prove otherwise. As shown in Section II.H.2.m.3 above, Claimants provide no evidence (even of the speculative sort that characterizes the rest of their argument) that there was an agreement or plan for Gazprom to acquire Sibneft at the time the Yukos-Sibneft merger project was abandoned, let alone that such a plan caused Sibneft to pull back from its plans with Yukos. All available evidence indicates the contrary.

1451. Claimants have failed to allege or establish any facts that could amount to a violation of Article 13 ECT.

F. The Russian Court Decisions In The Criminal Proceedings Against Messrs. Khodorkovsky And Lebedev And Related Enforcement Measures Did Not Constitute Or Contribute To "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1452. As recently confirmed by the tribunal in *Hamester v. Ghana*, a State is obviously entitled to investigate and prosecute criminal conduct:

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stage and management's ambivalence towards its predecessor was hardly conducive to carrying out the predecessors' policies and agreements, including the deal with Sibneft."

> "A State may obviously exercise its sovereign powers to investigate and prosecute criminal actions."[2269]

1453. In the case of Messrs. Khodorkovsky and Lebedev, as shown at Section II.H.2(i) above, their arrest and prosecution was the result of criminal investigations with roots in 2001 in connection with taxation matters. By July 2003, the Lesnoy tax investigation which had been halted on various occasions pending identification of the suspects, was reopened.

1454. This tax investigation was then consolidated with other criminal investigations, as explained above, and was thus the result of the normal exercise of the Russian Federation's power to investigate and prosecute criminal conduct.

1455. Reliance on Messrs. Khodorkovsky's and Lebedev's arrests and eventual convictions on several charges of corporate tax evasion detailed at ¶¶ 318-320 above is of no further help to Claimants' case. Claimants have failed to establish that these convictions or the related investigation and arrests have caused sufficient interference in the operations of Yukos to substantially deprive Claimants of their rights as shareholders or of the economic use of their investments.[2270] Yukos quickly replaced Mr. Khodorkovsky with Simon Kukes, the former Chief Executive Officer of its competitor TNK. According to an analyst report's evaluation of the situation in April 2004, "*[t]he transition of power was smooth and well executed.*"[2271] Indeed, four months after that transition, and shortly after the tax assessment for the year 2000, Yukos' Chief Financial Officer Bruce Misamore told the press that the April Injunction "*wouldn't have a significant effect on the company's operation*."[2272] As shown above, Yukos maintained full

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2269 *Gustaf F W Hamester GmbH & Co. KG v. Republic of Ghana*, ICSID ARB/07/24, Award (June 18, 2010), ¶ 297 (Exhibit RME-1079).

2270 In any event, as explained at ¶¶ 321 above, these convictions were subject to appeal, which were in part successful, and Claimants have failed to establish that any of the Russian court decisions constitute a radical departure from Russian law or involve serious due process violations.

2271 Troika Dialog, Yukos/Sibneft Corporate Governance Risk Increase (Apr. 2, 2004), 6 (Exhibit RME-703).

2272 Gregory L. White, Guy Chazan, *Yukos Is Further Squeezed by Ban - Russian Court Bars Sales of Assets, as Authorities Seek Back Taxes and Fines*, Wall St. J. (Apr. 19, 2004), A8 (Exhibit RME-456).

control of its operations and continued to conduct business as usual -- and such "business as usual" was the source of its downfall, not the conduct of the Russian Federation.

1456. Absent such substantial deprivation attributable to the Russian Federation, the criminal investigations against Messrs. Khodorkovsky and Lebedev and the related enforcement measures fall outside of the Tribunal's jurisdiction or are inadmissible, and should be dismissed on the merits.

G. The Russian Court Decisions Concerning The Bankruptcy Proceedings Did Not Constitute Or Contribute To "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1457. Yukos' bankruptcy was the unfortunate, yet unavoidable, consequence of reckless and often lawless conduct, over a period of many years, on the part of Yukos' own management and controlling shareholders, including Claimants, in turn proxies for the Oligarchs. It was not, as Claimants contend, the result of a plot "*orchestrated*" by the Russian Federation for the expropriation of Yukos.[2273]

1458. Yukos' management and controlling shareholders, including Claimants, forced Yukos into bankruptcy, initially by exposing the company to multi-billion dollar tax and related company liabilities, and thereafter by systematically failing to remedy this self-inflicted wound, which they aggravated instead, through obstructionism and further asset stripping, thereby sealing Yukos' ultimate fate.[2274]

1459. In furtherance of this strategy that consistently favored the interests of the controlling shareholders over those of the company and its creditors, Yukos' management caused Yukos to frustrate the efforts of the SocGen syndicate to collect its long-overdue claim against Yukos' foreign assets, which

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2273 Claimants' Memorial on the Merits, ¶ 800-801.

2274 *See* ¶¶ 528-559.

by then Yukos had shielded under the Dutch Stichting to remain at the disposal of the Oligarchs.[2275]

1460. Following a familiar pattern, Yukos' managers attempted to blame the company's insolvency on the Russian authorities and the seizures imposed on corporate assets, a claim that was disproved by Yukos' own attorney, who -- well before SocGen filed its bankruptcy petition on March 6, 2006 -- publicly admitted: "*Yukos has assets outside Russia free from the Russian Court's freezing order which could have been, and which could be, exploited to raise money with which to make payments under the Loan Agreement* [to the syndicate] *as they become due*."[2276]

1461. SocGen's bankruptcy filing was thus the direct result of Yukos' willful default, not, as Claimants allege, a "*cover*"[2277] for Rosneft in furtherance of a broader conspiracy. The bankruptcy filing was in the banks' commercial interest and complied with Russian law, which is in turn consistent with international practice.[2278] Through the purchase of the syndicate's bankruptcy claim, Rosneft accomplished the twofold business purpose -- which was extraneous to any State conspiracy -- of avoiding a cross-default under its own borrowings, while maintaining the ability to access Western capital markets in view of its upcoming IPO.[2279] Claimants' allegation that Rosneft purchased the claim so as not "*to appear as the instigator of Yukos' bankruptcy*"[2280] is belied by the fact that Rosneft's subsidiary YNG filed a bankruptcy petition against Yukos shortly after the banks did.[2281]

1462. Claimants' arguments about SocGen's motives are thus just a sideshow to divert attention from the fact that Yukos was, in fact, insolvent. As demonstrated at length above, the bankruptcy petition met the requisite

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2275 *See* ¶¶ 528-539, 551-559.

2276 *See* ¶¶ 553-554.

2277 *See e.g.,* Claimants' Memorial on the Merits, ¶ 822.

2278 *See* ¶¶ 560, 566-570, 1487-1494.

2279 *See* ¶¶ 576-583.

2280 *See* Claimants' Memorial on the Merits, ¶ 414.

2281 *See* ¶ 572 *supra*.

insolvency requirements, Yukos had been insolvent for many months by the time the SocGen syndicate finally filed for bankruptcy, and it remained insolvent upon completion of the bankruptcy proceedings.[2282] As a result, the economic value of Claimants' equity stake in Yukos would remain nil regardless of the identity and motives of the bankruptcy petitioner.

1463. On March 29, 2006, the Russian arbitrazh court, upon acceptance of the bankruptcy petition, commenced bankruptcy supervision over Yukos and appointed Mr. Rebgun as interim manager.[2283] But Yukos' management, which remained in office, effectively frustrated the efforts of the bankruptcy manager to recover Yukos' foreign assets, including by withholding relevant information. Meanwhile, Yukos' management and controlling shareholders liquidated a significant portion of those assets and appropriated, along with GML subsidiary Moravel, the relevant proceeds.[2284]

1464. With the apparent purpose of further pillaging Yukos' bankruptcy estate, a number of related entities ultimately controlled by or under common control with Claimants filed huge, sham bankruptcy claims. Those claims were shams even in the eyes of Yukos' managers and controlling shareholders, who -- in the Rehabilitation Plan proposed to the creditors -- volunteered that "*to reflect the true economic picture of the Company*," Yukos " *would use its position as ultimate owner of all its subsidiaries to order that none of them file or pursue any intercompany claims against Yukos*."[2285] Indeed, upon reviewing the merits of those claims, the Moscow Arbitrazh Court denied them.[2286] Had they been admitted, however, those claims could not have altered the outcome of the creditors' vote on Yukos' liquidation nor, more generally, the outcome of Yukos' Bankruptcy Proceedings -- they would have increased Yukos' liabilities and further ensured that nothing would be left for Claimants' equity position.

2282 *See* ¶ 542-551, 560, 563, 567, 669-670 *supra*.

2283 *See* ¶ 563 *supra*.

2284 *See* ¶¶ 586-595 *supra*.

2285 *See* ¶¶ 596-603 *supra*.

2286 *See* ¶¶ 1521-1538 *infra*.

1465. While the Moscow Arbitrazh Court rejected those claims that were shams, it admitted other claims by Yukos-related entities that were not.[2287] As discussed in detail in section VI.G.9.c below, this circumstance alone is dispositive of Claimants' charge of bias and discrimination on the part of the court. There was also neither bias nor discrimination in the court's accepting claims from the Federal Tax Service and YNG (by then a Rosneft subsidiary), which were valid and arose from Yukos' own misconduct.[2288] It is Yukos' managers and controlling shareholders that must be blamed for the fact that Yukos was burdened with such huge claims, not the bankruptcy court.

1466. In July 2006, Claimants approved and caused Yukos' management to propose to the creditors a Rehabilitation Plan whose stated purpose was to protect Claimants at the expense of the creditors.[2289] While "*preserv[ing] an enterprise value that would make the Yukos common stock worth over 15 billion,*" the proposed plan would have granted the creditors only the possibility of hypothetical future recoveries resulting from the sale of ancillary assets claimed to have an estimated value of US$ 10.4 billion, from hypothetical awards that Yukos might obtain if it were successful in unidentified litigations and from Yukos' future cash flow. Payments to the creditors would thus be made in uncertain and overly long installments and would have left two-thirds of Yukos' assets out of their reach. Not surprisingly, the creditors rejected that plan and, given Yukos' evident insolvency, voted for the liquidation of its assets. Claimants have failed to establish that any improprieties took place in the preparation for, and in the decision of, the creditors' meeting rejecting the plan.[2290]

1467. Pursuant to this vote of the creditors, the Moscow Arbitrazh Court declared Yukos bankrupt on August 4, 2006, ordered the liquidation of the

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2287 *See* ¶ 1523 *infra*.

2288 *See* ¶¶ 1539-1543.

2289 *See* ¶¶ 620-627 *supra*.

2290 *See* ¶¶ 628-632 *supra*, ¶¶ 1516-1517 *infra*.

company's assets and appointed Mr. Rebgun as receiver to oversee the liquidation process, replacing Yukos' management.[2291]

1468. The bankruptcy auctions, like the YNG auction, were open to any bidder and widely publicized. Despite a renewed intimidation campaign unleashed by Yukos' management and controlling shareholders, the auctions produced fair results, in excess of independent market value appraisals and estimates, and those of Yukos' own management and expert,[2292] including for the auctions of Tomskneft and Samaraneftegaz, whose results Claimants strenuously criticize.[2293] When State-owned companies succeeded, it was not because of State-prerogatives or conspiratorial intervention, as Claimants allege, but as a result of a transparent and competitive process that complied with Russian law and international practice,[2294] and achieved market prices. Claimants have failed to establish that any impropriety took place during the bankruptcy auctions. Moreover, considering that approximately US$ 9.2 billion of creditor claims remained unpaid upon Yukos' ultimate liquidation,[2295] even if, *quod non*, it could be shown that the bankruptcy auctions could have generated even greater proceeds than they actually did, Claimants, as Yukos' shareholders, with subordinate "last in line" status in the hierarchy of bankruptcy claimants, would in any event have recovered nothing.

1469. The "*further liabilities*" allegedly "*fabricated to ensure*" the liquidation of Yukos[2296] in fact consisted of taxes on profits generated from the sale of assets carried at low values on Yukos' books. There is no dispute that such taxes were due, and as would be expected, they had to be and were filed as late claims, in accordance with Russian law. They remained partially unsatisfied because of the insufficiency of the bankruptcy estate. As discussed below, the

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2291 *See* ¶ 609 *supra*.

2292 *See* ¶¶ 634-637, 650-656 *supra*.

2293 *See* ¶ 655 *supra*.

2294 *See* ¶¶ 657-662 *supra*, 1484-1485, 1503-1504 *infra*.

2295 *See* ¶ 669 *supra*.

2296 Claimants' Memorial on the Merits, ¶ 822.

allowance of such tax claims is typical in international practice, and in some other jurisdictions these taxes are treated more favorably for the tax authorities than they are in Russia.[2297]

1470. As discussed in detail in Sections VI.G.5 and VI.G.6 below, Yukos' bankruptcy proceedings -- far from being a "charade"[2298] -- were conducted in full compliance with Russian law and in accordance with international practice, which, in many respects, is significantly less debtor-friendly. All measures and court decisions adopted in the course of the bankruptcy proceedings could have been challenged by Yukos and Yukos' shareholders. Where challenged, the measures and decisions were fully reviewed and upheld by Russian courts. As discussed in Section VI.G.8 below, Claimants have failed to allege or establish that any due process violation took place in the course of those court proceedings.

1. The Conduct Of Rosneft And YNG In The Creditors' Meetings And The Bankruptcy Proceedings Is Not Attributable To The Russian Federation

1471. As set forth at paragraphs 1439 to 1441 above, under applicable customary international law, the conduct of a person or entity other than a State organ is not attributable to the State unless the person or entity exercises governmental authority or acts under the instructions, direction or control of the State.

1472. There is no allegation that Rosneft or Yuganskneftegaz exercised governmental authority in participating in the creditors' meetings and the bankruptcy proceedings. Indeed, Rosneft and Yuganskneftegaz were participating in the proceedings in their capacity as bankruptcy creditors as any private party in similar circumstances could do. Their conduct is therefore not attributable to the Russian Federation under Article 5 of the ILC's Articles on State Responsibility.

2297 *See* ¶¶ 1506-1507 *infra*.

2298 Claimants' Memorial on the Merits, ¶ 822.

1473. Neither is the conduct of Rosneft and Yuganskneftegaz attributable to the Russian Federation under Article 8 of the ILC's Articles on State Responsibility. In the context of State-owned and controlled companies, the commentary to Article 8 states:

> "The fact that the State initially establishes a corporate entity, whether by special law or otherwise, is not a sufficient basis for the attribution to the State of the subsequent conduct of that entity. Since corporate entities, although owned by and in that sense subject to the control of the State, are considered to be separate, *prima facie* their conduct in carrying out their activities is not attributable to the State unless they are exercising elements of governmental authority within the meaning of article 5."[2299]

1474. International jurisprudence supports the International Law Commission's commentary. For example, in *Flex-Van Leasing v. Iran*, the Iran-U.S. Claims Tribunal rejected attribution of the conduct of two State-controlled companies for lack of proof of control of the conduct complained of.[2300]

1475. Claimants have failed to proffer any evidence that Rosneft or Yuganskneftegaz acted under the instructions, control or direction of the Russian Federation in participating in the July 25, 2006 Creditors' Meeting in particular and the bankruptcy proceedings in general. Their conduct is therefore not attributable to the Russian Federation under Article 5 of the International Law Commission's Articles on State Responsibility.

2299 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 48 ¶ 6 (Exhibit RME-1031).

2300 *Flexi-Van Leasing, Inc. v. The Government of the Islamic Republic of Iran*, Iran-U.S. Claims Tribunal, Case No. 36, Award (Oct. 11, 1986), 12 Iran-U.S.C.T.R. 335 (1988), 349 (Exhibit RME-1154): "Expropriation of the Claimant's contract rights can only be found in case of interference with these contract rights themselves, and a basic condition for such a finding is that such interference be attributable to the Government. The Claimant does not assert that the Government has itself interfered with its contract rights, but rather that it has done so through the Foundation. To give rise to an expropriation claim this would require that, from the time it came under the control of the Foundation, Star Line had acted under orders, directives, recommendations or instructions from the Foundation or the Government when it did not pay rentals or return the leased equipment to the Claimant."

2. The Conduct Of The Russian Tax Authorities In The Creditors' Meetings And The Bankruptcy Proceedings Is Conduct *Iure Gestionis* Which Does Not Amount To A Treaty Violation

1476. It is well established that conduct of State organs does not constitute a violation of a State's international obligations under an investment treaty unless they act in the exercise of *puissance publique*. Numerous investment treaty tribunals have accepted and applied this rule. For example, the tribunal in *Impregilo v. Pakistan* held that the claimant would need to prove that the acts complained of involved "*activity beyond that of an ordinary contracting party ('*puissance publique*')*"[2301] to constitute a violation of Pakistan's treaty obligations:

> "[O]nly measures taken by Pakistan in the exercise of its sovereign power ('*puissance publique*'), and not decisions taken in the implementation or performance of the Contracts, may be considered as measures having an effect equivalent to an expropriation."[2302]

1477. Similarly, the tribunal in *Biwater v. Tanzania* found that conduct *iure gestionis* does not amount to a breach of an investment treaty:

> "The critical distinction is between situations in which a State acts merely as a contractual partner, and cases in which it acts '*iure imperii*', exercising elements of governmental authority. These are often termed '*actes de puissance publique*', where the use by the State of its public prerogatives or *imperium* is involved in the actions complained of."[2303]

1478. In *Siemens v. Argentina*, the tribunal summarized the arbitral case law on the "puissance publique" requirement as follows:

> "What all these decisions have in common is that for the State to incur international responsibility it must act as such, it must use its

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2301 *Impregilo S.p.A. v. Islamic Republic of Pakistan*, ICSID ARB/03/3, Decision on Jurisdiction (Apr. 22, 2005), ¶ 266 (Exhibit RME-1155).

2302 *Ibid.*, ¶ 281.

2303 *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID ARB/05/22, Award (July 24, 2008), ¶ 458 (Annex (Merits) C-991). [italics in original]

public authority. The actions of the State have to based on its 'superior governmental power'."[2304]

1479. Or as stated by the tribunal in *Salini v. Jordan*:

"Only the State, in the exercise of its sovereign authority (*puissance publique*), and not as a contracting party, has assumed obligations under the bilateral agreement."[2305]

1480. The tax authorities participated in Yukos' Creditors' Meetings and the bankruptcy proceedings in their capacity as Yukos' creditors. They acted in a role that any private party could fill in similar circumstances. Claimants have failed to allege or establish that the impugned conduct of the Russian tax authorities in Yukos' Creditors' Meetings and the bankruptcy proceedings involved the exercise of Respondent's governmental authority. Such conduct therefore cannot entail a breach of Article 13(1) ECT.

3. Claimants Have Failed To Establish That The Decisions To Open Bankruptcy Proceedings Against Yukos And Liquidate Yukos Were Sham Decisions Designed To Appropriate To The State Yukos' Assets

1481. It is uncontested that the judicial liquidation of a company forms part of the administration of justice and law enforcement and thus is permitted under international law. As stated by the Permanent Court of International Justice in *Certain German Interests in Upper Silesia*:

"It follows from the same principles that the only measures prohibited are those which generally accepted international law does not sanction in respect of foreigners ; expropriation for reasons of public utility, judicial liquidation and similar measures are not affected by the Convention."[2306]

1482. Furthermore, Claimants' contentions that Yukos' bankruptcy was "artificial" and that the company was "clearly solvent" are as irresponsible as

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2304 *Siemens A.G. v. The Argentine Republic*, ICSID ARB/02/08, Award (Feb. 6, 2007), ¶ 253 (Annex (Merits) C-983).

2305 *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*, ICSID ARB/02/13, Decision on Jurisdiction (Nov. 29, 2004), 44 I.L.M. 573 (2005), 597 ¶ 155 (Exhibit RME-1156).

2306 *Case Concerning German Interests in Polish Upper Silesia (Germany v. Poland)*, Judgment on the Merits (May 25, 1926), 1926 P.C.I.J. (Ser. A) No. 10, 22 (Annex (Merits) C-923).

misconduct of Yukos' controlling shareholders and managers that created the Yukos' insolvency, the undeniable fact that proves the falsity of these baseless contentions.[2307] As shown above, Yukos' controlling shareholders and management exposed the company to multi-billion dollar tax and intercompany liabilities and failed to pay its debts to the SocGen syndicate.[2308] One of Yukos' own presentations for its top managers shows that at, at the end of 2005, its deficit was approximately RUB 497 billion, or approximately US$ 17.3 billion, and the value of its non-tax liabilities alone exceeded the value of its assets. This presentation therefore concludes that "[i]*t must be admitted that [Yukos] shows all signs of bankruptcy envisaged by Russian law*," as indeed the company did.[2309] This acknowledgement belies Claimants' further contention here that Yukos could have avoided bankruptcy if only it had been permitted to pay off its tax debts, which of course Yukos repeatedly and consistently refused to do.[2310] Further, as shown below and as repeatedly affirmed by the Russian courts, Yukos therefore undoubtedly satisfied the Russian law "illiquidity test" for bankruptcy, based on its inability to pay its outstanding debts. Whoever now believes that Yukos' bankruptcy was "artificial" and the company was "cleary solvent" needs only to refer to the company's contemporaneous records and the indisputable facts they report to realize that those words are a complete fantasy.

4. This Tribunal Cannot Act As An Appellate Court To Review Russian Court Decisions

1483. In any event, as set forth at Section VI.C.1 above, the Tribunal cannot sit as an appellate court reviewing Russian court decisions, including those concerning the bankruptcy proceedings.

2307 Claimants' Memorial on the Merits, ¶¶ 820, 822.

2308 *See* ¶¶ 541-559 *supra*.

2309 *See* ¶¶ 546-549 *supra*.

2310 Claimants' Memorial on the Merits, ¶ 825.

5. Claimants Have Failed To Establish That The Russian Court Decisions Concerning The Bankruptcy Proceedings Constitute A Radical Departure From Russian Law

1484. Claimants have failed to establish that the court decisions and the actions taken during the Bankruptcy Proceedings constitute a radical departure from Russian law. To the contrary, as shown at Section II.L.5 above, those decisions and actions were consistent with Russian law.

1485. This holds true, for example, for: (i) the court decision of March 9, 2006 verifying that the requisite legal indicia of insolvency were present and, accordingly, accepting the bankruptcy petition submitted by the SocGen syndicate;[2311] (ii) the court decision of March 29, 2006 further verifying that the requisite indicia remained present, the underlying claim was valid and outstanding, and, accordingly, introducing supervision proceedings against Yukos;[2312] (iii) the bankruptcy manager's calling for and the vote of the first meeting of Yukos' creditors held on July 20-25, 2006, at which the creditors voted to ask the bankruptcy court to formally declare Yukos bankrupt and to liquidate its assets in receivership proceedings (*see* ¶¶ 606-614 above); (iv) the court decision of August 4, 2006 granting the creditors' request;[2313] (v) the receiver's appointment of the Roseko consortium to appraise at market value Yukos' assets at a sale at auction;[2314] (vi) the appraisals of Yukos' assets performed by the Roseko consortium,[2315] (vii) the vote of the creditors' committee setting the starting price for each of the lots equal to at least the appraised market value;[2316] (viii) the conduct of the Bankruptcy Auctions;[2317] (ix) the court decision of August

2311 *See* ¶¶ 560-584 *supra*.

2312 *See* ¶ 562 *supra*.

2313 *See* ¶ 609 *supra*.

2314 *See* ¶ 633 *supra*.

2315 *Ibid*.

2316 *See* ¶ 638 *supra*.

2317 *Ibid*.

8, 2007 extending the receivership by three months (*see* ¶ 663 above); and (x) the court decision of November 15, 2007 finalizing receivership proceedings.[2318]

6. The Bankruptcy Proceedings Were Conducted In Accordance With International Practice

1486. The following survey clearly shows that each phase of Yukos' Bankruptcy Proceedings was conducted in accordance with international practice, which is in many respects significantly less debtor-friendly than Russian law.

a) Bankruptcy Laws Further Strong Public Policy Goals

1487. Both under Russian law and under the laws of other countries, a central goal of bankruptcy proceedings is to satisfy the claims of a debtor's creditors, as it was in the Yukos case. In this respect, bankruptcy laws, like tax laws, implement very strong public policies. These policy objectives are typically described as the need to protect potential creditors from the risk that they will unknowingly extend credit to a bankrupt entity that will not be able to repay, and, more generally, the need to remove from the marketplace participants whose inability to repay their debts threatens the financial well-being of solvent businesses, thereby putting at risk the health of the marketplace as a whole.

1488. Concerns of this kind underlie the bankruptcy laws of many jurisdictions. For example, in the United Kingdom, bankruptcy law is driven by the recognized public interest in satisfying the claims of creditors and eliminating insolvent companies from the marketplace in order to protect the public from the risk of trading with them.[2319] In this process, once a company is insolvent (or

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2318 *See* ¶ 670.

2319 According to an institutional statement of the policy underlying U.K. bankruptcy law, the "*aims*" of that law include "*to recognise that the effects of insolvency are not limited to the private interests of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded*" and "*to recognise that the world in which we live and the creation of wealth depend upon a system founded on credit and that such system requires, as a correlative, an insolvency procedure to cope with its casualities*." *See* Report of the Review Committee on Insolvency Law and Practice (the "Cork Report"), Cmnd 8558 (1982), ¶¶ 198(i) and 198(a) (Exhibit RME-1705). Another public policy underlying U.K. bankruptcy law is "*to provide a mechanism by which the causes of failure can be identified and those guilty of mismanagement brought*

even merely of doubtful solvency)[2320] and at least until all creditors (including post-bankruptcy creditors) have been paid, bankruptcy law is driven by a policy that openly favors the interests of creditors over those of shareholders.[2321]

1489. When exercising discretionary powers in bankruptcy matters, English courts -- in compliance with these public policy goals -- are guided by the principle that:

> "where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."[2322]

1490. The need to protect creditors and, more generally, the marketplace, from the risks posed by insolvent participants is also recognized in France,[2323] Germany,[2324] Italy,[2325] Sweden,[2326] and the United States.[2327]

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to book and, where appropriate, deprived of the right to be involved in the management of other companies." *See* Roy Goode, PRINCIPLES OF CORPORATE INSOLVENCY LAW (Thomson, 3rd ed. 2005), 39 (Exhibit RME-1706). This policy -- to maintain confidence in the capitalist system by preventing the abuse of "*the privilege of incorporation with limited liability*" -- is evident in the Judgment of Lord Walker in *Official Receiver v. Wadge Rapps & Hunt*, House of Lords, [2004] BPIR 129 HL, ¶ 77 (July 31, 2003) (Exhibit RME-1707).

2320 *See Brady v. Brady*, Court of Appeal, Civil Division, [1988] BCLC 20, 40 (Exhibit RME-1708). In this judgment, the court referred to creditors' interests having priority even when a company is "*doubtfully*" solvent.

2321 *See West Mercia Safetywear v. Dodd*, Court of Appeal, Civil Division, [1988] BCLC 250 CA, 252-253 (Nov. 19, 1987) (Exhibit RME-1709).

2322 *Ibid.*, 253 (Exhibit RME-1709). In a case where certain shareholders had accused the U.K. Secretary of State for Transport of misfeasance in public office (including malicious intent) for petitioning to place a publicly listed company in administration with a view to taking it into government ownership, the court rejected the charge of misfeasance and upheld the validity of the bankruptcy (administration) proceedings, noting that the debtor was insolvent and that there were "*ample and sound public policy reasons for the government wishing to be rid of* [the debtor]." *See Weir v. Secretary of State for Transport*, High Court of Justice of England and Wales, Chancery Division, [2005] EWHC 2192 (Ch) (Oct. 14, 2005), ¶¶ 273 *et seq.* (Exhibit RME-1710).

2323 French bankruptcy law is driven, *inter alia*, by the policy of "*eliminating non viable enterprises in a free market economy*" and "*the goal of rescuing the company* [excludes] *any kind of therapeutic obstinacy*," as authoritatively stated by Mr. Robert Badinter, the "father" of that law. *See*

b) "Illiquidity" Is The Common Test For Commencing Bankruptcy Proceedings

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Examen du rapport de la législation applicable en matière de prévention et de traitement des difficultés des entreprises par l'Office au cours de sa réunion du 5 décembre 2001, Sénat (Exhibit RME-1711).

2324 In Germany, "*[i]nsolvency proceedings shall serve the purpose of collective satisfaction of a debtor's creditors*." *See* German Bankruptcy Law (Oct. 5, 1994) (*Insolvenzordnung vom 5. Oktober 1994 (BGBl. I S. 2866) zuletzt geändert durch Art. 3 Haushaltsbegleitgesetz 2011 vom 9 Dezember 2010 (BGBl. 2010 I S. 1885)* (*Insolvenzordnung*), § 1 (Exhibit RME-1723). Given that "*removing an insolvent enterprise from the economy promotes creditors' protection*," German bankruptcy law is also aimed at the elimination of insolvent companies from the marketplace. *See* Hermannjosef Schmahl, MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG (2nd ed., C.H. Beck Verlag, 2007), § 14 ¶ 60 (Exhibit RME-1712). Accordingly, German law requires that a company be stricken off the companies' register upon completion of the bankruptcy proceedings. *See* German Act on Proceedings Concerning Family Matters and Matters of Voluntary Jurisdiction (*Gesetz über das Verfahren in Familiensachen und in den Angelegenheiten der freiwilligen Gerichtsbarkeit*), § 394 (Exhibit RME-1713). The purpose of this provision is, *inter alia*, to "*ensure that insolvent companies no longer participate in contractual relations after commencement of the proceedings*." *See* Ulrich Haas, INSOLVENZRECHTS-HANDBUCH (Peter Gottwald, 3rd ed. 2006), § 91 ¶ 12 (Exhibit RME-1714). *See also* Stephan Kolmann, GMBHG HANDKOMMENTAR (Saenger, Inhester, 2010), § 64 ¶ 121 (Exhibit RME-1715) (according to which "*[t]he purpose of the duty to file for insolvency* […] *consists in keeping insolvent legal entities off the market because of the dangers emanating from them, since no natural person is liable for the entity's obligation. Furthermore, the purpose of the duty is to save and protect the assets of the legal entity in the interests of the creditors of said legal entity*.").

2325 According to leading Italian authors, bankruptcy law "*mainly aims at protecting the general interest in eliminating inefficient companies from the market*," since "*an insolvent company is a virus capable of infecting the whole market, thereby driving other undertakings to insolvency sooner or later*." *See* Danilo Galletti, LA RIPARTIZIONE DEL RISCHIO DI INSOLVENZA, Il Mulino (2006), 15 (Exhibit RME-1716); Claudio Cecchella, IL DIRITTO FALLIMENTARE RIFORMATO, Il Sole24Ore Editore (2007), 3 (Exhibit RME-1717).

2326 In Sweden, tax authorities are encouraged to file bankruptcy petitions against tax debtors "*in the interest of general deterrence*," *inter alia*, "*to counter unsound competition*" resulting from the company's failure to pay taxes, and "*to prevent financial crimes*" as well as "*further indebtness of the debtor*." According to the Swedish tax authorities' internal guidelines, "*[i]f the company cannot give satisfactory explanations for its inability to pay its tax debt, it can be appropriate to make an application for declaration of bankruptcy in the interest of general deterrence*." Thus, even if a debtor "*incurs parking fines, totalling a substantial amount,* [he] *should be declared bankrupt*." *See* Internal Practice Guidelines for the Tax Authority in its Capacity as Creditor (*Handledning för borgenärsarbetet*) (2008), ¶ 14.1 and Appendix 1, ¶ 5.4 (Exhibit RME-1718).

2327 In the United States, under state law the directors of a company that is insolvent (or, in certain jurisdictions, "in the zone" of insolvency) owe fiduciary duties to the creditors of that company. *See Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 790-91 (Del.Ch. 2004) (Exhibit RME-1719) (indicating that "*[w]hen a firm has reached the point of insolvency, it is settled that under Delaware law, the firm's directors are said to owe fiduciary duties to the company's creditors*.") and *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) (Exhibit RME-1720). Federal bankruptcy includes the so-called "absolute priority rule," which generally provides that shareholders may not receive any distributions under a plan unless creditor classes have either been paid in full (including interest) or vote in favor of the plan. *See* 11 U.S.C. § 1129(b) (Exhibit RME-1735).

1491. Under Russian law, the test applied by the courts to open bankruptcy proceedings is based on the debtor's inability to pay outstanding debts, the so-called "illiquidity test," which was satisfied by the bankruptcy petition filed by the SocGen syndicate. This test is applied in many other jurisdictions.[2328]

[2328] For example:

Canadian law defines an "*insolvent person*" as a person "*whose liabilities to creditors provable as claims* […] *amount to one thousand dollars, and who is for any reason unable to meet his obligations as they generally become due*." *See* Canadian Bankruptcy and Insolvency Act, § 2 (Exhibit RME-1721).

Under French law, "*the judicial recovery procedure* [redressement judiciaire] *is available to any debtor referred to under Articles L.631-2 or L.631-3 which, being unable to pay its outstanding liabilities with its available assets, is in a state of insolvency* [cessation des paiements]." *See* French Commercial Code, Art. L. 631-1 (Exhibit RME-1722). Similarly "*[t]he judicial liquidation procedure* [liquidation judiciaire] *is available to any debtor referred to under Article L.640-2 which is in a state of cessation of payments and whose reorganization is manifestly impossible*." *See* French Commercial Code, Art. L.640-1 (Exhibit RME-1722).

Under German law, "*illiquidity constitutes the general reason to open insolvency proceedings*" and "*a debtor is deemed illiquid if it is unable to meet its payment obligations when due*," regardless of the reasons for the lack of liquidity. *See* German Bankruptcy Law, § 17 (Exhibit RME-1723). In order to assess the debtor's inability to meet its monetary obligations, German courts usually compare the debtor's overdue monetary obligations with the liquid funds available to the debtor (*Liquiditätsbilanz*). If the insufficiency of funds is only temporary, the debtor will not be found illiquid. While the exact meaning of "*temporary*" has been the subject of debate, a period exceeding two or three weeks is considered to be more than "*temporary*." *See* Judgment of the German Supreme Court (*Bundegerichtshof*), Case No. IX ZR 123/04 (May 24, 2005) *in* NEUE JURISTICHE WOCHENSCHRIFT (2005) (Exhibit RME-1724); Guido Eilenberger *in* MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG, Vol. 1 (Hans-Peter Kirchhof, Rolf Stürner and Hans-Jürgen Lwowski, 2nd ed. 2008) (Exhibit RME-1725). Furthermore, a debtor is also deemed illiquid if it has ceased to pay, as a result of lack of available funds, a substantial amount of its liabilities when due and that cessation of payments has become recognizable by the debtor's business partners (*Zahlungseinstellung*).

Under Italian law, "*the state of insolvency is demonstrated by inability to pay or other external signs evidencing that the debtor is not able to regularly meet its obligation*s." *See* Italian Bankruptcy Law (Royal Decree No. 267 of Mar. 16, 1942) ("Italian Bankruptcy Law"), Art. 5 (Exhibit RME-1726).

In Spain, "*illiquidity*" constitutes a reason to initiate insolvency proceedings, and a debtor is deemed "*illiquid*" if it is unable to meet regularly and generally its payment obligations when due. In particular, a creditor may initiate bankruptcy proceedings against a debtor who ceased to regularly meet its monetary obligations. *See* Spanish Insolvency Law No. 22/2003 (July 9, 2003) ("Spanish Insolvency Law"), Art. 2 (Exhibit RME-1727). Spanish courts clarified that "*under Spanish bankruptcy law, what matters is the debtor's inability to regularly meet its monetary obligations, regardless of the reason for such inability and of whether the inability is attributable to the debtor*." *See* Judgment of the Provincial Court of Madrid, Case No. 149/2008 (May 8, 2008) (Exhibit RME-1728); Judgment of the Commercial Court of Madrid, Case No. 5/2008 (Sept. 8, 2008) (Exhibit RME-1729).

c) The Motives Of A Creditor In Filing A Bankruptcy Petition Are Irrelevant

1492. In Russia as in many other jurisdictions, the motives of a creditor in filing a bankruptcy petition -- even if, *quod non*, they are shown to be suspect or malicious -- are irrelevant to the validity of a petition, provided only that the applicable insolvency requirements are met, as they were in the case of the SocGen syndicate's petition.

1493. Because of the important objectives furthered by bankruptcy laws, courts are unsympathetic to attempts by insolvent companies to avoid judicial administration by impugning the motives of persons filing bankruptcy proceedings. Thus, in the United Kingdom, courts have held that:

Similar requirements apply in Sweden, where "*insolvency means that the debtor cannot pay its debts as they become due and that this incapacity is not merely temporary*." *See* Swedish Bankruptcy Act (1987:672), Ch. 1, § 2 (Exhibit RME-1730).

English law provides a number of different insolvency proceedings, either oriented towards the debtor's winding up (*e.g.*, compulsory liquidation, members' or creditors' voluntary liquidation) or towards the debtor's reorganization (*e.g.*, most commonly, administration, or schemes of arrangement, or company voluntary arrangements which are often promoted within the protection of the administration regime and its moratorium provisions). The debtor's inability to pay its debts constitutes the most common legal ground for commencing winding up proceedings and reorganization proceedings (*i.e.*, administration). Indeed, under English law, "*a company is deemed unable to pay its debts*" if it "*is indebted in a sum exceeding £750* [. . .] *and the company has for 3 weeks* [after the relevant notice has been served on it by the creditor] *neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor.*" *See* Insolvency Act 1986, c 45, § 122(1)(f) (Exhibit RME-1731); *see also* Insolvency Act 1986, c 45, § 123(1)(a) and (e) (Exhibit RME-1731) and Roy Goode, PRINCIPLES OF CORPORATE INSOLVENCY LAW (3rd ed. 2005), ¶ 4-02 (Exhibit RME-1732), according to whom "*[i]nability to pay debts is the fundamental concept on which all insolvency law is based.*" The debtor's inability to pay debts also justifies a winding up order if the debt remains unpaid. *See Cornhill Insurance Plc v. Improvements Services Limited*, Chancery Division, [1986] 1 WLR 114 (July 22, 1985) (Exhibit RME-1733); *Re Taylor's Industrial Flooring Ltd v. M & H Plant Hire (Manchester) Ltd*, Court of Appeal, Civil Division, [1990] BCLC 216, 219 CA (Oct. 27, 1989) (Exhibit RME-1734).

Under the U.S. Bankruptcy Code, to commence a voluntary case under Chapter 11, the debtor needs only to demonstrate it is in financial distress. In the case of involuntary proceedings, a debtor may contest a bankruptcy petition by demonstrating that it is generally paying its debts as they become due. *See* 11 U.S.C. §303(h) (Exhibit RME-1735) (according to which "*the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed only if* […] *the debtor is not generally paying such debtor's debts as such debts become due, unless such debts are the subject of a bona fide dispute as to liability or amount.*")

Finally, *see also* the Principles of European Insolvency Law, a model instrument framed by a group of European legal scholars providing that "*a proceeding can be opened when a debtor is unable or is likely to become unable to pay debts as they become due*." *See* William W. McBryde et al., PRINCIPLES OF EUROPEAN INSOLVENCY LAW (1st ed., 2003), § 1.2 (Exhibit RME-1736).

> "[i]f a petitioner has a sufficient ground for petitioning, the fact that his motive for presenting a petition, or one of his motives, may be antagonism to some person or persons cannot [...] render that ground less sufficient. If, on the other hand, he has no sufficient ground, his petition will be an abuse, whether he acted by malice or not."[2329]

1494. The principle that, if a company is insolvent, bankruptcy proceedings must ensue regardless of the motives of the party initiating the proceedings is widely accepted in other countries.[2330]

2329 *See Bryanston Finance Ltd v. De Vries*, Judgment of Buckley LJ, Court of Appeal, Civil Division, *(No 2)* [1976] Ch 63 at 75E (Exhibit RME-1737), cited with approval by Slade L-J in *Coulson Sanderson & Ward Limited v. Ward*, Court of Appeal, Civil Division, [1986] BCC 99, 207, 99, 215 (Exhibit RME-1738) (according to which "*bad motives cannot render an otherwise good winding-up petition groundless*").

2330 For example, in Italy, the Supreme Court held that, in order to initiate bankruptcy proceedings, a court must ascertain only the "*objective condition of economic impotence, which occurs when the entrepreneur is unable to pay regularly, promptly and with normal means his obligations*." *See* Decision of the Italian Supreme Court, Case No. 1760 (Jan. 28, 2008) (Exhibit RME-1739).

Under French law, a creditor may file a bankruptcy petition for both procedures of reorganization and liquidation, whatever the motives of its filing. *See* French Commercial Code (*Code de commerce*), Art. L.631-5(2) and Art. L.640-5(2) (Exhibit RME-1722).

In Germany, once a debtor is found insolvent and bankruptcy proceedings are commenced, the latter are conducted in the interests of all creditors and the "*substance of the claim of the* [bankruptcy] *petitioner are irrelevant*." *See* Jens-Sören Schröder, HAMBURGER KOMMENTAR ZUM INSOLVENZRECHT (Andreas Schmidt, 3rd ed. ZAP 2009), 34, ¶ 16 (Exhibit RME-1740). This principle is further evidenced by § 13 (2) of the German Bankruptcy Law (Exhibit RME-1723), which reads as follows: "*[s]uch requests* [for opening the insolvency proceedings] *may be withdrawn until the insolvency court opens the insolvency proceedings or the request has been refused with final effect*." According to this rule, the bankruptcy petitioner can no longer dispose of its petition once the insolvency proceedings have been opened. Even if the claim of the bankruptcy petitioner has been paid after commencement of the insolvency proceedings (*e.g.* by a third party), these will continue in the interest of the other creditors. The reason for and the principle underlying this rule is explained by Hermanjosef Schmahl, MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG (2nd ed., C.H. Beck Verlag, 2007), § 13 ¶ 123 (Exhibit RME-1784) as follows: "*[t]he provision in paragraph 2 makes it clear that the initial contentious proceeding opposing Applicant and Debtor with the opening of the insolvency proceedings has turned into a proceeding conducted ex officio. The provision is the result of the fact that the decision to open the insolvency proceeding once it is issued, (i.e. once it is no longer an "internum" of the court) affects not only the applicant and the debtor, but also affects third persons, namely the totality of the creditors that have not been involved in the proceeding so far.*" *See also* Goetsch, BERLINER KOMMENTAR ZUR INSOLVENZORDNUNG (Blersch, Geotsch, Haas, 2010), § 13 ¶ 28 (Exhibit RME-1741) (noting that "*[o]nce the insolvency proceeding is opened, the individual claim of the creditor that has filed the request for bankruptcy loses its independent purpose/meaning for the insolvency proceeding, since the latter is conducted from now on in the interest of all creditors and not only in the interest of the applicant.*") That the public interest in filing a request for insolvency proceedings is considered more important than the interest of the individual claimant is also evidenced by the Judgment of the German Supreme Court (*Bundegerichtshof*), Case No. IX ZB 282/09 (Sept.

d) State Authorities, Public Officials, And Directors Are Required To File For Bankruptcy

1495. In most countries, the critical importance attached to the policy objectives furthered by bankruptcy laws is confirmed by rules that not only allow, but require, State authorities, public officials, and directors of insolvent companies to take the initiative of filing for bankruptcy, even if no creditor has voluntarily done so.[2331]

23, 2010), *in* NEUE ZEITSCHRIFT FÜR DAS RECHT DER INSOLVENZ UND SANIERUNG (NZI) (2011), 58 (Exhibit RME-1742) (according to which also a creditor with a subordinated debt who cannot expect any payments out of the assets of the insolvent debtor is entitled to file a request for the opening of the insolvency proceedings).

In Spain, the motives of a creditor in filing a bankruptcy petition are irrelevant to the validity of the petition. *See* Spanish Insolvency Law, Art. 3 (Exhibit RME-1727).

In Sweden, alleged bad faith in the filing of a bankruptcy petition is not listed among the impediments to the commencement of bankruptcy proceedings. *See* Swedish Bankruptcy Act (1978:672), Ch. 2, §§ 6 and 10 (Exhibit RME-1730).

[2331] In France, the public prosecutor and the courts are entitled to file a bankruptcy petition and to initiate *ex officio* winding-up proceedings over a debtor, provided the latter is insolvent, even if no creditor has requested such action. *See* French Commercial Code, Art. L.631-5(1), L.640-4, L.640-5(1), L.651-2 (Exhibit RME-1722).

In Germany, according to the predominant view, the director's duty to file for bankruptcy serves, *inter alia*, the stated purpose of protecting potential creditors from contracting with an insolvent company and, to this end, to "*prevent limited liability companies from entering into business relations*." *See* Decision of the German Supreme Court (*Bundesgerichtshof*), II ZR 292/91, NJW 1994, 2220 under II. 2 b (June 6, 1994) (Exhibit RME-1743).

In the United Kingdom, the Insolvency Act of 1986 expressly provides that the Secretary of State for Business, Innovation & Skills may present a petition for a winding-up order to be made against a company "*in the public interest*." *See* Insolvency Act 1986, c 45, § 124A (Exhibit RME-1731). There does not need to be a debt due to the Crown, there is no requirement of insolvency (*see Re a Company* (No. 007923, 1994), Court of Appeal, Civil Division, [1995] 1 WLR 953 CA (Exhibit RME-1744)), and the company does not have to be conducting criminal activities. It has been said that the phrase "*expedient in the public interest*" is "*of the widest import*." *See Re Senator Hanseatische Verwaltungsgesellschaft mbh*, Court of Appeal, Civil Division, [1997] 1 WLR 515, 526 BC (Exhibit RME-1745). In particular, winding up a company in the public interest may even be justified where the company has ceased to carry on the business concerned. By doing so, the court will be expressing in a meaningful way its disapproval of such misconduct. Moreover, in addition to being a fitting outcome for the company itself, such a course has the further benefit of spelling out to others that the court will not hesitate to wind up companies whose standards of dealing with the investing public are unacceptable. *See Re Walter L Jacob & Co Ltd*, Court of Appeal, Civil Division, [1989] BCLC 345, 360 per Nicholls LJ CA (Exhibit RME-1746).

In Italy, if a court finds that a debtor is insolvent, it can request the public prosecutor to file a bankruptcy petition against the debtor, even if no creditor has chosen to do so. *See* Italian Bankruptcy Law, Art. 7 (Exhibit RME-1726).

1496. Typically, a director ignoring this obligation exposes himself to personal civil liability, a major deterrent to failing to fulfil this obligation, given that large sums (potentially, the totality of the insolvent company's liabilities)

In Spain, the debtor is under a duty to initiate insolvency proceedings "*within two months following the date when it becomes aware, or should have become aware, of its insolvency*." If the debtor is a company, the board of directors is the competent body to take the decision to file a bankruptcy petition. *See* Spanish Insolvency Law, Art. 2, 3(1) and 5(1) (Exhibit RME-1727).

could be at stake.[2332] In some countries, delinquent directors are even exposed to criminal[2333] or administrative sanctions.[2334]

[2332] The United Kingdom provides for a civil cause of action called "wrongful trading" that imposes liability on directors of a company who knew or ought to have known that insolvent liquidation was unavoidable but continued to cause the company to trade. In such circumstances, the court can order the director to pay a sum representing the increase in the deficiency caused by the company continuing to trade after it should have been put into liquidation. *See* Insolvency Act 1986, c 45, § 214 (Exhibit RME-1731).

In France, the debtor has the duty to apply for its own liquidation no later than 45 days after the date in which it has ceased to regularly fulfil its debts. *See* French Commercial Code, Art. L.640-4 (Exhibit RME-1722). During liquidation proceedings, the court can hold the company's directors liable to the creditors for the difference between the company's liabilities and its assets. *See* French Commercial Code, Art. L.651-2 (Exhibit RME-1722). In addition, a director who fails to timely disclose the company's illiquidity may be prohibited from managing or controlling, directly or indirectly, any business. *See* French Commercial Code, Art. L.653-8 (Exhibit RME-1722). The court may also disqualify a director who abusively operated an unprofitable business activity that would necessarily lead to illiquidity. *See* French Commercial Code, Art. L.653-1 and L.653-4 (Exhibit RME-1722).

Likewise, in Germany, directors of closed stock companies who did not timely file for bankruptcy are liable to creditors that have contracted with the company after the latter became insolvent. *See* German Civil Code (*Burgerlichegesetzbuch*), § 823(2) (Exhibit RME-1748) and German Bankruptcy Law, § 15a(1) (Exhibit RME-1723).

Under Italian law, directors of joint-stock companies are liable for damages that result from their not having caused the timely liquidation of the company. *See* Italian Civil Code (*Codice civile*), Art. 2394, Art. 2485, Art. 2497(4) (Exhibit RME-1749).

In Spain, directors could be declared responsible for the debts of the bankrupt company if: (i) the bankruptcy proceedings lead to the liquidation of the debtor, and (ii) the bankruptcy has been caused or aggravated by the directors' wilful misconduct or gross negligence. Unless evidence to the contrary is provided, wilful misconduct or gross negligence will be presumed if the directors fail to file an application for bankruptcy within two months from the date when they became aware or should have become aware of the debtor's bankruptcy. *See* Spanish Insolvency Law, Art. 163(1), 164(1) and 165(2) (Exhibit RME-1727). If the directors are found negligent and the company is liquidated, the judge may hold the directors liable to indemnify, totally or partially, the creditors for the part of their claims against the bankrupt company that remained unpaid upon liquidation. *See* Spanish Insolvency Law, Art. 172 (Exhibit RME-1727).

Swedish law establishes similar rules imposing on directors a duty to initiate a voluntary liquidation in cases of capital deficiency. If directors fail to do so, they may be personally liable for the debts that the company has incurred as a result of their inaction. *See* Swedish Company Act, *(Aktiebolagslag)* (2005:551), Ch. 25, §§ 13-20 (Exhibit RME-1750).

[2333] For example, for France, *see* French Commercial Code, Art. L.654-2 and L.654-3 (Exhibit RME-1722); for Germany, *see* German Bankruptcy Law, § 15a(4) (Exhibit RME-1723); and, for Italy, *see* Italian Bankruptcy Law, Art. 217(4) (Exhibit RME-1726).

[2334] This is true in Russia, where directors may be subjected to administrative fines or disqualified from acting as a director for up to two years. *See* Administrative Code of the Russian Federation 2001, Art. 14.13(5) (Exhibit RME-1751). In the U.K., a director can be disqualified from acting as a director for up to 15 years if he is found liable for wrongful trading. *See* Company Directors Disqualification Act 1986, § 10 (Exhibit RME-1752). Under German law, a director may be disqualified from acting as a director for up to five years. *See* German Law

e) The Majority Of Bankruptcy Petitions Are Presented By Tax Authorities

1497. In many jurisdictions, a majority of petitions for the wind up of insolvent companies are presented by tax authorities, as distinguished from other creditors or the companies' own directors.[2335]

f) "Suspect" Pre-Bankruptcy Transactions May Be Revoked

1498. In numerous countries, transactions carried out in anticipation of bankruptcy may be rescinded.[2336]

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on Public Limited Liability Companies (*Aktiengesetz*), § 76(3)(3) (Exhibit RME-1753). Under Spanish law, a director may be disqualified from managing the property of others and from acting as representative of any person up to 15 years. *See* Spanish Insolvency Law, Art. 172(2) (Exhibit RME-1727).

2335 For example, according to a study by the Insolvency Service (a U.K. government agency), focusing on the period from 1995/96 to 2007/09, on average 60% of winding-up orders in England and Wales are made on petitions presented by the Government tax departments, formerly known as HM Customs & Excise or the Inland Revenue, now collectively known as Her Majesty's Revenue and Customs (HMRC). *See* The Insolvency Service, *A Study of Petitions for Compulsory Liquidation up to 2008* (Exhibit RME-1754). The same percentage holds true for 2010. *See* Study of Hacker Young Chartered Accountants, http://www.uhy-uk.com/pages/posts/percentage-of-petitions-submitted-by-hmrc-to-wind-up-companies-jumps-by-a-third-in-just-one-year770.php (Exhibit RME-1755).

In France, it was noted that "*[w]hen petitions for orders to wind-up insolvent companies are made, those petitions are filed by the Public Treasury or, less frequently, by the Social Security Authority* [the URSAFF]." *See* Marie-Carmen Merchan de la Pena, *Six mois d'application de la loi de sauvegarde des entreprises* (June 23, 2006) (Exhibit RME-1756).

In Germany "*tax offices are regularly and consistently requesting the opening of insolvency proceedings*." *See* Jens Schmittman, *Besonderheiten bei der Insolvenzantragstellung durch das Finanzamt*, *in* INSBURO (9/2006), 341 (Exhibit RME-1757). Moreover, according to a statistical survey conducted in the bankruptcy court of Duisburg (Germany) in the years 1999 and 2000, public authorities filed 80% of the bankruptcy petitions for proceedings initiated by creditors. *See* Hermanjosef Schmal, *Zur Praxis öffentlich-rechtlicher Gläubiger bei der Stellung und Rücknahme von Eröffnungsanträgen–Tatsachen und Anmerkungen am Beispiel des AG Duisburg*, *in* NZI, Vol. 4 (2002), 177 (Exhibit RME-1758).

Generally, in Sweden, "*the Swedish Enforcement Agency presently makes a large number of applications for declaration of bankruptcy. The state of affairs must be assumed to mainly be the same when the task hereafter shall be handled by the tax authority*." *See* Internal Practice Guidelines for the Tax Authority in its Capacity as Creditor (*Handledning för borgenärsarbetet*) (2008), ¶ 14.1.1 (Exhibit RME-1718).

2336 For example, in Spain, under Article 71 of the Spanish Insolvency Law (Exhibit RME-1727), once the insolvency is declared, acts that are detrimental to the debtor's estate performed by the debtor within two years prior to the date of the insolvency declaration may be revoked, even if there has not been a fraudulent intention. The detriment to assets is presumed, without evidence to the contrary being admissible, in case of acts of disposal without a consideration, and payments whose maturity was after the date of the insolvency declaration.

g) Claims From Affiliated Companies Are Often Subordinated To Claims From Creditors

1499. Claimants complain that Russian courts denied a number of claims from entities related to Yukos' or Yukos' shareholders.[2337] Unlike in Russia, in other jurisdictions, claims by entities related to the debtor, if included in the creditors' register, are automatically subordinated to the claims of third-party creditors.[2338] In Yukos' bankruptcy proceedings, this treatment would have

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In the absence of evidence to the contrary, detriment to the debtor's estate is presumed in relation to transfer for a valuable consideration in favor of any of persons related to the insolvent debtor.

Similarly, English law provides that "*transactions at an undervalue*" and "*preferences*" may be challenged during the "*suspect period*." In both cases the transaction will not be set aside unless the company was insolvent or became insolvent as a result of the transaction. *See* Insolvency Act 1986, c 45, §§ 238(4), 240(2) (Exhibit RME-1731). "*Preferences*" include when the company does anything or suffers anything to be done which (in either case) has the effect of putting the other person into a position that, in the event of the company going into insolvent liquidation, will be better than the position it would have occupied if that thing had not been done. If the preference has been given to a person who is "*connected*" with the company, the "*suspect period*" is two years before the onset of insolvency. *See* Insolvency Act 1986, § 240(1) (Exhibit RME-1731). "*Connected*" is widely defined and includes, *inter alia*, directors, companies associated with directors and companies in the same group. *See* Insolvency Act 1986, c 45, §§ 249, 435 (Exhibit RME-1731).

In Sweden, pursuant to Chapter 4, section 5 of the Bankruptcy Act (Exhibit RME-1730), the general provision on *actio pauliana* allows, under certain conditions, the bankruptcy estate to revoke a transaction undertaken during a five-year period preceding the bankruptcy date. If the transaction involves a subject affiliated with the debtor, as defined by the Bankruptcy Act (*e.g.* directors and shareholders, for debtors being legal entities) there is no limit in time for revoking the transaction.

2337 *See* Claimants' Memorial on the Merits, ¶¶ 440-451.

2338 For example:

In Italy, pursuant to Article 2467 and 2497-V of the Civil Code, claims from shareholders and affiliates are subordinated to those of all other creditors, if financing took place when the company was overindebted or in all cases in which it would have been reasonable for the company to raise equity, rather than incur new debt. *See* Italian Civil Code, Art. 2467, 2497-V (Exhibit RME-1749). According to commentators, these provisions create a general system where all claims from related entities (as long as they have or had, directly or indirectly, power upon the debtor) are subordinated to those of all other creditors, if financing was extended (or maintained) when the company was overindebted or insolvent. *See* Alberto Maffei Alberti, COMMENTARIO BREVE AL DIRITTO DELLE SOCIETÀ (2007), 992 (Art. 2467, V), 1162 (Art. 2497-V) (Exhibit RME-1759). With regard to voluntary reorganization procedures, claims of related entities cannot be paid the same or more than all other credits. *See* Court of Cassation, Case No. 2706 (Feb. 4, 2009) (Exhibit RME-1760).

In Germany, section 39(1)(5) of the German Bankruptcy Law (Exhibit RME-1723) provides that "*claims to the refund of loans provided by a shareholder or claims arising out of transactions that are economically comparable to a loan*" are considered subordinated debts. The definition of a loan is interpreted in a very broad sense, as is the definition a of shareholder, which refers also to "indirect" or affiliated shareholders.

resulted in no distribution to related-company creditors, given the insufficiency of the bankruptcy estate.

h) Bankruptcy Managers Often Submit To The Creditors An Estimate Of The Debtor's Assets At Liquidation Value

1500. Mr. Rebgun, in his capacity as Yukos' interim manager, submitted to the creditors an analysis of Yukos' financial situation in anticipation of their vote on the liquidation or rehabilitation of the company. In that analysis, which was made available for consultation by creditors and the debtor before the creditors' meeting,[2339] Mr. Rebgun provided an estimate of Yukos' assets at market value and liquidation value, and discounted any taxes that might have been levied on the proceeds from prospective sales. This approach is common to bankruptcy managers in numerous other countries.[2340]

In Spain certain shareholders of the debtor company (the ones that hold at least 10% of its share capital, or 5% if the debtor is a listed company) and the companies that belong to the same group as the debtor are deemed persons "*specially related*" to the debtor and their claims are automatically classified as subordinated. *See* Spanish Insolvency Law, Art. 92(5) and 93(2) (Exhibit RME-1727).

2339 Similarly, in Spain, a copy of the manager's report is made available for consultation at the court's offices. *See* Spanish Insolvency Law, Art. 95 (Exhibit RME-1727). The same is true for Italy, where the report is made available to the creditors at least three days before the creditors' meeting called to vote on the reorganisation plan. *See* Italian Bankruptcy Law, Art. 172 (Exhibit RME-1726). In Germany, the summary of the debtor's property prepared by the bankruptcy manager must be filed, at the latest, one week prior to the creditors' meeting, with the registry of the insolvency court for inspection by the stakeholders (including the debtor). *See* German Bankruptcy Law, § 154 (Exhibit RME-1723). There is no duty of the receiver – beyond the one regulated in section 154 – to further inform the creditors or stakeholders prior to the creditors' meeting or to deposit other documents than the ones enumerated in § 154. *See* Wegener, *in* FRANKFURTER KOMMENTAR ZUR INSOLVENZORDNUNG (Wimmer, 6th ed. Luchterhand Verlag 2011), § 154 ¶ 4 (Exhibit RME-1761). As a matter of practice, bankruptcy managers are recommended to have a written report ready for distribution at the beginning of the creditors' meeting. *See* Wilhelm Uhlenbruck, *in* KOMMENTAR ZUR INSOLVENZORDNUNG (Uhlenbruck, 13th ed., Vahlen Verlag 2010), § 156 ¶ 5 (Exhibit RME-1762); Dithmar, *in* KOMMENTAR ZUR INSOLVENZORDNUNG (Braun, 4th ed., C.H. Beck Verlag 2010), § 156 ¶ 3 (Exhibit RME-1763); Balthasar, *in* KOMMENTAR ZUR INSOLVENZORDNUNG (Nerlich/Römermann, C.H. Beck Verlag, Loseblattsammlung, 2010), § 156 ¶ 31 (Exhibit RME-1764).

2340 For example, according to Italian standard practice, the bankruptcy manager estimates and compares: (i) cash flows available in the rehabilitation option (the manager will assess whether expected cash flows are reasonable and will estimate the assets at liquidation value if, according to the plan, they must be liquidated); and (ii) cash flows available in the liquidation option (in such case, the manager will apply liquidation value). As a matter of practice, when estimating the debtor's assets, the bankruptcy manager always discounts the

i) The Vote Of The Creditors' Meeting For Receivership Or Rehabilitation Is Generally Discretionary

1501. In Russia, as elsewhere,[2341] the vote for the liquidation or rehabilitation of the debtor is within the full discretion of creditors, and the bankruptcy court has very limited powers of review.

1502. Further, the identity and number of creditors who vote for the introduction of receivership proceedings or rehabilitation are irrelevant as a

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applicable portion of "latent" tax. *See* Luigi Guatri & Mauro Bini, NUOVO TRATTATO SULLA VALUTAZIONE DELLE AZIENDE (2009), 132-134 (§ 5.3) (Exhibit RME-1765).

In France, the taxes on the prospective proceeds from the sale of the assets may be provisionally declared and included in the register of bankruptcy creditors. *See* French Commercial Code, Art. L.622-24, L.631-14(1) (Exhibit RME-1722). Therefore, if a rehabilitation plan is contemplated, then the valuation of the debtor's assets will take those taxes into account.

In Germany, the bankruptcy manager draws an inventory of the debtor's property, estimating the value of the assets both at the liquidation value, in a scenario where the business of the debtor is closed down and the assets sold off, and at market value, in a scenario where the debtor's business will continue. *See* Dithmar, *in* KOMMENTAR ZUR INSOLVENZORDNUNG (Braun, 4th ed., C.H. Beck Verlag 2010), § 151 ¶ 5 (Exhibit RME-1763); Füchsl/Weishäupl, *in* MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG (2nd ed., C.H. Beck Verlag, 2007), § 151 ¶ 9 (Exhibit RME-1766). Both estimates will take into account the taxes on prospective proceeds from the sale of the assets. *See* Füchsl/Weishäupl, *in* MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG (2nd ed., C.H. Beck Verlag, München 2007), § 151 ¶ 14 (Exhibit RME-1766); Wegener, *in* FRANKFURTER KOMMENTAR ZUR INSOLVENZORDNUNG (Wimmer, 6th ed., Luchterhand Verlag, 2011), § 151 ¶ 25 (Exhibit RME-1761).

In the United Kingdom, as a matter of practice, the manager's appraisal of the debtor's assets will be based on book value, liquidation value and market value, or at the very least, liquidation value versus market value. By reference to the differing values, creditors are able to assess whether rehabilitation would provide a better outcome for creditors than a compulsory winding up. *See Re Primlaks (U.K.) Ltd*, Chancery Division, [1989] BCLC 734, 739-747 (Exhibit RME-1767). The valuation should take into account taxes on sales proceeds because (as with any other costs associated with the sale – legal costs, auction costs, the fees of the officeholder) they are an expense of realisation and therefore payable in priority to any other debt owed by the debtor company. *See Re Toshoku Finance (U.K.) Plc*, House of Lords, [2002] 1 WLR 671 HL (Exhibit RME-1768).

2341 As in Russia, the vote of creditors for receivership, rehabilitation, or external management is generally discretionary in other jurisdictions too. This is true, for example, for Germany (*see* German Bankruptcy Law, § 157 (Exhibit RME-1723) and Dithmar, KOMMENTAR ZUR INSOLVENZORDNUNG (Braun, 4th ed. 2010), § 157, ¶ 3 (Exhibit RME-1763) (according to whom "*[i]n its decision* [to liquidate the debtor's estate, to restructure it or to continue business], *the creditor's meeting is practically not bound by any mandatory provisions*")); for Italy, where the creditors' meeting has unfettered discretionary powers to reject a proposed rehabilitation plan, without giving any reason, and no judicial review of the creditors' meeting decision is allowed (*see* Italian Bankruptcy Law, Art. 177 (Exhibit RME-1726)); for Spain (*see* Spanish Insolvency Law, Art. 121(4) (Exhibit RME-1727)); for the United Kingdom (*see* Insolvency Act 1986, c 45, Schedule B1, ¶ 53 (Exhibit RME-1731)); and for the United States (*see* 11 U.S.C. § 1112 (Exhibit RME-1735)).

matter of Russian law, which simply requires that there be a vote by the majority of creditors, determined on the basis of one-ruble-one-vote, rather than one-creditor-one-vote. Not surprisingly, an identical approach to voting is followed in other countries.[2342]

j) Bankruptcy Auctions Are Generally Subject To Rules That Are Significantly Less Debtor-Friendly Than Russia's

1503. In many countries, auction procedures are notably less debtor-friendly than Russia's. In particular, in the United Kingdom, France, Germany, and the United States:

(i) auction sales are not mandated and receivers are free to sell assets of the bankruptcy estate on a negotiated, one-on-one basis;[2343] and

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2342 For example in Germany, pursuant to section 76(2) of the German Bankruptcy Law (Exhibit RME-1723), "*[a] decision of the creditors' meeting shall be valid if the sum of the claims held by endorsing creditors exceeds one half of the sum of the claims held by the creditors with voting rights*."

In Italy, a rehabilitation plan is also approved by the majority of the claims, not by the majority of the creditors. *See* Italian Bankruptcy Law, Art. 177 (Exhibit RME-1726).

In Spain, a restructuring plan is approved by the majority of the claims, not by the majority of the creditors. *See* Spanish Insolvency Law, Art. 124 (Exhibit RME-1727).

In the United Kingdom, at a creditors' meeting in administration proceedings, "*a resolution is passed when a majority (in value) of those present and voting, in person or by proxy, have voted in favour of it*." *See* Insolvency Rules 1986, Rule 2.43(1) (Exhibit RME-1770). Rule 2.43(1) applies to administration, but the same criterion holds true for meetings across all insolvency regimes. Notably, where a resolution is put to a creditors' meeting in administration, it is invalid if those voting against include more than half in value of the creditors to whom notice of the meeting was sent and who are not, to the best of the chairman's belief, persons connected with the company. *See* Insolvency Rules 1986, Rule 2.43(2) (Exhibit RME-1770). "*Connected*" has a broad meaning and includes affiliates and subsidiaries. *See* Insolvency Act 1986, c 45, § 249 (Exhibit RME-1731). Rule 2.43(2) therefore precludes connected parties from carrying a resolution where they form the majority in value of creditors, but more than 50% in value of independent creditors have voted against it.

2343 U.K. bankruptcy law expressly provides that the liquidator (whether in a voluntary or compulsory liquidation procedure) "*has the power to sell any of the company's property by public auction or private contract*" [emphasis added] (*see* Insolvency Act 1986, c 45, ¶ 6 of Schedule 4 (Exhibit RME-1731)) and that the administrator (in the administration procedure) has "*the power to sell or otherwise dispose of the property of the company by public auction or private contract*" [emphasis added] (*see* Insolvency Act 1986, c 45, ¶ 2 of Schedule 1 (Exhibit RME-1731)). If the auction route is chosen, there is no obligation to value the assets prior to sale, to set a minimum starting price, or to add conditions to the auction. On the contrary, it is for the officeholder "*to decide how the sale should be advertised and how long the property should be left on the market*. […] *Such decisions inevitably involve an exercise of informed judgment on the part of the* [officeholder] *in respect of which there can, almost by definition, be no absolute requirements*." *See*

(ii) even when auctions are used, specific requirements seldom limit receivers' broad discretion in determining the applicable parameters (including whether to set a starting price for the auctioned assets). Typically, receivers are only required to seek the best sale price reasonably achievable under the circumstances.[2344]

Michael & Others v. Miller, Court of Appeal, Civil Division, [2004] EGLR 151, ¶ 132 (Exhibit RME-1771).

Similarly, in France the bankruptcy court may choose whether to sell off the debtor's properties by public auction or private sale. *See* French Commercial Code, Art. L.642-19 [(Exhibit RME-1722). In case of a private sale, the bankruptcy court will determine the assets of the debtor that may be sold. *See* French Commercial Code, Art. L.644-2 (Exhibit RME-1722).

Likewise, under Germany Bankruptcy Law, normally "*the realization of the insolvency estate, in particular any chattel, is carried out through private sales.*" S*ee* Wilhelm Uhlenbruck, INSOLVENZORDNUNG KOMMENTAR (Wilhelm Uhlenbruck, 12th ed. 2003), § 159 (Exhibit RME-1772); *see also* Wilhelm Uhlenbruck, INSOLVENZORDNUNG KOMMENTAR (Wilhelm Uhlenbruck, 13th ed. 2010), § 159 ¶ 3 (Exhibit RME-1762) (according to which "*[t]he receiver must choose the type of realization of the insolvency estate which is likely to achieve the highest price under the circumstances of the specific case and in view of the characteristics of the market situation in relation to time and place.* […] T*he task of the receiver consists first and foremost to maximize the debtor's estate and by that to optimize the chances of satisfaction of the totality of creditors.*")

Under U.S. law, sales can be accomplished under court supervision with or without a public auction. *See* 11 U.S.C. § 363(b) (Exhibit RME-1735).

2344 Under French bankruptcy law, the public officer in charge of the auction (*commissaire-priseur*) has broad discretion as to the inventory and the evaluation of the auctioned assets, the organization of the sale and the adjudication to the highest bidder (*see* Law No. 2000-642 of July 10, 2000 Regarding the Sale of Movable Assets by Public Auction, Art. 29 (Exhibit RME-1773); *JurisClasseur Procédures Collectives, Fascicule 2709: Redressement et liquidation judiciaire -- Réalisation de l'actif -- Vente de biens meubles isolés en liquidation judiciaire,* § 21 (Exhibit RME-1774) and French Commercial Code, Art. L.642-18 (Exhibit RME-1722)). In France, auction starting prices are deliberately set significantly below market value in order to attract prospective bidders. *See Réponse du Garde des Sceaux à M. Martin Philippe Armand, Député de la Marne, Publication au JO Assemblée Nationale du 4 janvier 1999, Question n°13525* (Exhibit RME-1775).

Likewise, under German bankruptcy law, "*[w]hen liquidating the insolvency estate, the insolvency receiver's sole guidance is to obtain the highest price possible leaving him a wide scope of discretion.*" *See* Klaus Hubert Görg, MÜNCHENER KOMMENTAR ZUR INSOLVENZORDNUNG, Vol. 2 (Hans-Peter Kirchhof, Rolf Stürner and Hans-Jürgen Lwowski, 2nd ed. 2008), § 159 (Exhibit RME-1776). German law does not contain a provision requiring a minimum number of auction participants.

Under U.K. law, "*[a]n administrator owe[s] a duty to the company over which he was appointed to take reasonable care to obtain the best price that the circumstances as he reasonably perceived them to be permitted.*" *See Re Charnley Davies Ltd*, High Court of England and Wales, Chancery Division, [1990] BCC 605 (Exhibit RME-1777). U.K. law does not contain any provision requiring a minimum number of auction participants.

Under U.S. law, the trustee or debtor in possession has an obligation to maximize recovery for creditors when selling assets. *See* 11 U.S.C. § 363(b) (Exhibit RME-1735). U.S. law does not contain a provision requiring a minimum number of auction participants.

1504. Similar rules also apply in Canada,[2345] Italy,[2346] Spain,[2347] and Sweden.[2348]

k) Extensions Of Receivership Proceedings Are Routinely Granted

1505. In Yukos' Bankruptcy Proceedings, Mr. Rebgun requested and obtained from the bankruptcy court a three–month extension of the receivership proceedings (during which the assets of the company were being liquidated). In many jurisdictions -- unlike in Russia -- receivership proceedings do not have a limited duration[2349] and, when they do, bankruptcy receivers routinely request from the courts and obtain extensions, especially in a complex and sizable proceeding such as the Yukos bankruptcy.

2345 In Canada, "*[t]he trustee may* […] *sell or otherwise dispose of for such price or other consideration as the inspectors may approve all or any part of the property of the bankrupt* […] b*y tender, public auction or private contract, with power to transfer the whole thereof to any person or company*." *See* Canadian Bankruptcy and Insolvency Act, § 30 (Exhibit RME-1721). Canadian law does not provide for a minimum number of auction participants or for a minimum starting price.

2346 Italian Bankruptcy Law only requires the receiver to liquidate the bankruptcy estate "*by means of a competitive procedure*," and public auctions are not mandatory. *See* Italian Bankruptcy Law, Art. 107 (Exhibit RME-1726). Italian law does not provide for a minimum number of auction participants or for a minimum starting price.

2347 In Spain, the receiver is free to determine the modalities for the sale of the debtor's assets (public auction or direct sale), subject to court approval. *See* Moralejo Imbernón, Nieves, *COMENTARIOS A LA LEY CONCURSAL*, Vol. II (Bercovitz Rodrigues-Cano, Rodrigo, Tecnos, 2004), 1588-1589 (Exhibit RME-1778); Velasco San Pedro, Luis Antonio, *COMENTARIOS A LA LEGISLACIÓN CONCURSAL*, Vol. II (Alonso Ureba, Alberto et al., Dykinson, 2004), 1326-1327 (Exhibit RME-1779). If the receiver chooses the auction route, there is no requirement for an auction starting price (for movable assets, including shares) nor for a minimum number of auction participants and the auction can result in the assets being sold significantly below the appraised value. In particular, Spanish law requires a prior appraisal of the assets to be sold at auction, which serves as a reference price. The assets shall be transferred to the highest bidder if the bid is equal to or higher than 50% of the appraised value. If the bid is lower than 50% of the appraised value, the assets shall not necessarily be transferred to the highest bidder. *See* Spanish Enforcement Law No. 1/2000 (Jan. 7, 2000), Art. 650 (Exhibit RME-1780).

2348 In Sweden, the bankruptcy receiver is required to divest all of a company's assets "*as soon as reasonably possible*," either by public auction or by private sale, and no minimum starting price is required. *See* Swedish Bankruptcy Act (1978:672), Ch. 8, §§ 1, 6 and 7 (Exhibit RME-1730). Swedish law does not contain a provision requiring a minimum number of auction participants or a minimum auction starting price.

2349 This is true for Italy, Germany (*see* German Bankruptcy Law, § 200 (Exhibit RME-1723)); Spain (*see* Spanish Insolvency Law, Art. 176(1)(3), and (4) (Exhibit RME-1727); Sweden, the United Kingdom (with respect to liquidation proceedings), and the United States.

l) Treatment Afforded To Late Claims

1506. Under Russian law, any claim submitted after closure of the register of claims, as well as any claim for mandatory payments arising after the commencement of receivership, is validly filed as a "late" claim and recorded on a separate list. "Late" claims are satisfied after full payment of timely claims included in the register of bankruptcy claims. In Yukos' bankruptcy proceedings, "late" claims consisted chiefly of claims by the Federal Tax Service for 24% profit taxes on proceeds from the bankruptcy auctions.[2350]

1507. These "late" tax claims in the Yukos bankruptcy were treated considerably less favorably than such claims would have been treated in other countries.[2351]

2350 *See* 2002 Russian Bankruptcy Law, Art. 142(4) (Exhibit RME-1747).

2351 In many jurisdictions, claims can be validly filed until completion of the bankruptcy proceedings. For example, in the United Kingdom, Germany, and Sweden, creditors can file their claims at any time during the winding-up proceedings until the receiver declares the final dividend (late creditors that file claims after a distribution has already been made will only receive a share of the remaining funds). *See* Insolvency Rules 1986, Rule 4.180-4.182, 4.185 (Exhibit RME-1770); German Bankruptcy Law, § 177 (Exhibit RME-1723); Swedish Bankruptcy Act (1978:672), Ch. 9, § 20 (Exhibit RME-1730). Unlike in Russia, in numerous other countries, claims for taxes assessed on proceeds of asset sales typically qualify as "*administrative costs*" of the bankruptcy proceedings and, as such, have priority over most other claims previously filed by creditors.

In Germany, for example, tax claims on profits realized after the commencement of the bankruptcy proceedings are considered costs of the proceedings to be settled prior to any other claim. *See* German Bankruptcy Law, §§ 53-55 (Exhibit RME-1723); *see also* Decision of the German Tax Court (*Bundesfinanzhof*), Case No. 447 (Nov. 11, 1993) (Exhibit RME-1781)and Case No. 602 (Mar. 29, 1984) (Exhibit RME-1782).

In France and in Italy as well, taxes on profits accrued after the commencement of the bankruptcy proceedings are to be paid as administrative costs before all other claims (excluding employees' claims in France). *See* French Commercial Code, Art. L.641-13 and L.643-2 (Exhibit RME-1722). The same holds true for Italy. *See* Italian Bankruptcy Law, Art. 111 (Exhibit RME-1726).

A similar principle applies in the United Kingdom, where all fees, costs, charges and other expenses incurred in the course of the liquidation (including costs associated with the sale of the debtor's assets) are treated as "*expenses of the liquidation*" and have priority over pre-liquidation debts. *See* Insolvency Rules 1986, Rule 4.218 (Exhibit RME-1770). Taxes payable on the proceeds of an auction would come within the definition of "*expenses of the liquidation*," as confirmed by U.K. courts, and in particular, in the House of Lords' decision *Re Toshoku Finance*, where it was held that corporation tax was payable as an expense of the liquidation even though the "*income*" in respect of which the tax was assessed had not been (and never would be) received by the company and even though the tax debt had not arisen as a result of

7. The Alleged Violations Of Due Process Do Not By Themselves Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1508. As shown at Section VI.C.5.a above, in the absence of proof of total or substantial deprivation caused by alleged due process violations, such violations by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*."

8. In any event, Claimants Have Failed To Establish The Alleged Due Process Violations

1509. Claimants generally contend that the Bankruptcy Proceedings "*show a blatant disregard for the requirements of due process at every turn,*"[2352] and raise a number of specific "due process" violation allegations. None has any merit.

a) The Alleged Due Process Violations In The Bankruptcy Proceedings Were Subject To Court Review

1510. In the Russian legal system, all of Claimants' allegations with respect to the Bankruptcy Proceedings were subject to court review. Yukos and its shareholders were entitled to seek judicial review of all court decisions and actions taken during the Bankruptcy Proceedings, including by the bankruptcy manager, the creditors' meeting, and the arbitrazh court. In addition, Yukos and its shareholders were entitled to appeal the court decisions confirming each of these actions and court decisions.[2353]

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something done with a view to obtaining a benefit for the company in liquidation. *See Re Toshoku Finance (U.K.) Plc*, House of Lords, [2002] 1 WLR 671 HL (Exhibit RME-1768).

Similarly, in the United States, "*all taxes 'incurred by the estate' are administrative expenses entitled to second priority*," *i.e.*, to be paid before unsecured creditors and before equity holders. "*It is clear that any taxes measured by income earned postpetition will be administrative expenses*." *See* Matthew Bender & Co., COLLIER ON BANKRUPTCY, Vol. 4 (15th ed. rev. 2009), § 503.07 (Exhibit RME-1783); *see also* 11 U.S.C. §§ 502(i), 503(b)(1)(b) and 507(a)(2) (Exhibit RME-1735).

2352 Claimants' Memorial on the Merits, ¶ 601.

2353 Article 60(1) and (3) of the 2002 Russian Bankruptcy Law provides that the actions of the bankruptcy manager and the decisions of creditors' meetings can be appealed by the debtor, the representative of the debtor's shareholders and the creditors (Exhibit RME-776). Articles 61 and 126(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776) and Article 41 of the Arbitrazh Procedure Code of the Russian Federation (Exhibit RME-1796) in turn provide that

1511. With a few exceptions,[2354] Yukos exercised these rights and sought the annulment of the complained-of actions and court rulings. Yukos' challenges were subject to full judicial review at the first instance, and, if further appealed, review at the appellate court level (in some cases, *de novo*) as well as legal scrutiny at the cassation court level.[2355]

1512. Most of the allegations Claimants raise with respect to the Bankruptcy Proceedings were also raised by Yukos before Russian courts and were fully reviewed, through various layers of appeals.

1513. Out of more than 40 separate court proceedings relating to the Bankruptcy Proceedings, Claimants allege procedural improprieties with respect only to a few. These allegations are without merit, as shown below.

b) The Alleged Due Process Violations In The Bankruptcy Proceedings Were Either Reviewed By The Russian Courts Or Were Not Raised By Yukos At The Time

1514. The following allegations raised here by Claimants were also raised by Yukos before Russian courts, and were fully reviewed.

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the first instance court's decisions in bankruptcy proceedings can be appealed by the debtor and creditors before initiation of receivership and also by the representative of the debtor's shareholders during receivership. The following rulings are not subject to cassation review and can only be challenged the appellate court: (i) rulings invalidating/dismissing a claim for invalidation of decisions of the creditors' meeting; (ii) rulings accepting bankruptcy petitions; and (iii) rulings extending receivership. In respect of these rulings, the resolution of the appellate instance court is final. *See* Resolution of the Plenum of the Supreme Arbitrazh Court, Case No. 4, Item 14 of the (April 8, 2003) (Exhibit RME-1795). For these purposes Mr. Tim Osborne was elected the representative of Yukos' shareholders on June 1, 2006. *See* (Annex (Merits) C-311). In addition, Article 245(3) of the Russian Arbitrazh Procedure Code (Exhibit RME-1796) entitles a debtor to appeal a ruling enforcing a foreign court judgment or arbitral award in Russia.

2354 For example, Yukos voluntarily withdrew the appeal against the Moscow Arbitrazh Court's order of March 9, 2006 accepting the bankruptcy petition of the SocGen syndicate. Further, neither Yukos, nor its shareholders appealed the Moscow Arbitrazh Court's order of August 8, 2007 extending receivership. Yukos' shareholders did not appeal the November 15, 2007 order finalizing receivership.

2355 Subject to the limitations of the 2002 Russian Bankruptcy Law. *See* ¶ 1510. *See also* ¶¶ 1287-1289.

(i) The allegation that "[i]n December 2005 [...] Yukos was anything but a company on the verge of bankruptcy."[2356] This allegation was raised by Yukos and dismissed.[2357] As set forth at paragraphs 560, 563 and 584 above, the courts correctly held that the SocGen bankruptcy petition satisfied the "insolvency test" under Russian law and no procedural irregularities in that matter have been alleged.

(ii) The allegation that Rosneft "used the cover of Western banks to force Yukos into bankruptcy."[2358] This allegation was raised by Yukos before courts and dismissed.[2359] As set forth at paragraphs 560, 563 and 584 above, the bankruptcy filing of the SocGen syndicate was in accordance with Russian law and no procedural irregularities in that matter have been alleged.

(iii) The allegation that the Moscow Arbitrazh Court included in the Bankruptcy Register various claims from YNG "totalling US$ 10.69 billion."[2360] The rulings admitting YNG's claims to bankruptcy were appealed and upheld.[2361] As set forth at paragraphs 1539-1543 below, YNG's claims were included in the Bankruptcy Register in accordance with Russian law, and no procedural irregularities in that matter have been alleged.

2356 Claimants' Memorial on the Merits, ¶ 602.

2357 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-306); Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KG-A40/7072-06-B (Oct. 20, 2006) (Exhibit RME-761).

2358 Claimants' Memorial on the Merits, ¶ 602.

2359 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-307). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KG-A40/7072-06-B (Oct. 20, 2006) (Exhibit RME-761).

2360 Claimants' Memorial on the Merits, ¶ 607. *See also Ibid*., ¶¶ 435-439.

2361 In respect of claims specifically mentioned by Claimants, *see* (1) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-10669/2006-GK (Sept. 7, 2006) (upholding Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (July 19, 2006)) (Annex (Merits) C-339); (2) Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-10671/2006-GK (Sept. 7, 2006) (upholding Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (July 19, 2006)) (Annex (Merits) C-340); and (3) Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Oct. 12, 2006) (Annex (Merits) C-343).

(iv) The allegation that "[t]he Russian courts prevented other creditors related to Yukos or Yukos' shareholders from asserting claims against Yukos in the bankruptcy, thus maximizing the Russian State's share of Yukos' assets."[2362] The rulings refusing inclusion in the Bankruptcy Register of claims from Yukos-related entities were appealed and upheld.[2363] As set forth at paragraphs 1525-1538 below, related company claims were rejected in accordance with

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2362 Claimants' Memorial on the Merits, ¶ 608. *See also ibid.*, ¶¶ 440-449.

2363 (1) As to claims from Yukos Capital, *see* Order of the Moscow Arbitrazh Court (July 19, 2006) (Annex (Merits) C-332); and Resolution of the Ninth Appellate Arbitrazh Court (Feb. 22, 2007) rejecting Yukos Capital's appeal against Order of the Moscow Arbitrazh Court (Dec. 4, 2006), which refused for the second time to include Yukos Capital's claims in the Bankruptcy Register (Annex (Merits) C-345); (2) as to Moravel, *see* Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation No. 15954/06 (June 19, 2007) (Annex (Merits) C-351) and Order of the Moscow Arbitrazh Court (Nov. 14, 2007) (Annex (Merits) C-352); (3) as to Glendale, *see* Resolution of the Ninth Appellate Arbitrazh Court (Mar. 12, 2007) rejecting appeal of Glendale against Order of the Moscow Arbitrazh Court (Dec. 4, 2006), which refused to include Glendale's claims in the Bankruptcy Register (Annex (Merits) C-346); (4) as to OOO Yu- Mordovia, *see* Resolution of the Ninth Appellate Arbitrazh Court (Sept. 7, 2006) granting YNG's and Federal Tax Service's appeals against Order of the Moscow Arbitrazh Court (July 19, 2006), which included OOO Yu-Mordovia's claim in the Bankruptcy Register (Annex (Merits) C-341); (5) as to OOO Yukos Vostok Trade, *see* Order of the Moscow Arbitrazh Court (July 19, 2006) refusing to include the major part of OOO Yukos Vostok Trade's claims in the Bankruptcy Register (Annex (Merits) C-333); (6) as to ZAO Yukos-M, *see* Resolution of the Ninth Appellate Arbitrazh Court (Aug. 2, 2006) rejecting ZAO Yukos-M's appeal against Order of the Moscow Arbitrazh Court (June 9, 2006), which refused to include ZAO Yukos-M's claims in the Bankruptcy Register (Annex (Merits) C-334); (7) as to OOO Siberian Internet Company, *see* Resolution of the Ninth Appellate Arbitrazh Court (Aug. 7, 2006) rejecting appeal of OOO Siberian Internet Company against Order of the Moscow Arbitrazh Court (June 8, 2006), which refused to include OOO Siberian Internet Company's claims in the Bankruptcy Register (Annex (Merits) C-335); (8) as to OOO Trading House Yukos-M, *see* Resolution of the Ninth Appellate Arbitrazh Court (Aug. 31, 2006) rejecting OOO Trading House Yukos-M's appeal against Order of the Moscow Arbitrazh Court (June 8, 2006), which refused to include OOO Trading House Yukos-M's claims in the Bankruptcy Register (Annex (Merits) C-337); (9) as to ZAO Krasnoyarskgeofizika, *see* Resolution of the Ninth Appellate Arbitrazh Court (Aug. 31, 2006) rejecting appeal of ZAO Krasnoyarskgeofizika against Order of the Moscow Arbitrazh Court (June 8, 2006), which refused to include ZAO Krasnoyarskgeofizika's claims in the Bankruptcy Register (Annex (Merits) C-338); (10) as to ZAO Lipetsnefteproduct, *see* Resolution of the Ninth Appellate Arbitrazh Court (Oct. 4, 2006) rejecting appeal of ZAO Lipetsknefteproduct against Order of the Moscow Arbitrazh Court (June 8, 2006), which refused to include ZAO Lipetsknefteproduct's claims in the Bankruptcy Register (Annex (Merits) C-342); (11) as to OOO Alta-Trade, *see* Resolution of the Ninth Appellate Arbitrazh Court (Mar. 13, 2007) rejecting appeal of OOO Alta-Trade against Order of the Moscow Arbitrazh Court (Dec. 27, 2006), which refused to include OOO Alta-Trade's claims in the Bankruptcy Register (Annex (Merits) C-347). The only exception is a claim from OOO Yu-Mordovia, where the appellate court did not agree with the reasoning of the Moscow Arbitrazh Court. *See* ¶ 1537. As to a claim from Yukos' lawyers, which is a claim from unrelated third parties and therefore irrelevant, *see* note 2404.

Russian law, and no procedural irregularities in that matter have been alleged.

1515. The following due process violation alleged by Claimants here was also raised by Yukos before Russian courts, and was fully reviewed.

(i) The allegation that the Moscow Arbitrazh Court allegedly included the tax authorities' claim for the 2004 assessment into bankruptcy "after spending only 15 minutes examining 127,000 pages of information."[2364] This contention is manifestly false. Both before and at the hearing of June 14, 2006,[2365] the judge had ample opportunity to familiarize himself with the content of the "*127,000 pages*" and the underlying issues. These issues had been previously discussed at the hearings of June 1, June 7 and June 8, 2006 in the same proceedings,[2366] and were further addressed in the course of the June 14 hearing -- which lasted four hours, not 15 minutes.[2367] Moreover, following Yukos' appeal of the June 14, 2006 court decision, the appellate court reviewed the case *de novo* in the course of a three-day hearing.[2368] Finally, the merits of the 2004 tax assessment were also the subject of separate proceedings initiated by Yukos,[2369] whose outcome was fully taken into account for the purposes of determining the amounts of the claims ultimately included in the Bankruptcy Register.

2364 Claimants' Memorial on the Merits, ¶¶ 605. *Ibid.*, ¶ 434.

2365 The hearing of June 14, 2006 was obviously "*conducted by* a *bankruptcy Judge*," being a hearing held during the proceedings for the admission of claims into Yukos' bankruptcy. Claimants' Memorial on the Merits, ¶ 434.

2366 *See* Minutes of the Hearing before the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 "B" (June 1-14, 2006) (Exhibit RME-1799).

2367 *See ibid.* (Exhibit RME-1799). With reference to the the "*127,000 pages*," the Appellate Court noted that: "*documents* [that Yukos] *has produced to support its claims constitute documentation of* [Yukos] *and its dependent companies* […] *and* [Yukos] *could not be unaware of the circumstances of such operations*." *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-8628/2006-GK (Aug. 18, 2006) (Annex (Merits) C-336).

2368 *See ibid.* (Annex (Merits) C-336).

2369 *See* Claimants' Memorial on the Merits, ¶ 267.

1516. The following allegations raised by Claimants in this arbitration were not raised by Yukos before Russian courts, nor by Claimants in their capacity as Yukos' shareholders.

(i) The allegation that Mr. Rebgun provided "*active cooperation*" to the "dismantlement" of Yukos.[2370] As set forth at paragraphs 563, 609 and 613-619 above, the appointment of Mr. Rebgun as Yukos' interim manager and then receiver, as well as his conduct throughout the Bankruptcy Proceedings, were in compliance with Russian law and no procedural irregularities have been alleged.

(ii) The allegation that, by decision of August 4, 2006, the Moscow Arbitrazh Court "approved almost all of the proposals adopted" at the creditors' meeting and "also made available all of Yukos' assets for further sell-off by lifting the previous seizures on those assets."[2371] As set forth at paragraph 632 above, the decision of the Moscow Arbitrazh Court of August 4, 2006 upholding the creditors' vote for the liquidation of Yukos' assets (and consequently lifting all existing seizures) was in compliance with Russian law, and no procedural irregularities have been alleged.

(iii) The allegation that the Bankruptcy Auctions were "almost always won by Rosneft" "at below market prices."[2372] Claimants did not challenge before any courts the appraisal of Yukos' assets by the Roseko consortium, upon which the starting prices for each auction were set, even though they had the ability to do so.[2373] As set forth at paragraphs 635-638, 1468 above, the Bankruptcy Auctions were

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2370 Claimants' Memorial on the Merits, ¶ 605.

2371 Claimants' Memorial on the Merits, ¶ 611. Yukos appealed the Moscow Arbitrazh Court judgment declaring it bankrupt, but the appeal was dismissed after due consideration. *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-11597/2006-GK (Sept. 26, 2006) (Exhibit RME-785).

2372 Claimants' Memorial on the Merits, ¶ 613.

2373 *See* previous discussion in this section and Article 130(3) of 2002 Russian Bankruptcy Law (Exhibit RME-776).

held in compliance with Russian law, and no procedural irregularities have been alleged.

(iv) The allegation that "[t]he Russian Federation, acting through its Federal Taxation Service and Rosneft, ensured that Yukos' shareholders would not get a single cent of [the estate] surplus by filing subsequent claims," which "were allowed by the Moscow Arbitrazh Court."[2374] As set forth at paragraphs 665 to 667 above, the filing of "late claims" by the Federal Taxation Service (consisting mainly of taxes on the proceeds from the Bankruptcy Auctions) was in accordance with Russian law, and no procedural irregularities have been alleged.

1517. The following due process violations alleged by Claimants in this arbitration were not raised by Yukos before the courts, nor by Claimants themselves in their capacity as Yukos' shareholders.

(i) The allegation that the "planned steps" (*i.e.*, allegedly, the enforcement in Russia of the English High Court judgment recognizing SocGen's claim, the enforcement of that judgment by the Russian bailiffs and the filing of the bankruptcy petition against Yukos by SocGen) were implemented with "incredible speed and efficiency" so that Yukos did not have "at any point [...] an opportunity to fight Rosneft's ordered plans."[2375] This contention is demonstrably false. In reality, (i) Yukos actively participated in every stage of the judicial process leading to the enforcement of the English High Court judgment in Russia and was granted a full opportunity to present its case at each level of the judicial system[2376] and did appeal the lower court's ruling enforcing that

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2374 Claimants' Memorial on the Merits, ¶ 614.

2375 Claimants' Memorial on the Merits, ¶ 604.

2376 *See* Order of the Moscow Arbitrazh Court, Case No. A40-53839/05-8-388 (Dec. 21, 2005) (Exhibit RME-749). In particular, the Order notes that Yukos presented the same defenses as it presented in September: "*The respondent disputed the complainants' arguments on the grounds*

judgment,[2377] (ii) Yukos was entitled to challenge the actions of the bailiffs relating to the enforcement of the English High Court judgment (*see* discussion above), and (iii) Yukos appealed the ruling of the Moscow Arbitrazh Court accepting SocGen's bankruptcy petition, but subsequently withdrew its appeal.[2378]

(ii) The allegation that the Moscow Arbitrazh Court allegedly accepted SocGen's bankruptcy petition in "three days."[2379] This allegation is unclear. In any event, Claimants' criticism is misplaced since, under the law, the court had no more than five days to decide whether to accept the petition.[2380]

(iii) The allegation that Mr. Rebgun's failure to distribute a copy of the Rehabilitation Plan to the creditors and a copy of his Financial Analysis to the debtor before the first meeting of Yukos' creditors "highlights the due process violations and the fundamental lack of good faith that permeated the bankruptcy proceedings."[2381] This allegation is without merit both as a legal and a factual matter.[2382] In particular, Mr. Rebgun's alleged failure to act as Yukos' post office did not deprive Yukos of the ability to challenge the recommendations made in his Financial Analysis. Any issues Yukos' representatives might have had with respect to that document could have been raised and discussed at the creditors'

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stated in the previous examination of the case". *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KG -A40/698-06-P (Mar. 2, 2006) (Annex (Merits) C-302).

2377 *See* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KG -A40/698-06-P (Mar. 2, 2006) (Annex (Merits) C-302). Yukos based its appeal on the following grounds: "*In its cassation complaint, OAO YUKOS Oil Company requests to cancel the Ruling.*"

2378 *See* Order of the Ninth Arbitrazh Appellate Court, Case No. 09AP-3681/06-GK (Apr. 18, 2006) (Exhibit RME-1797).

2379 Claimants' Memorial on the Merits, ¶ 604.

2380 *See* Article 42(3) of the 2002 Russian Bankruptcy Law (Exhibit RME-776).

2381 Claimants' Memorial on the Merits, ¶ 610.

2382 *See* ¶¶ 613-614 above. In a nutshell, (i) under the 2002 Russian Bankruptcy Law, Mr. Rebgun was under no obligation to circulate either document to the creditors and the debtor and (ii) in fact, Yukos and its creditors had ample time to familiarize themselves with these documents.

meeting where Mr. Rebgun presented the analysis.[2383] Yukos did in fact challenge the results of Mr. Rebgun's analysis in the context of its challenge of the creditors' decision. Yukos' application was considered by the Moscow Arbitrazh Court and dismissed.[2384]

(iv) The allegation that the hearing on August 1, 2006 allegedly was in violation of Article 72(1) of the 2002 Russian Bankruptcy Law, which requires a minimum period of ten days between the creditors' meeting and the court's hearing. This allegation is irrelevant as a matter of fact and incorrect as a matter of law. The ten-day period is calculated from the first day of the creditors' meeting, before any adjournment (*i.e.*, July 20, 2006).[2385] In any event, according to Russian court practice, there are no legal consequences that follow even if the 10-day period has been breached.[2386]

(v) The allegation that the Bankruptcy Auctions "frequently involve[ed] only two bidders" and "at times last[ed] a few minutes."[2387] As discussed in detail at ¶¶ 638-649 above, the auctions involved a competitive process, were widely publicized, and were open to any bidder and held in accordance with Russian law.

2383 *See* Protocol (Annex (Merits) C-319).

2384 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 30, 2006) (RM-343). In its application seeking to invalidate the decision of the first meeting of creditors, Yukos attacked evaluation of its assets made by Mr. Rebgun, once again alleging the accurateness and validity of its rehabilitation plan. *See* Application Seeking to Invalidate the Decision of the Meeting of Creditors (July 31, 2006) (Exhibit RME-1804).

2385 *See* Resolution of the Tenth Arbitrazh Appellate Court, Case No. A41-K2-5360/06 (Nov. 20, 2006) (Exhibit RME-1803).

2386 *See, e.g.*, Resolution of the Federal Arbitrazh Court of the Volgo-Viatskiy District, Case No. A79-1602/2005 (Nov. 9, 2005) (Exhibit RME-803).

2387 Claimants' Memorial on the Merits, ¶ 613.

c) Claimants Have Failed To Allege Any Procedural Irregularities In Respect Of Most Of The Court Decisions Issued In The Context Of The Bankruptcy Proceedings

1518. Claimants do not allege, nor contend that Yukos alleged, any procedural improprieties with respect to any of the following court proceedings:

(i) The court proceedings accepting the SocGen syndicate's bankruptcy petition.[2388] The related ruling was challenged by Yukos, which subsequently withdrew its appeal;[2389]

(ii) The court proceedings replacing the SocGen syndicate with Rosneft as a creditor in the Bankruptcy Proceedings, as a result of Rosneft's purchase of the SocGen syndicate's claim.[2390] Yukos appealed the Moscow Arbitrazh Court's order before the Ninth Appellate Arbitrazh Court and then the Federal Arbitrazh Court of the Moscow District. Both courts confirmed the validity of the first instance ruling;[2391]

(iii) The court proceeding introducing "supervision proceedings" against Yukos after verification that the requisite indicia of legal insolvency were present, and appointing Mr. Rebgun as "interim manager."[2392] On Yukos' appeal, the ruling was confirmed by both the Ninth Appellate Arbitrazh Court and the Federal Arbitrazh Court of the Moscow District;[2393]

2388 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 9, 2006) (Annex (Merits) C-304).

2389 *See* Order of the Ninth Arbitrazh Appellate Court, Case No. 09AP-3681/06-GK (Apr. 18, 2006) (Exhibit RME-1797), upholding Yukos' withdrawal of the appeal and terminating the relevant proceedings.

2390 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-307).

2391 *See* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KG-A40/7072-06-A (Sept. 26, 2006) (Exhibit RME-760).

2392 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Mar. 29, 2006) (Annex (Merits) C-306).

2393 *See* Resolution of the Federal Arbitrazh Court of the Moscow District, No. KG-A40/7072-06-B (Oct. 20, 2006) (Exhibit RME-761).

(iv) The court proceedings upholding the decision of Yukos' creditors' meeting held on July 20-25, 2006 as legal and appropriate.[2394] Neither Yukos nor Claimants ever appealed the Moscow Arbitrazh Court's order;

(v) The court proceedings extending receivership,[2395] at the request of Mr. Rebgun, for three months. Again, neither Yukos nor Claimants appealed the Moscow Arbitrazh Court's order; and

(vi) The court proceedings finalizing Yukos' receivership[2396], leaving upwards of RUB 227.1 billion (approximately US$ 9.2 billion[2397]) in unsatisfied liabilities. Claimants did not challenge this decision at the time.

9. The Alleged Discrimination Does Not Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*" And, In Any Event, No Discriminatory Conduct Cognizable Under Article 13(1)(b) ECT Has Been Established

a) The Alleged Discrimination Does Not By Itself Establish "*Measures Having Effect Equivalent To Nationalization Or Expropriation*"

1519. As shown at ¶¶ 1096-1104 above, in the absence of proof of total or substantial deprivation caused by allegedly discriminatory measures, such measures by themselves do not amount to "*measures having effect equivalent to nationalization or expropriation*."

b) In Any Event, No Discriminatory Conduct Cognizable Under Article 13(1)(b) ECT Is Alleged

1520. As shown in Section VI.C.4.B above, the alleged discriminatory treatment of Yukos-related and Yukos shareholder-related claims in the

2394 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 30, 2006) (Exhibit RME-784).

2395 *See* Order of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (Aug. 8, 2007) (Annex (Merits) C-360).

2396 *See* Finalization Order (Exhibit RME-752).

2397 Based on the RUB/US$ exchange rate on Nov. 15, 2007.

Bankruptcy Proceedings is not for a discriminatory purpose within the meaning of Article 13(1)(b) ECT.

c) In Any Event, Neither Claimants Nor Their Investments Were Discriminated Against

1521. Claimants contend that the Russian Federation discriminated against them during Yukos' bankruptcy proceedings because the Moscow Arbitrazh Court "systematically rejected claims filed by creditors related to Yukos or Yukos' shareholders, while systematically admitting claims of the Russian State and of entities affiliated to the State."[2398] This claim is demonstrably false.

1522. First, as a threshold point, Claimants do not allege that the Russian Federation discriminated in some manner against them because of their foreign ownership. Moreover, at all stages of Yukos' bankruptcy proceedings, Claimants were treated no differently than any other Yukos shareholder.

1523. Second, it is simply not correct that the Moscow Arbitrazh Court "*systematically*" rejected claims filed by creditors related to Yukos or Yukos' shareholders. To the contrary, the court included Yukos' related company claims in the Bankruptcy Register when it found them valid, regardless of the identity of the creditor. Accordingly, the Bankruptcy Register reflected claims from related company creditors such as OAO Tomskneft VNK, ZAO Orelnefteproduct, OAO SvNIIP (Middle Volga Scientific Research Institute of Oil Refinery), OAO Samaraneftegaz, OOO Top-Master-Realty, OOO Sibintek-Leasing, ZAO Yukos Exploration and Production, ZAO Yukos Refining and Marketing, ZAO Briansknefteproduct, OOO Yukos-Moscow, OAO Syzran Refinery, AB Mazeikiu Nafta (plc), OOO Yu-Mordovia, OOO Yukos Vostok Trade, OAO TomskNIPIneft VNK, OAO Samaraneftegeofizika, ZAO Lipetsknefteproduct, ZAO Penzanefteproduct, OAO Tomsknefteproduct VNK, ZAO

2398 Claimants' Memorial on the Merits, ¶¶ 789 *et seq.*

Ulianovsknefteproduct, ZAO Tambovnefteproduct and OAO Belgorodnefteproduct.[2399]

1524. Third, even if the claims from Yukos-related entities that, according to Claimants, were improperly not allowed into the Bankruptcy Register[2400] were instead admitted, they were insufficient in amount to have been able to alter the vote taken by the creditors[2401] or, more generally, the outcome of the Bankruptcy Proceedings. If anything, the admission of those claims in the Bankruptcy

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2399 *See* Bankruptcy Register (Oct. 30, 2007) (Annex (Merits) C-353).

2400 *See* Claimants' Memorial on the Merits, ¶ 790.

2401 At the first meeting of Yukos' creditors (July 20-25, 2006), 242,977,843,105 votes were cast for Yukos' liquidation (equal to 93.87% of the voting claims), 14,564,992,054 votes were cast against liquidation (equal to 5.63% of the voting claims) and 315,290,789 votes were cast for abstention (0.12% of the voting claims). *See* Protocol of the Creditors' Meeting, 17 (Annex (Merits) C-319).

At paragraphs 440–449 of their Memorial on the Merits, Claimants identify a number of Yukos–related creditors whose claims, allegedly, were improperly rejected by the Moscow Arbitrazh Court for inclusion in the Bankruptcy Register and were, thus, precluded from voting at the first meeting of Yukos' creditors. Yukos' Rehabilitation Plan included as an exhibit a declaration prepared by Yukos' own expert, Wayne R. Wilson Jr., which in turn attached a chart showing the number of votes that would have been attributable to such creditors had they been allowed to participate in that meeting, namely: (1) Yukos Capital -- 102,858,065,800.44 votes; (2) Moravel -- 18,898,850,554.06 votes; (3) OOO Yu-Mordovia -- 36,888,631.28 votes; (4) OOO Yukos Vostok Trade -- 11,517,748,441.32 votes; (5) ZAO Yukos–M -- 2,375,638,420.18 votes; (6) OOO Trading House Yukos-M -- 435,262,738.90 votes; (7) ZAO Krasnoyarskgeofizika -- 3,356,000.00 votes; (8) ZAO Lipetsknefteproduct -- 52,073,698.63 votes; and (9) OOO Alta-Trade -- 620,060,633.28 votes. *See* Exhibit B to the Third Declaration of Wayne R. Wilson Jr. (May 18, 2006), submitted as Exhibit C to the Rehabilitation Plan (Annex (Merits) C-312). The foregoing figures take into account exclusively claimed principal and contractual interest since, as a matter of Russian law, penalties and fines do not give votes to creditors. *See* 2002 Russian Bankruptcy Law, Art. 12(3) (Exhibit RME-776).

According to this chart, the aggregate amount of additional votes that, if admitted to the Bankruptcy Register, Yukos-related creditors could have enjoyed at the first meeting of Yukos' creditors is 136,797,944,918.09. If these votes were added to the votes actually cast against liquidation (14,564,992,054), the total is 151,362,936,972.09 votes, equal to only 38.35% of the voting claims. In this hypothetical scenario, the votes cast for liquidation would still retain an ample majority (61.56% of voting claims).

The hypothetical does not take account of claims from Glendale Group Limited ("Glendale"), because they were first submitted to the bankruptcy court after the creditors' meeting, nor claims from OOO Siberian Internet Company, which were not mentioned by Mr. Wilson and were, in any case, for a relatively insignificant amount (RUB 45,862,202 or approximately US$ 1.7 million, based on the RUB/US$ exchange rate on July 20, 2006); *see* Resolution of the Ninth Arbitrazh Appellate Court (Aug. 7, 2006) rejecting appeal of OOO Siberian Internet Company against Order of the Moscow Arbitrazh Court (June 8, 2006), which refused to include OOO Siberian Internet Company's claims in the Bankruptcy Register (Annex (Merits) C-335).

Register would have resulted in even greater liabilities, which ultimately would have further still exceeded Yukos' assets. The foregoing disposes of Claimants' allegation that "*[t]he purpose of such deliberate discrimination was* […] *to ensure that the Russian State represented the overwhelming majority of Yukos' creditors*" so as to "*ensure that it would dictate the course of the bankruptcy proceedings.*"[2402]

1525. Fourth, when the Moscow Arbitrazh Court rejected Yukos' intercompany claims, it was because -- upon reviewing their merits -- it concluded that they were not legitimate. Claimants' allegation that the review by the court "*was done without any regard to the underlying merits of the claims*"[2403] is therefore simply wrong, as demonstrated below. Intercompany claims from Yukos Capital, Moravel, Glendale, and other Yukos-related entities[2404] were correctly rejected since they originated from, and in turn implemented, abusive schemes. To the contrary, the admitted claims from the Federal Tax Service and YNG were valid claims, all resulting from Yukos' own misconduct.

(1) Rejected Claims By Yukos-Related Entities Were Abusive

(a) Claims from Yukos Capital[2405]

1526. Yukos Capital is a special purpose vehicle whose only business has been to accumulate funds from various off-shore and on-shore entities ultimately controlled by the Oligarchs (mostly as proceeds of Yukos' tax evasion scheme), and to lend those funds to Yukos and Yukos' production subsidiaries.[2406] Until

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2402 Claimants' Memorial on the Merits, ¶ 789.

2403 Claimants' Memorial on the Merits, ¶ 789.

2404 Claimants' Memorial on the Merits, ¶¶ 790, 796. Claimants take issue with the Ninth Arbitrazh Appellate Court's rejection of claims from Yukos' lawyers. These are claims by individuals that were not related to Yukos or its shareholders and are therefore irrelevant to Claimants' charge of discrimination. In any event, these claims were given full consideration by the Russian courts. *See* Resolution of the Ninth Arbitrazh Appellate Court (Mar. 21, 2007) (Annex (Merits) C-350).

2405 Claimants complain that the Moscow Arbitrazh Court "*rejected the request by Yukos Capital S.A.R.L., a Yukos Luxembourg subsidiary, to be admitted into the bankruptcy proceedings in relation to its claims for principal and interest of U.S.$ 4.37 billion based on two intercompany loan agreements of December 2, 2003 and August 19, 2004.*" Claimants' Memorial on the Merits, ¶ 446.

2406 *See Yukos Capital S.a.r.l. v. OAO Samaraneftegaz*, Petition to confirm Arbitral Award [Yukos Capital S.a.r.l., Dist. Ct. S.D.N.Y. (July 2, 2010), ¶ 19 (Exhibit RME-1810) ("*Yukos Capital was incorporated in Luxembourg on January 31, 2003 as a 'societe a responsabilite limitee'. Its intended*

April 2005, Yukos Capital was controlled by Yukos' management and majority shareholders through Yukos Finance B.V., a wholly-owned subsidiary of Yukos. Thereafter, Yukos Capital was beneficially owned by the Oligarchs, through the Dutch Stichtings.[2407]

1527. Yukos Capital filed two claims in Yukos' bankruptcy, totaling US$ 4.37 billion.[2408] The first arose from a loan agreement dated December 2, 2003 valued up to RUB 80 billion (approximately US$ 2.9 billion, based on the RUB/US$ exchange rate on July 17, 2006), the second from a loan agreement dated August 19, 2004 up to US$ 355 million.[2409] Both claims were shams for the following reasons.

1528. The 2003 loan was one of the various instruments the Oligarchs used to repatriate to Yukos barely taxed profits artificially accumulated by the trading shells.[2410] In particular, the 2003 loan came from such funds which had been transferred to Yukos Capital through the chain of Cypriot/BVI shell companies, including Fair Oaks Trade & Investments Limited.[2411] Based on these findings, the Russian courts rejected Yukos Capital's claims, holding that "*through YUKOS Capital S.a.r.l. the debtor was trying to have the claims related to the loans, which were actually the monies of OAO Yukos Oil Company itself, included in the register of creditors.* […] *OAO Yukos Oil Company actually used loan agreements to*

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purpose was to serve as a vehicle to provide financing to international companies within the Yukos group engaged in merger and acquisition activities. While Yukos Capital engaged in certain such activities, as events transpired, by far the largest recipient of financing from Yukos Capital was Yukos Oil"). As a classic financing shell, Yukos Capital had, at least in 2005, no employees and no assets other than loans, interest receivables and residual cash. *See* Yukos Capital's Financial Statements for the Period Ended Dec. 31, 2005 (Exhibit RME-287).

2407 *See* ¶ 529 *supra. See also* Annual Report of Yukos International U.K. B.V. (Dec. 31, 2006), listing Yukos Capital among subsidiaries of Yukos International U.K. B.V. (Exhibit RME-777).

2408 Equivalent to RUB 117,814,316,436.44, based on the RUB/US$ exchange rate on July 17, 2006.

2409 Claimants' Memorial on the Merits, ¶ 446 and footnote 687.

2410 *See* ¶¶ 256-277 *supra*.

2411 Yukos Capital's Financial Statements for the Period Ended Dec. 31, 2005 show that the principal amount under the 2003 loan to Yukos, RUB 79,301,105,902 (approximately US$ 2.9 billion, based on the RUB/US$ exchange rate on July 17, 2006), was matched penny-for-penny by a loan to Yukos Capital from Fair Oaks Trade & Investments Limited. *See* Yukos Capital's Financial Statements for the Period Ended Dec. 31, 2005, Notes 1 and 6 (Exhibit RME-287).

reserve its own money that had earlier been siphoned off to the offshore jurisdictions through the use of tax evasion schemes."[2412]

1529. The claim under the 2003 loan agreement was also totally artificial because it was the means by which the extraordinary US$ 2 billion intermediate dividend[2413] was funded.[2414] It was tantamount to a loan from Yukos to itself to pay a dividend to Claimants, not a genuine creditor's claim.

1530. The claim under the 2004 loan agreement was similarly artificial because the funds "loaned" by Yukos Capital originated from the sale of Yukos' own asset, an indirect stake in a Russian oil and gas company, CJSC Rospan International, and were therefore Yukos' own funds.[2415] Yukos had proposed to sell its interest in Rospan as the means to pay a portion of its tax liabilities[2416]--

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2412 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-18728/2007-GK (Feb. 22, 2007) (Annex (Merits) C-345).

2413 *See* ¶¶ 350-352 *supra*.

2414 For example, extracts from Yukos' bank account No. 40702810330140000847 as of December 3 and 8, 2003 show, on the one hand, that as much as RUB 34,539,719,901 (approximately US$ 1.16 billion, based on the RUB/US$ exchange rate on Dec. 8, 2003) was credited to that account by Yukos Capital from account No. 40814810430140101990 and, on the other hand, that RUB 30,389,300,856.88 (approximately US$ 1.02 billion, based on the RUB/US$ exchange rate on Dec. 8, 2003) was immediately debited for "Payment of intermediate dividends for 2003" to the account of Hulley No. 40814810930140101092. *See* Extracts from Yukos' Account No. 40702810330140000847 with Investment Bank "TRUST" (OAO) as of Dec. 3, 2003 and Dec. 8, 2003 (Exhibit RME-1814). *See also* Payment Order No. 5815 dated Dec. 8, 2003 (Exhibit RME-1815).

2415 On Aug. 19, 2004 Yukos' Board of Directors acknowledged the sale of Yukos' indirect interest in CJSC Rospan International and approved a US$ 355 million loan from Yukos Capital to Yukos, which was to be funded by "*the company that sold its stake in the gas company "ROSPAN.*" *See* Minutes No. 120-18 of the Meeting of the Board of Directors of OAO Yukos Oil Company (Aug. 19, 2004) (Annex (Merits) C-210). *See also* Yukos Capital's Financial Statements for the Period Ended Dec. 31, 2005, evidencing a penny-for-penny flow of money to Yukos Capital and from Yukos Capital to Yukos. *See* Yukos Capital's Financial Statements for the Period Ended Dec. 31, 2005, Notes 1 and 6 (Exhibit RME-287).

2416 In an undated letter received by the Federal Bailiff Service on or about August 2, 2004, Yukos' General Counsel Mr. Gololobov noted that Yukos was considering a sale of its indirect stake in CJSC Rospan International to TNK-BP for approximately US$ 357 million, which in turn would be paid to the tax authorities to help discharge Yukos' tax liabilities for the year 2000. In that letter, Mr. Gololobov also disclosed the shareholding structure of CJSC Rospan International as follows: (i) CJSC Rospan International was a 100% subsidiary of Rospan Overseas Limited, a Cypriot company; (ii) Rospan Overseas Limited was owned by another two Cypriot companies, Hedgerow Limited (56%) and Rizben Enterprises Limited (44%); and (iii) Yukos was the sole shareholder of Hedgerow Limited, while TNK-BP controlled Rizben Enterprises Limited. *See* Letter from Yukos to the Federal Bailiff Service, received on or about Aug. 2, 2004 (undated) (Exhibit RME-1816).

implying that it would use its own resources to make the payment. Instead of causing the funds to be dividended to Yukos, however, Yukos created the artifice of a loan, in effect transforming its equity asset into a debt. Based on these findings, the Russian courts rejected this claim, holding that "*OAO Yukos Oil Company in fact reserved its own money in order to settle the claims of the tax authorities.*"[2417]

(b) Claim from Moravel[2418]

1531. Moravel, a Cypriot indirect subsidiary of GML, apparently succeeded to the position of lender under the US$ 1.6 billion loan taken by Yukos ostensibly from SocGen on September 30, 2003.[2419] While Claimants contend that this loan and the US$ 1 billion SocGen syndicate loan on which Rosneft based a claim were "*identical for all intents and purposes,*"[2420] that is not correct in the following respect: according to Claimants' exhibit, a Yukos press release, Claimants' parent GML provided "*financial support*" for the loan held by Moravel,[2421] but not the SocGen syndicate loan.

1532. The available evidence suggests that the "financial support" was provided by Claimants Hulley and YUL in a cash transfer in the amount of US$ 1.6 billion to SocGen on October 6, 2003, the very date Yukos announced the loan was made.[2422] Unless there was no loan by SocGen to Yukos at all, *i.e.*,

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2417 Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-18728/2007-GK (Feb. 22, 2007) (Annex (Merits) C-345).

2418 Claimants' Memorial on the Merits, ¶¶ 441-444.

2419 Claimants contend that the Russian courts improperly rejected a claim for US$ 655.7 million (plus interest and penalties) submitted by Moravel. Claimants' Memorial on the Merits, ¶ 441. Moravel's claim under the US$ 1.6 billion loan had been recognized by an LCIA award (Sept. 16, 2005). Needless to say, in the LCIA arbitration proceedings, Yukos did little to resist Moravel's claim. *See Moravel Investments Limited v. Yukos Oil Company*, LCIA, Award (Sept. 16, 2005) (Exhibit RME-466).

2420 Claimants' Memorial on the Merits, ¶ 792; *see ibid.* ¶ 441.

2421 (Annex (Merits) C-653). No such language regarding "financial support" appears in the announcement of the SocGen syndicate loan. *See* (Annex (Merits) C-647).

2422 The funds were advanced to SocGen as follows:

1. (a) YUL credited RUB 12,670,780,669.05 from its account No. 40807840530140101107, and (b) Hulley credited RUB 36,614,174,980.25 from its account No. 40807840030140101092 to Bank of New York's account No. 30114840800000000027 (*i.e.*, the aggregate of RUB 49,284,955,649.30). *See* Extract from Bank of New York's account

unless this was a disguised direct shareholders loan from Hulley and YUL to Yukos, then the funds provided by Hulley and YUL would appear to be full cash collateral for the loan to Yukos -- in effect a contingent shareholders loan.

1533. Typically, cash collateral would appear to secure the lender in the event there is a default. A default by Yukos on a US$ 1.6 billion loan would be an indication of insolvency. As a result, in such a scenario, GML's (or Claimants') "financial support" would have the effect, in the one circumstance in which it would be called upon, of transforming GML's (or Claimants') equity position, which has lowest priority in insolvency, into debt, which has higher priority, something insolvency laws typically do not allow.

1534. Mindful of this, the Russian courts ultimately declined Moravel's claim for the enforcement in Russia of the LCIA award recognizing the Moravel claim under the US$ 1.6 billion loan. In particular, the Supreme Arbitrazh Court asked the lower court on remand:

> "to examine the information on the affiliation of both the company [Moravel] and the principal shareholders of OAO Yukos Oil Company and, based on this factor, consider the effects of the enforcement of the London Court of International Arbitration award of September 16, 2005 at this time during the bankruptcy proceedings in order to comply with the public policy of the Russian Federation expressed in maintaining the balance of interests of the debtor, the debtor's shareholders and affiliates, on the one hand, and the debtor's creditors, on the other, within the framework of Yukos Oil Company's bankruptcy proceedings in the Russian Federation."[2423]

No. 30114840800000000027 for the period from Aug. 1, 2003 until Oct. 31, 2003 (Exhibit RME-1823);

2. on the same date the Bank of New York transferred RUB 49,294,664,900 from this account to SocGen's account No. 30114840800050000080. *See* Extract from SocGen's account No. 30114840800050000080 for the period of Sept. 1, 2003 until Oct. 31, 2003 (Exhibit RME-1824); and

3. also on the same date, SocGen transferred RUB 48,701,120,000 (US$ 1.6 billion based on the exchange rate on Oct. 6, 2003) from this account to Yukos' account No. 40702840090000000187, which is Yukos' account for receipt of the B Loan Agreement. *See* Schedule 4 (*Notice of Drawdown*) to the B Loan Agreement (Exhibit RME-1828).

[2423] Resolution of the Presidium of the Highest Arbitrazh Court, Case No. 15954/06 (June 19, 2007), 3 (Annex (Merits) C-351). On remand, the Moscow Arbitrazh Court held that "*[t]he*

Based on such analysis, enforcement of the claim was denied.[2424]

1535. Ultimately, Moravel's claim for the outstanding amounts under the US$ 1.6 billion loan was repaid in 2008 through the proceeds from the sale of the most valuable asset controlled by the Dutch Stichtings, the Lithuanian refinery Mazeikiu Nafta.[2425] The affiliation proved decisive in this circumstance, as no other creditor of Yukos but Moravel has been able to satisfy its claim against those proceeds.[2426]

(c) Claims From Glendale And Other Yukos-Related Entities

1536. Claimants' *cahier de doléances* also includes claims from Glendale for RUB 65,562,009,947 (approximately US$ 2.5 billion, based on the RUB/US$ exchange rate on July 17, 2006). These claims were based on 74 promissory notes issued by Yukos in the principal amount of RUB 46,294,209,319 (approximately US$ 1.7 billion)[2427] in the period from April to October 2003 in favor of Yukos' Russian trading shells OOO Fargoil and ZAO Yukos-M.[2428] As discussed at paragraphs 261-265 above, one mechanism Yukos used to obtain the fruits of its tax fraud was to issue "promissory notes" to the trading shells in consideration for the trading shells transferring to Yukos the proceeds of Yukos' "tax optimization" scheme, with the purpose of concealing that scheme, while moving cash within the group and allowing Yukos to avoid payment of dividend taxes.[2429] Accordingly, there was in fact no real obligation underlying the

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Debtor [Yukos] *is economically dependent on the creditor* [Moravel]." Order of the Moscow Arbitrazh Court (Nov. 14, 2007) (Annex (Merits) C-352).

2424 *See* Order of the Moscow Arbitrazh Court (Nov. 14, 2007) (Annex (Merits) C-352).

2425 *See OOO Promneftstroy v. Godfrey et al.*, Case No. 422465/KG ZA 09-569 WT/MV, Judgment of the Dist. Ct. of Amsterdam, Civil Law Sector, Preliminary Relief Judge (May 1, 2009), ¶ 3.2 (Exhibit RME-758).

2426 *See OOO Promneftstroy et al. v. Yukos International UK B.V. et al.*, Case No. 388931/KG ZA 08-104 P/CN and No. 389897/KG ZA 08-174 P/CN, Judgment in Preliminary Relief Proceedings, Dist. Ct. of Amsterdam (Mar. 6, 2008), 28 (Exhibit RME-759).

2427 *See* Resolution of the Ninth Arbitrazh Appellate Court (Mar. 12, 2007) (Annex (Merits) C-346).

2428 *Ibid.*

2429 Consistently with the scheme, Glendale was not even mentioned as an endorsee of those notes: the endorsement was left blank so as to allow any member of the group to avail itself of the notes whenever convenient to effectuate the scheme.

promissory notes in question and the funds claimed were funds attributable to Yukos itself.

1537. The same flaw defeats the claims by OOO Yu-Mordovia, OOO Alta-Trade, ZAO Lipetsknefteproduct, and most claims by ZAO Yukos–M, which were also based on promissory notes of similar nature.[2430] The claim from OOO Yukos Vostok Trade, which was based on a commission agreement, likewise was used to move funds to implement the tax evasion scheme, as discussed in detail at paragraphs 237 to 243 above, and was denied on that basis. Accordingly, when the Moscow Arbitrazh Court rejected this claim, it held: "*OAO YUKOS Vostok Trade's claim against OAO Yukos Oil Company in the amount of 11,517,748,441.32 rubles is not sound because it is based on artificial rechanneling of commodity and cash flows by establishing a dependent entity that effectively did not conduct any independent business operations and only possessed a formal set of attributes uniquely specific to a legal entity*."[2431]

1538. Finally, that all of these intercompany claims lacked economic substance, even in the eyes of Yukos' management and controlling shareholders, is demonstrated by their stated intention to waive all of them, except for the claim by Moravel, as part of the Rehabilitation Plan they proposed.[2432] In causing these claims to be filed, Claimants and GML appear to have had the purpose of further stripping the bankruptcy estate.

2430 *See* Claimants' Memorial on the Merits, ¶¶ 448, 790. Claimants contend that "*[i]n those instances in which Yukos' subsidiaries sought the courts' assistance to provide further evidence, the courts simply dismissed such requests, showing that, in fact, they did not care for such evidence to be submitted.*" *Ibid.* The only example offered in support of this contention is the July 19, 2006 order of the Moscow Arbitrazh Court dismissing OOO Yu-Mordovia's application to adjourn the hearing in order to request evidence from the General Prosecutor's Office (*Ibid.*, ¶ 448). Claimants do not focus, however, on the fact that, by that same order, the Moscow Arbitrazh Court included OOO Yu-Mordovia's claim in the Bankruptcy Register. [emphasis added] *See* Order of the Moscow Arbitrazh Court (July 19, 2006) (Annex (Merits) C-330). Although, this order was invalidated on appeal, there is no evidence the court frustrated any attempt by OOO Yu-Mordovia to provide evidence of its claim on appeal or that the lower court's order admitting the claim had such an intent. S*ee* Resolution of the Ninth Arbitrazh Appellate Court (Sept. 7, 2006) (Annex (Merits) C-341).

2431 *See* Order of the Moscow Arbitrazh Court (July 19, 2006) (Annex (Merits) C-333).

2432 *See* ¶ 622 *supra*.

(2) Admitted Claims From The Federal Tax Service And YNG Were Valid Claims

1539. That the Federal Tax Service and YNG held the bulk of the bankruptcy claims admitted against Yukos is the result of Yukos' own reckless conduct that gave rise to unsatisfied liabilities to them, and not, as Claimants contend, due to biased and discriminatory conduct of the Russian courts.[2433]

1540. The sound basis for admitting the Tax Service's claims for Yukos' tax liabilities is well known and will not be repeated here.[2434] As discussed at paragraph 1515 above, Claimants' contention that a portion of these claims were improperly admitted into Yukos' bankruptcy[2435] is demonstrably false.

1541. YNG's claims were based on Yukos' persistent abuse of its power as corporate parent against the separate economic interests of its subsidiary. This consisted in part of Yukos forcing YNG to sell its products to Yukos' captive sham purchasers at prices well below market -- the first leg of Yukos' low–tax region tax evasion. On that basis, YNG claimed for US$ 5.55 billion in lost profits sustained in 2000-2003 as a result of the fact that "*the oil produced by Yuganskneftegaz was sold to Yukos' trading companies at below-market prices following Yukos' instructions*."[2436] The Moscow Arbitrazh Court admitted this claim in Yukos' bankruptcy, having found that Yukos had abused its power as ultimate parent to force YNG to enter into oil sales agreements at below market prices, in furtherance of:

> "a tax evasion scheme to leach proceeds from the sales of oil out of the oil producing enterprises, including OAO YNG […] in favor of entities dependent on OAO Yukos Oil Company and unlawfully registered in tax havens. Such proceeds de facto accrued in favor of OAO Yukos Oil Company since the activities of the said

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2433 Claimants' Memorial on the Merits, ¶¶ 430-439, 797.

2434 *See* Sections II.H and VI.A.3 *supra*.

2435 Claimants' Memorial on the Merits, ¶¶ 433-434, 605.

2436 Claimants' Memorial on the Merits, ¶ 437.

dependent companies were recognized by the aforementioned judgments to be activities of OAO Yukos Oil Company."[2437]

1542. The other claims arose from even more direct asset stripping. Yukos forced YNG to sell oil to Yukos or its sham trading companies and then did not pay for it. In the case of Yukos, this was a direct commercial liability to YNG in the amount of approximately US$ 2 billion for Yukos' failure to pay the price of the oil produced by YNG and exported by Yukos in 2004-2005.[2438]

1543. In the case of YNG's claims based on sales to Yukos' trading companies OOO Energotrade and OOO Yukos Vostok Trade, the Moscow arbitrazh court took note of the then recent findings of the tax authorities that they were entities "*that engaged in sham operations to serve the purpose of tax evasion by OAO NK Yukos, rather than for commercial reasons.*"[2439] On that basis, the court found that the unpaid balance for the transfer of oil was due from Yukos, which had in fact "*transacted the operations to buy/sell oil and oil products and obtained the economic benefit from these operations*."[2440] These are the claims for US$ 1.25 billion "*based on the sale of oil produced by Yuganskneftegaz and sold to Yukos' trading companies in 2004*" about which Claimants complain.[2441] Given their straightforward nature, it is no surprise the claims for unpaid oil deliveries were admitted.

2437 *See* Decision of the Moscow Arbitrazh Court (Oct. 12, 2006), 3, 6 of the English translation (Annex (Merits) C-343).

2438 *See* Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35"B" (June 9, 2006) (Exhibit RME-1829). *See also* Resolution of the Federal Arbitrazh Court of the Moscow District, Case NO. KG-A40/8748-05 (Sept. 22, 2005) (Exhibit RME-1830).

2439 *See* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-10669/2006-GK, (Sept. 7, 2006), 4 of the English translation (upholding the Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35-B (July 19, 2006)) (Annex (Merits) C-339); *see also* Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-10671/2006-GK (Sept. 7, 2006) (Annex (Merits) C-340).

2440 *Ibid*.

2441 Claimants' Memorial on the Merits, ¶ 435.

VII. IN ANY EVENT, CLAIMANTS HAVE FAILED TO ESTABLISH A VIOLATION OF ARTICLE 10(1) ECT

1544. As set forth at Section IV.B. above, Article 21(1) ECT precludes any claim under Article 10(1) ECT with respect to Taxation Measures. Accordingly, any Article 10(1) ECT claim based on a tax enforcement or collection measure or a measure linked, directly or indirectly, to a tax enforcement or collect measure, must be dismissed pursuant to Article 21 ECT. Since Claimants' Article 10(1) ECT claim is based exclusively on measures "*with respect to Taxation Measures*," subject to the exception of the Sibneft de-merger allegations, and Claimants have failed to specify any injury cognizable under Article 10(1) based on this allegation, the Article 10(1) ECT claim fails. In any event, as set forth below, Claimants have failed to establish any violation of Article 10(1) ECT.[2442]

1545. No claim of denial of "*fair and equitable*" treatment or "*stable*" and "*transparent*" investment conditions will lie, where, as here, it is premised on the investor's expectations that are based on benefits resulting from conduct in breach of host State law (**A**). Nor can Claimants meet the demanding threshold of establishing a denial of justice or conduct that is otherwise "*manifestly unfair or unreasonable (such as would shock, or at least surprise a sense of judicial propriety*)." (**B**)

1546. Claimants have also failed to establish that the measures complained of constitute "*unreasonable measures*" for purposes of Article 10(1) ECT because -- as shown above -- (i) they have failed to establish "*a willful disregard of due process of law, and act which shocks or at least surprises, a sense of juridical propriety*," and (ii) unreasonableness is excluded if a measure is in line with internationally recognized practices and policies. Likewise, Claimants have failed to establish that the measures complained of constitute "*discriminatory measures*" for purposes of Article 10(1) ECT because (i) Article 10(1) ECT prohibits discrimination based on foreign nationality, which is not alleged, and (ii) in any event, Claimants have failed to establish differential treatment of Yukos without reasonable justification. (**C**).

2442 In addition, the authorities set forth below, make clear that no Article 10(1) claim based on Taxation Measures can lie here, even if Article 21(1) did not independently have that effect.

A. Claimants Have Failed To Establish That The Non-Taxation Measures Complained Of Constitute Constitute Unfair Or Inequitable Treatement Within The Meaning Of Article 10(1) ECT

1547. As set forth at paragraph 875 above, out of the numerous allegations put forward by Claimants in connection with their Article 10(1) ECT claim, only one, concerning the "unwinding" of the Yukos-Sibneft merger, is not linked to a Taxation Measure. Even if, *quod non*,[2443] the failure of this merger project were attributable to the Russian Federation, Claimants have failed to establish that the Russian Federation's conduct in this regard amounts to a violation of the fair and equitable treatment standard within the meaning of Article 10(1) ECT.

1. Claimants Cannot Demonstrate Interference With Their Specific, Reasonable Expectations With Respect To Their Investment

1548. An investor's legitimate and reasonable expectations form a central element in determining whether the host State's conduct is "*fair and equitable*." As underscored by the tribunal in *Saluka v. Czech Republic*:

> "An investor's decision to make an investment is based on an assessment of the state of the law and the totality of the business environment at the time of the investment as well as on the investor's expectation that the conduct of the host State subsequent to the investment will be fair and equitable. The standard of 'fair and equitable treatment' is therefore closely tied to the notion of legitimate expectations which is the dominant element of that standard."[2444]

1549. Specifically, the investor must have legitimate and reasonable expectations about the legal and business environment in the host country:

> "The stability of the legal and business environment is directly linked to the investor's justified expectations. The Tribunal acknowledges that such expectations are an important element of fair and equitable treatment. At the same time, it is mindful of their limitations. To be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes

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2443 *See* Section VI.E.1. above.

2444 *Saluka Investments BV v. The Czech Republic*, PCA, UNCITRAL, Partial Award (Mar. 17, 2006), ¶¶ 301-302 (Annex (Merits) C-977).

> the investment. The assessment of the reasonableness or legitimacy must take into account all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State. In addition, such expectations must arise from the conditions that the State offered the investor and the latter must have relied upon them when deciding to invest."[2445]

1550. Thus, host State conduct that does not frustrate an investor's legitimate expectations cannot be deemed "*unfair or inequitable*." As confirmed in *Saluka v. Czech Republic* and *Duke Energy v. Ecuador*, the assessment of the reasonableness and legitimacy of the investor's expectations of "*fair and equitable*" treatment must be based on the state of the law of the host State, the political and historical conditions prevailing in the host State, and any particular conditions of treatment the State offered to the investor at the time it made its investment. State measures that are provided by the host State's law and in line with such conditions do not constitute a violation of Article 10(1) ECT.

a) There Can Be No Legitimate Expectations Or Guaranty Of Stability And Transparency Based On Benefits Resulting From Conduct In Breach Of Host State Law

1551. As set forth at paragraphs 978 to 986 above, legitimate expectations are expectations deriving from a specific commitment of the host State and, in the absence of any such commitment, those grounded in and enforceable under the legal system of the State in which the investment was made. Equally, the obligation on Contracting Parties in Article 10(1) ECT to provide investors with "*stable, equitable, favourable and transparent conditions*" for making investments in their respective territories cannot be construed as an obligation to refrain from enforcing existing law. A stated by the tribunal in *M.C.I. v. Ecuador*:

> "The investor's expectations of fair and equitable treatment and good faith, in accordance with the BIT, must be paired with a legitimate objective. The legitimacy of the expectations for proper treatment entertained by a foreign investor protected by the BIT does not depend solely on the intent of the parties, but on certainty about the contents of the enforceable obligations. Consequently,

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2445 *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID ARB/04/19, Award (Aug. 18, 2008), ¶ 340 (Annex (Merits) C-993).

> Seacoast's legitimate expectations as to the outcome of the negotiations in the Liquidation Commission cannot be disassociated from the scope and legal effects of the applicable rules […]."[2446]

1552. Commentary is in accord. Professor Dolzer elaborates on the requirement that expectations protected under the fair and equitable treatment standard be grounded in the objective state of law of the host State:

> "The pre-investment legal order forms the framework for the positive reach of the expectation which will be protected and also the scope of considerations upon which the host state is entitled to rely when it defends against subsequent claims of the foreign investor. Here, it becomes clear that the standard of fair and equitable treatment centers to a considerable degree, on the expectations of the foreign investor and that in the individual case the legitimacy of these expectations will largely depend upon the objective state of the law as it stands at the time when the investor acquires the investment. […] Whereas the law protects expectations of the foreign investor, it does so only to the extent that these expectations are grounded in the legal order of the host state as determined by the host state in accordance with the principles of territorial sovereignty and economic self-determination."[2447]

1553. Specifically, as held by the tribunal in *Lauder v. Czech Republic*, absent any specific commitment that a foreign investor or its investment will be exempt from law enforcement, there cannot be any "inconsistent" conduct in breach of the fair and equitable treatment standard in authorities taking the necessary actions to enforce the law:

> "The Media Council's duties were, among others, to ensure the observance of the Media Law.
>
> There can not be any inconsistent conduct in a regulatory body taking the necessary actions to enforce the law, absent any specific undertaking that it will refrain from doing so. No such

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2446 *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador*, ICSID ARB/03/6, Award (July 31, 2007), ¶¶ 278-279 (Exhibit RME-1157).

2447 Rudolf Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 Int'l Law. 87 (2005), 103 (Exhibit RME-1158).

undertaking was given by the Media Council or any other organ of the Czech Republic."[2448]

1554. Accordingly, the *Lauder* tribunal dismissed Mr. Lauder's claim that the initiation of administrative proceedings by the Media Council for unauthorized broadcasting in violation of the Czech Media Law violated the "*fair and equitable*" treatment standard in the U.S.-Czech Republic BIT on the ground that it was inconsistent with the Media Council's prior conduct.

b) Claimants Were Not Deprived Of Any Legitimate Expectations

1555. As set forth in Section II.H.2.m.l. above, the Yukos-Sibneft merger did not proceed because the parties were not able to reach agreement on how to address a material change in circumstance concerning the leadership of a combined company going forward, and because of violations of minority shareholders' rights. Claimants could not have had any legitimate expectations that Yukos would succeed in the face of its own and its counterparties' business decision and its violation of the legal rights of minority shareholders.

1556. In addition, Claimants have failed to identify any specific undertaking from the Russian Federation in relation to the completion of this merger project, and the business decision to halt the process by Sibneft and Sibneft shareholders is not attributable to the Russian Federation.

1557. That the Russian Federation through its courts enforced the law against Yukos and its management, which in turn may have resulted in Sibneft and Sibneft shareholders deciding that, as a business matter, the merger with Yukos was no longer welcome, cannot give rise to a legitimate expectation claim. As set forth at paragraphs 978 to 986 above, the Russian Federation enforced its laws and did not deprive Claimants of any legitimate expectations.

1558. Equally, as demonstrated at Section II.H.2.m.2. above, the Russian court decisions concerning the claims brought by minority shareholders were

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2448 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award (Sept. 3, 2001), ¶¶ 296-297 (Annex (Merits) C-959).

entirely proper and consistent with Russian law. Because Claimants cannot legitimately expect that they will be exempted from the enforcement of Russian law, and because the Russian Federation cannot be blamed for any "inconsistent" conduct in breach of the fair and equitable treatment standard where its courts simply took the necessary actions to enforce the law, Claimants' Article 10(1) claims based on non-Taxation Measures must fail.

2. Claimants Have Failed To Establish That The Non-Taxation Measures Complained Of Constitute A Denial Of Justice Or Are Otherwise Manifestly Unfair Or Unreasonable

1559. Article 10(1) ECT provides an international minimum standard of treatment of foreign investment, which as emphasized by the tribunal in *Genin v. Estonia*, is indeed a minimum standard:

> "While the exact content of this standard is not clear, the Tribunal understands it to require an 'international minimum standard' that is separate from domestic law, but that is, indeed, a *minimum* standard. Acts that would violate this minimum standard would include acts showing a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith."[2449]

1560. The standard applied by the Genin tribunal is set forth in Article II(3) of the U.S.-Estonia BIT, which provides that "[i]nvestment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law."[2450]

1561. The Article 10(1) ECT minimum standard incorporates the customary international law minimum standard of treatment for alien property, as well as treaty obligations of the host State, excluding "*decisions taken by*

2449 *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 17 ICSID Rev. 395 (2002), 91 ¶ 367 (Exhibit RME-1095). [italics in original]

2450 Treaty Between the Government of the United States of America and the Government of the Republic of Estonia Concerning the Encouragement and Reciprocal Protection of Investment (Apr. 19, 1994) (Exhibit RME-1159).

international organizations, even if they are legally binding,"[2451] such as decisions of the European Court of Human Rights, and "*treaties which entered into force before 1 January 1970*,"[2452] such as the Convention for the Protection of Human Rights and Fundamental Freedoms of November 4, 1950, which entered into force on September 3, 1953.

1562. Claimants' burden for demonstrating a violation of the minimum standard enshrined in Article 10(1) ECT is demanding. The tribunal in *AES v. Hungary* articulated the Article 10(1) ECT standard as follows:

> "[N]ot every process failing or imperfection that will amount to a failure to provide fair and equitable treatment. The standard is not one of perfection. It is only when a state's acts or procedural omissions are, on the facts in the context before the adjudicator, manifestly unfair or unreasonable (such as would shock, or at least surprise a sense of juridical propriety) – to use the words of the *Tecmed* Tribunal – that the standard can be said to have been infringed."[2453]

1563. NAFTA Chapter Eleven tribunals charged with interpreting the minimum standard of treatment in Article 1105 NAFTA,[2454] such as the tribunal in *Waste Management v. Mexico*, have interpreted this standard as follows:

> "Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in

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2451 Understanding No. 17 adopted by the representatives by signing the Final Act (Exhibit RME-1160). This Understanding pertains to the interpretation of Article 10(1) ECT which provides that "[i]n no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations."

2452 *Ibid.*

2453 *AES Summit Generation Limited and AES-Tisza Erömü Kft v. Hungary*, ICSID ARB/07/22, Award (Sept. 23, 2010), ¶ 9.3.40 (Exhibit RME-1103). [emphases added]

2454 The Parties to NAFTA Chapter Eleven have equated the fair and equitable treatment obligation in Article 1105 NAFTA with the minimum standard of treatment: NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001), ¶ B (Exhibit RME-1204).

> judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[2455]

1564. Some arbitral tribunals have equated the minimum standard with the *Neer* standard, which requires a showing of outrage, bad faith, willful neglect of duty, or "*insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency*."[2456] Tribunals that have not applied the *Neer* standard have nevertheless emphasized the demanding threshold for finding a violation of the minimum standard of treatment:

> "The content of the minimum standard should not be rigidly interpreted and it should reflect evolving international customary law. Notwithstanding the evolution of customary law since decisions such as *Neer Claim* in 1926, the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a

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2455 *Waste Management, Inc. v. United Mexican States*, ICSID ARB(AF)/00/3, Award (Apr. 30, 2004), ¶ 98 (Annex (Merits) C-968). *See also S. D. Myers, Inc. v. Government of Canada*, UNCITRAL, Partial Award (Nov. 12, 2000), 40 I.L.M. 1408 (2001), 1438 ¶ 263 (Exhibit RME-1161): "The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective."

2456 *L. F. H. Neer and Pauline E. Neer v. Mexico*, General Claims Commission (United States and Mexico), Opinion (Oct. 15, 1926), 21 A.J.I.L. 555 (1927), 556 (Exhibit RME-1162). *See also Glamis Gold, Ltd. v. United States of America*, UNCITRAL, Award (June 8, 2009), ¶ 22 (Exhibit RME-1107): "[T]he Tribunal finds that Glamis fails to establish the evolution in custom it asserts to have occurred. It thus appears that, although situations presented to tribunals are more varied and complicated today than in the 1920s, the level of scrutiny required under Neer is the same. Given the absence of sufficient evidence to establish a change in the custom, the fundamentals of the *Neer* standard thus still apply today: to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1). Such a breach may be exhibited by a 'gross denial of justice or manifest arbitrariness falling below acceptable international standards;' or the creation by the State of objective expectations *in order to induce* investment and the subsequent repudiation of those expectations." [italics in original]

> gross denial of justice or manifest arbitrariness falling below acceptable international standards."[2457]

1565. Therefore, arbitral tribunals charged with interpreting the minimum standards of treatment guaranteed by fair and equitable treatment obligations have uniformly recognized that the threshold for finding a breach of that standard is high.

1566. In particular, where, as in the present case, an investor complains about insufficiencies in law enforcement actions provoked by its own or its investment's illegal conduct, not every procedural illegality, even if established, will violate Article 10(1) ECT. As confirmed in *Genin v. Estonia*, if an investor fails to cooperate properly with the regulators of the host State and *a fortiori* violates the host State's laws or regulations, procedural irregularities that could otherwise amount to violations of an investment treaty do not necessarily constitute a violation of the host State's obligation to treat the investor or its investment fairly and equitably and to refrain from arbitrary measures against the investor or the investment. The *Genin* tribunal determined that there were the following insufficiencies of proceedings that resulted in the revocation of a banking license by the Estonian Central Bank:

> "(1) No formal notice was given to EIB that its license would be revoked unless it complied with the Bank of Estonia's demands within a reasonable time;
>
> (2) no representative of EIB was invited to the session of the Bank of Estonia's Council that dealt with the revocation to respond to the charges brought by the Governor;
>
> (3) the revocation of the license was made immediately effective, giving EIB no opportunity to challenge it in court before it was publicly announced."[2458]

The tribunal nevertheless concluded:

2457 *International Thunderbird Gaming Corporation v. The United Mexican States*, UNCITRAL, Award (Jan. 26, 2006), ¶ 194 (Exhibit RME-1143).

2458 *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 17 ICSID Rev. 395 (2002), 90 ¶ 364 (Exhibit RME-1095).

> "Having considered the totality of the evidence, the Tribunal concludes that while the Central Bank's decision to revoke EIB's license invites criticism, it does not rise to the level of a violation of any provision of the BIT."[2459]

1567. Specifically, on the facts of that case, the *Genin* tribunal dismissed the claim that Estonia violated Article II(3)(a) of the U.S.-Estonia BIT, pursuant to which "[i]*nvestment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than required by international law*."[2460] The *Genin* tribunal also dismissed the claim that Estonia violated Article II(3)(b) of the U.S.-Estonia BIT prohibiting "*arbitrary or discriminatory measures*" that impair the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments.[2461] The tribunal explained that where a State's action is a justified exercise of its power to enforce its laws and regulations, "*any procedural irregularity that may have been present would have to amount to bad faith, a wilful disregard of due process of law or an extreme insufficiency of action*" to amount to a violation of the U.S.-Estonia BIT.[2462] None of the insufficiencies set forth above, individually or collectively, were found to be sufficient to constitute a violation of this standard.

1568. As regards alleged due process violations and denial of justice by the judiciary, Claimants' own authorities confirm the exacting burden that Claimants must meet in order to establish a violation of the fair and equitable treatment obligation in Article 10(1) ECT. The Mixed Claims Commission in the *Chattin* case held:

2459 *Ibid.*, 90-91 ¶ 365.

2460 Treaty Between the Government of the United States of America and the Government of the Republic of Estonia Concerning the Encouragement and Reciprocal Protection of Investment (Apr. 19, 1994) (Exhibit RME-1159). *See also Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 17 ICSID Rev. 395 (2002), 91 ¶ 367 (Exhibit RME-1095).

2461 Treaty Between the Government of the United States of America and the Government of the Republic of Estonia Concenring the Encouragement and Reciprocal Protection of Investment (Apr. 19, 1994) (Exhibit RME-1159). *See also Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 17 ICSID Rev. 395 (2002), 92-93 ¶ 371 (Exhibit RME-1095).

2462 *Ibid.*

> "Since this is a case of alleged responsibility of Mexico for injustice committed by its judiciary, it is necessary to inquire whether the treatment of Chattin amounts even to an outrage, to bad faith to wilful neglect of duty, or to an insufficiency of governmental action recognizable by every unbiased man […]."[2463]

1569. Recent investment treaty cases relied upon by Claimants articulate the standard as follows:

> "A denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way […].
>
> There is a fourth type of denial of justice, namely the clear and malicious misapplication of the law."[2464]
>
> "In the *ELSI* case, a Chamber of the Court described as arbitrary conduct that which displays 'a wilful disregard of due process of law, … which shocks, or at least surprises, a sense of judicial propriety'. […] [T]he Tribunal regards the Chamber's criterion as useful also in the context of denial of justice, and it has been applied in that context, as the Claimant pointed out. The Tribunal would stress that the word 'surprises' does not occur in isolation. The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection."[2465]

1570. These cases reflect the "*modern consensus*" of the constituent elements of a denial of justice, which Professor Paulsson summarizes as follows:

2463 *B.E. Chattin (U.S.) v. United Mexican States*, U.S.-Mexico General Claims Commission, Opinion (July 23, 1927), 4 U.N.R.I.A.A. 282, 295 ¶ 29 (Annex (Merits) C-924).

2464 *Robert Azinian and others v. United Mexican States*, ICSID ARB(AF)/97/2, Award (Nov.1, 1999), ¶¶ 102-103 (Annex (Merits) C-951).

2465 *Mondev International Ltd v. United States of America*, ICSID ARB(AF)/99/2, Award (Oct. 11, 2002), ¶ 127 (Annex (Merits) C-963). *See also Waste Management Inc. v. United Mexican States*, ICSID ARB(AF)/00/3, Award (Apr. 30, 2004), ¶ 98 (Annex (Merits) C-968).

> "The modern consensus is clear to the effect that the factual circumstances must be egregious if state responsibility is to arise on the grounds of denial of justice."[2466]

1571. As established at ¶¶ 1563 and 1564 above and confirmed in *AMTO v. Ukraine*, in the context of the present arbitration, which involves claims based on a myriad of court decisions, the treatment of an investor must be examined in its entirety to determine "*the judicial propriety of the outcome*." Due process violations in one or more proceedings do not by themselves establish a treaty violation if the procedures are only parts of the judicial process available to the parties. The assessment of the conduct of the national courts must include the availability of remedies in the host State's legal system, whether or not such remedies were exercised, and if they were exercised, whether they were exercised fully and wisely:

> "In respect of the applicable standard to establish a case of denial of justice under Article 10(1) [ECT] in respect of judicial decisions, the Tribunal refers to the discussion in *Mondev International Limited v United States of America*, (ICSID Case No. ARB(AF)(99/2) Award of October 11, 2002 (42 *ILM* 85 (2003)), at paragraphs 126-127. This tribunal concluded (paragraph 127):
>
> '*The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns about the judicial propriety of the outcome, bearing in mind on one hand that international tribunals are not courts of appeal, and on the other hand* [investment treaties are] *intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to*

2466 JAN PAULSSON, DENIAL OF JUSTICE IN INTERNATIONAL LAW (2005), 60 (Annex (Merits) C-1016). *See also* IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW (7th ed. 2008), 529 (Exhibit RME-1163): "It has been pointed out that the term [denial of justice] has been given such a variety of definitions that it has little value and the problems could be discussed quite adequately without it. However, if the phrase has a presumptive meaning, the best guide to this is probably the Harvard Research draft, which provides as follows:

Article 9. A State is responsible if an injury to an alien results from a denial of justice. Denial of justice exists when there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or a manifestly unjust judgment. An error of a national court which does not produce manifest injustice is not a denial of justice." [emphases added]

> *unfair and inequitable treatment. This is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities.*' (footnote omitted)
>
> In the context of the present arbitration, the Tribunal would add that the experience of an investor in domestic courts may involve a series of decisions, and these decisions should be considered in their entirety. Further, the available means within the host State's legal system to address errors or injustices, and whether or not they were exercised, are relevant to the assessment of the propriety of the outcome. The investor that fails to exercise his rights within a legal system, or exercises its rights unwisely, cannot pass his own responsibility for the outcome to the administration of justice, and from there to the host State in international law."[2467]

1572. It is common ground between the Parties that in order to establish a claim for denial of justice based on the content of judicial opinions themselves, Claimants must show a "*clear and malicious misapplication of the law*."[2468] As stated by the tribunal in *Pantechniki v. Albania*:

> "The general rule is that 'mere error in the interpretation of the national law does not *per se* involve responsibility.' Wrongful application of the law may nonetheless provide 'elements of proof of a denial of justice.' But that requires an extreme test: the error must be of a kind which no 'competent judge could reasonably have made.' Such a finding would mean that the state had not provided even a minimally adequate justice system."[2469]

1573. As shown at Section Section II.H.2.m.(2) above, Claimants have failed to establish that the Moscow and Chukotka courts clearly and maliciously misapplied Russian law when granting Gemini Holdings' and Nimegan Trading's claims in the context of the Yukos-Sibneft merger project. Claimants have also failed to allege or establish that these court proceedings were tainted by due process violations. Accordingly, the non-Taxation Measures of which

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2467 *Limited Liability Company AMTO v. Ukraine*, SCC 080/2005, Final Award (Mar. 26, 2008), ¶ 76 (Annex C-1544) (Annex (Merits) C-989). [italics in original]

2468 Claimants' Memorial on the Merits, ¶ 621; *Robert Azinian et al. v. United Mexican States*, ICSID ARB(AF)/97/2, Award (Nov.1, 1999), ¶ 103 (Annex (Merits) C-951).

2469 *Pantechniki SA Contractors and Engineers v. Albania*, ICSID ARB/07/21, Award (July 30, 2009), ¶ 94 (Exhibit RME-982) [emphases added]. *See also* Eduardo Jiménez de Aréchaga, *International Law in the Past Third of a Century*, 159 Rec. des Cours 1 (1978), 281 (Exhibit RME-1164): "As a rule, a State does not incur responsibility towards aliens for judgments of its courts which are merely erroneous. No State can guarantee to private individuals, be they foreigners or its own nationals, that its courts are infallible."

Claimants complain cannot constitute a denial of justice or be deemed otherwise manifestly unfair or unreasonable.

B. Claimants Have Failed To Establish That The Non-Taxation Measures Complained Of Constitute "*Unreasonable Or Discriminatory Measures*" Within The Meaning Of Article 10(1) ECT

1. Claimants Have Failed To Establish That The Non-Taxation Measures Complained Of Constitute "*Unreasonable Measures*"

1574. Article 10(1) ECT requires the host State to refrain from subjecting the investor's investment to "*unreasonable or discriminatory measures*." The ECT does not define the term "unreasonable measure." According to the BLACK'S LAW DICTIONARY "*unreasonable*" means "*irrational; foolish; unwise; absurd; silly; preposterous; senseless; stupid*."[2470] According to the OXFORD ENGLISH DICTIONARY "*unreasonable*" means "*not endowed with reason; irrational*."[2471]

1575. Several investment treaty tribunals have applied the protection against "*unreasonable*" or "*arbitrary*" measures based on this ordinary meaning.[2472]

1576. As emphasized by the tribunal in *Siemens v. Argentina*, the International Court of Justice's definition of "*arbitrary measures*" in the *ELSI* case is the most authoritative interpretation, widely accepted by investment treaty tribunals, and "*close to the ordinary meaning of the term emphasizing the willful disregard of the law*"[2473]:

> "Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. […] It is a wilful

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2470 BLACK'S LAW DICTIONARY (6th ed. 1990), 1538 (Exhibit RME-1165).

2471 OXFORD ENGLISH DICTIONARY (Online Version) (Exhibit RME-1166).

2472 *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award (Sept. 3, 2001), ¶ 221 (Exhibit C-237) (Annex (Merits) C-959); *Occidental Exploration and Production Company v. The Republic of Ecuador*, Final Award (July 1, 2004), ¶ 162 (Annex C-247) (Annex (Merits) C-970); *CMS Gas Transmission Company v. The Argentine Republic*, ICSID ARB/01/8, Award (May 12, 2005), ¶ 291 (Annex (Merits) C-973); *Siemens A.G. v. The Argentine Republic*, ICSID ARB/02/08, Award (Feb. 6, 2007), ¶ 318 (Annex (Merits) C-983).

2473 *Siemens A.G. v. The Argentine Republic*, ICSID ARB/02/08, Award (Feb. 6, 2007), ¶ 318 (Annex (Merits) C-983).

> disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."[2474]

1577. As established at Section Section II.H.2.m.(2) above, Claimants have failed to allege or establish that the Moscow and Chukotka courts that granted Gemini Holdings' and Nimegan Trading's claims in the context of the Yukos-Sibneft merger project were at odds with the rule of law or otherwise constituted "*a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety*." Accordingly, Claimants have failed to allege or establish that the non-Taxation Measures complained of constitute "unreasonable measures" within the meaning of Article 10(1) ECT.

2. Claimants Have Failed To Establish That The Non-Taxation Measures Complained Of Constitute "*Discriminatory Measures*"

1578. The ECT does not define the term "*discriminatory*." It has been established at ¶¶ 1238 to 1249 above that the term "*discriminatory*" in Article 13(1) ECT prohibits discrimination based on nationality and as regards specifically taxation of a company owned or controlled by residents of another Contracting State, tax discrimination based on foreign capital ownership or control.

1579. Pursuant to the basic rule of treaty interpretation codified in Article 31(1) of the Vienna Convention on the Law of Treaties a treaty shall be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context, *i.e.*, the treaty, not merely the sub-paragraph, Article or section of the treaty in which the term appears.[2475] The same term used in different articles in a treaty is presumed to have the same meaning in each article. As stated by Sir Robert Jennings and Sir Arthur Watts:

2474 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment (July 20, 1989), 1989 I.C.J. Rep. 15, 76 ¶ 128 (Annex (Merits) C-942). *See also Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v. The Republic of Estonia*, ICSID ARB/99/2, Award (June 25, 2001), 92-93 ¶ 371 (Exhibit RME-1095).

2475 *See, e.g., Competence of the ILO to Regulate Agricultural Labour Case*, Advisory Opinion No. 2 (Aug. 12, 1922), 1922 P.C.I.J. (Ser. B) No. 2, 23 (Exhibit RME-1167); *Case of the Free Zones of Upper Savoy and the District of Gex (France v. Switzerland)*, Judgment (June 7, 1932), 1932 P.C.I.J. (Ser. A/B) No. 46, 140-141 (Annex C-210) (Exhibit RME-1168); *Italy-United States Air Transport Arbitration*, Advisory Opinion (July 17, 1965) 45 I.L.R. 393 (1972), 412-413 (Exhibit RME-1169).

> "The same term used in different places in a treaty may be presumed to bear the same meaning in each;"[2476]

1580. Accordingly, Article 10(1) ECT prohibits discrimination based on foreign nationality. This interpretation is supported by Canada's and the United States' Declaration with respect to Article 10:

> "In determining whether differential treatment of Investors or Investments is consistent with Article 10, two basic factors must be taken into account.
>
> The first factor is the policy objectives of Contracting Parties in various fields insofar as they are consistent with the principles of nondiscrimination set out in Article 10. Legitimate policy objectives may justify differential treatment of foreign Investors or their Investments in order to reflect a dissimilarity of relevant circumstances between those Investors and Investments and their domestic counterparts. For example, the objective of ensuring the integrity of a country's financial system would justify reasonable prudential measures with respect to foreign Investors or Investments, where such measures would be unnecessary to ensure the attainment of the same objectives insofar as domestic Investors or Investments are concerned. Those foreign Investors or their Investments would thus not be 'in similar circumstances' to domestic Investors or their Investments. Thus, even if such a measure accorded differential treatment, it would not be contrary to Article 10.
>
> The second factor is the extent to which the measure is motivated by the fact that the relevant Investor or Investment is subject to

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2476 OPPENHEIM'S INTERNATIONAL LAW, Vol. I (Robert Jennings and Arthur Watts, eds. 9th ed. 1996), 1273 note 12 (Exhibit RME-984). *See also* ULF LINDERFALK, ON THE INTERPRETATION OF TREATIES, THE MODERN INTERNATIONAL LAW AS EXPRESSED IN THE 1969 VIENNA CONVENTION ON THE LAW OF TREATIES (2007), 106 (Exhibit RME-1170): "It is the general view held in the literature that a word or phrase used on multiple occasions in the text of a treaty shall be assumed to bear a uniform meaning."; Rudolf Bernhardt, *Die Auslegung völkerrechtlicher Verträge*, 40 Beiträge zum ausländischen öffentlichen Recht und Völkerrecht (1963), 85-86 (Exhibit RME-1171): "Schließlich ist noch ein mehr technischer Aspekt des vertraglichen Zusammenhangs zu erwähnen. Es dürfte eine Vermutung dafür sprechen, daß bei der abschließenden Redaktion eines Vertrages die Terminologie regelmäßig in der Weise vereinheitlicht wird, daß gleiche Gegenstände in den verschiedenen Vertragsteilen gleich bezeichnet werden und der Interpret daher davon ausgehen kann, daß wiederkehrende Worte und Formulierungen eine übereinstimmende Bedeutung haben." "Finally, a more technical aspect of treaty context requires to be mentioned. A presumption might plead in favor of the fact that, during the final drafting of a treaty, terminology is regularly uniformized in a manner that identical objects in different parts of the treaty are referred to similarly and that the interpreter may assume that recurrent words and formulations have a concordant meaning." [unofficial translation].

> foreign ownership or under foreign control. A measure aimed specifically at Investors because they are foreign, without sufficient countervailing policy reasons consistent with the preceding paragraph, would be contrary to the principles of Article 10. The foreign Investor or Investment would be 'in similar circumstances' to domestic Investors and their Investments, and the measure would be contrary to Article 10."[2477]

1581. The Canadian and U.S. interpretation of Article 10(1) ECT is in line with international judicial and arbitral practice. In the *ELSI* case, the International Court of Justice rejected the United States claim that two U.S. companies were subjected to "*discriminatory measures*" on the ground that the impugned measures were not taken because of the foreign nationality of the shareholders:

> "The allegation of the United States that Raytheon and Machlett were subjected to 'discriminatory' measures can be dealt with shortly. It is common ground that the requisition order was not made because of the nationality of the shareholders[...] There is no sufficient evidence before the Chamber to support the suggestion that there was a plan to favour IRI [an entity controlled by Italy] at the expense of ELSI, and the claim of 'discriminatory measures' in the sense of Article I of the Supplementary Agreement must therefore be rejected."[2478]

1582. Similarly, the *Noble Venture* tribunal rejected Noble Venture's claim that the judicial reorganization proceedings complained of constituted a discriminatory measure because "*there was no indication whatsoever that the measure*

2477 Declaration of the Representatives to the Final Act With Respect to Article 10 ECT (Exhibit RME-1172).

2478 *Case Concerning Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment (July 20, 1989), 1989 I.C.J. Rep. 15, 72-73 ¶ 122 (Annex (Merits) C-942) [emphasis added]. *See also, The Oscar Chinn Case (United Kingdom v. Belgium)*, Judgment (Dec. 12, 1934), 1934 P.C.I.J (Series A/B) No. 63, 87 (Exhibit RME-1173): "On the other hand, the Government of the United Kingdom does not maintain, and there is no justification for supposing, that it was owing to his status as a British national that Mr. Chinn was not given the benefit of the arrangement accorded to the Belgian Company Unatra. In this respect, the position of the British national Mr. Chinn was not, as such, either better or worse than that of the other concerns not under State supervision; these included, according to the evidence produced, Belgian concerns and a French concern."

was specifically directed against the Claimant as a U.S. company."[2479] The tribunal underscored:

> "[T]he Claimant has to demonstrate that a certain measure was directed specifically against a certain investor by reason of his, her or its nationality."[2480]

1583. As set forth at Section III above, Claimants' case is that Yukos was targeted for domestic political reasons, which is inconsistent with nationality-based discrimination.

1584. Claimants' allegations concerning the Yukos-Sibneft de-merger do not involve discrimination based on nationality and thus do not constitute "discriminatory measures" under Article 10(1) ECT.

2479 *Noble Ventures, Inc. v. Romania*, ICSID ARB/01/11, Award (Oct. 12, 2005), ¶ 180 (Exhibit RME-1138). *See also LG&E Energy Corp. et al. v. Argentina*, ICSID ARB/02/1, Decision on Liability (Oct. 3, 2006), ¶¶ 146-147 (Annex (Merits) C-981): "In the context of investment treaties, and the obligation thereunder not to discriminate against foreign investors, a measure is considered discriminatory if the intent of the measure is to discriminate or if the measure has a discriminatory effect. As stated in the *ELSI Elettronica Sicula SpA* case *(United States of America v. Italy)*, I.C.J. Rep. 1989 RLA 56 at 61-62 (20 July 1989), in order to establish when a measure is discriminatory, there must be (i) an intentional treatment (ii) in favor of a national (iii) against a foreign investor, and (iv) that is not taken under similar circumstances against another national. While the Tribunal concludes that based on the evidence presented, Respondent treated the gas-distribution companies in a discriminatory manner, imposing stricter measures on the gas-distribution companies than other public-utility sectors, Claimants have however not proven that these measures targeted Claimants' investments specifically as foreign investments." [emphasis added]

2480 *Noble Ventures, Inc. v. Romania*, ICSID ARB/01/11, Award (Oct. 12, 2005), ¶ 180 (Exhibit RME-1138).

VIII. CLAIMANTS ARE NOT ENTITLED TO DAMAGES

A. Claimants Are Not Allowed To Reap Advantages By Claiming Damages Predicated On Illegal Conduct

1585. The Russian Federation has established at paragraph 890 to 909 above that a party that acts illegally with respect to the subject matter of a dispute lacks *locus standi* and is not entitled to treaty protection. In any event, even if the Tribunal were to assume jurisdiction, and grant standing and relief to Claimants, the value of Claimants' investment which is predicated, in whole or in part, on illegal conduct must be discounted in determining damages, in accordance with the principle *nullus commodum capere de sua injuria propria*.

1586. The Iran-U.S. Claims Tribunal elaborated on this principle in the context of assessing damages for the value of an interest in a company that wrongfully failed to pay its tax and social security obligations:

> "Claimant in the instant case seeks only the dissolution value of its interest in TAMS-AFFA, i.e the value of TAMS-AFFA after the collection of all assets and the discharge of all obligations. […]
>
> In this connection, the Tribunal notes that, if the CAO had paid the invoices submitted by TAMS-AFFA and such funds were part of the undistributed accounts of TAMS-AFFA, then obviously they would be part of the dissolution value of TAMS-AFFA. Similarly, if TAMS-AFFA had paid all its tax and social security obligations, those payments would have reduced the dissolution value of TAMS-AFFA. If payments for work on the TIA project have been wrongfully withheld by an Agency of the Government of the Islamic Republic of Iran and if for the lack of such payment the Tribunal did not include such monies in the dissolution value of TAMS-AFFA, then the Respondent Agency would profit by its own wrong. Conversely, if TAMS-AFFA wrongfully failed to pay tax and social security obligations and if the Tribunal did not deduct such obligations, then TAMS-AFFA would profit by its own wrong. It is a well recognized principle in many municipal systems and in international law that no one should be allowed to reap advantages from their own wrong, *Nullus Commodum Capere De Sua Injuria Propria*."[2481]

1587. As restated by Professor Bjorklund:

2481 *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA*, Iran-U.S. Claims Tribunal, Case No. 7, Award (June 22, 1984), 6 Iran-U.S.C.T.R. 219 (1986), 226-228 (Annex (Merits) C-935). [emphasis added]

> "Finally, an investor's compliance with municipal regulatory measures may have an effect on a tribunal's damages calculation. If a tribunal determines that a State expropriates an investor's factory, the tribunal will award prompt, adequate, and effective compensation -- generally the fair market value of the enterprise. If a State can show that the enterprise did not comport with mandatory environmental standards, for example, and thus would have to be substantially retrofitted in order to operate in compliance with those measures, it is possible that the amount of compensation owed would be reduced to take into account that effect."[2482]

1588. Thus, to the extent that Claimants seek compensation for an investment predicated in whole or in part on illegal conduct, their claims must be denied or at least discounted.

1589. In reality, the value of Yukos, and thus the entirety of Claimants' investment in it, was predicated on illegal conduct, beginning with the original unlawful and bad faith acquisition of Yukos shares by Bank Menatep. The litany of illegal activities committed by the Oligarchs, Yukos, and their associated entities, Claimants included, has been presented and discussed at length throughout this Counter-Memorial, and includes at least the following:

(i) Bank Menatep's abuse of the Russian Federation's loans-for-shares program, through which it acquired 78% of Yukos' shares in 1995, including:

(a) Bank Menatep's rigging of the auction for 45% of the shares of Yukos through the establishment of two proxy companies and their participation in the auction, plus its successful efforts to exclude others from that auction, guaranteeing that the auction proceeded with no meaningful competition and ensuring that Bank Menatep gained control of the shares;[2483] and

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2482 Andrea K. Bjorklund, *Mandatory Rules of Law and Investment Arbitration*, 18 Am. Rev. Int'l Arb. 175 (2007), 199 (Exhibit RME-1174). [emphasis added]

2483 *See* ¶¶ 23-28 *supra*.

(b) Bank Menatep's improper participation via one of those same Bank Menatep proxy companies in the investment tender for an additional 33% of the shares of Yukos, despite a law forbidding banks such as Bank Menatep from participation in the tender.[2484]

(ii) Bank Menatep's failure to comply with the requirement of the loans-for-shares program that, in the event of a default by the Russian Federation, the Yukos shares were to be sold in a fair, transparent auction. Instead, Bank Menatep indirectly sold the shares to itself (by way of a non-competitive sale to Monblan, a Bank Menatep affiliate) for a price much lower than fair market price.[2485]

(iii) A series of improper measures consolidating the Oligarchs' authority over the affairs and finances of Yukos' subsidiaries, and the use of that authority to implement self-dealing schemes and to deny minority shareholders (as well as creditors) their rights. These measures included:

(a) disenfranchising minority shareholders through the issuance of new shares in the subsidiaries to offshore companies controlled by the Oligarchs;

(b) imposing self-dealing arrangements with Yukos by causing the subsidiaries to ratify all past and future contracts with Yukos as if they were transactions in the normal course of business; and

(c) causing the subsidiaries, in manifestly improper procedures, to adopt resolutions providing for the transfer

2484 *See* ¶ 28 *supra*.

2485 *See* ¶¶ 29-30 *supra*.

of assets worth about US$ 2.8 billion, but without identifying the destination entities in the resolutions.[2486]

The impropriety of these measures was exacerbated by the means through which they were implemented. The Oligarchs and those under their control abused well-settled corporate governance rules to ensure that minority shareholders were excluded from exercising their rights by, among other things:

(d) passing resolutions at extraordinary shareholder meetings convened in such a way as to prevent the participation of minority shareholders who objected to the Oligarchs' misconduct, for example by relocating the meetings by hundreds of miles, mere hours beforehand, or by having other shareholders eliminated from the votes;[2487] and

(e) paying dissenting shareholders well below market value for the shares.[2488]

(iv) Abusing low-tax regions and using shell companies in a complex transfer pricing scheme designed to increase profits and illegally minimize taxes paid on Yukos' production and sale of oil.[2489]

(v) The abuse of the Russia-Cyprus Tax Treaty to remove "dividends" from Russia at an improper, favorable tax rate. This scheme involved establishing Hulley and VPL as Cypriot entities and causing them to claim improperly favorable Russian tax rates under the Russia-Cyprus Tax Treaty which were then applied to dividends paid by Yukos, not only for their own shares, but for those traded solely for these purposes with YUL, trades that

2486 *See* ¶¶ 44-75 *supra*; Kraakman Opinion, ¶¶ 45-47.

2487 *See* ¶¶ 64-65 *supra*; Kraakman Opinion, ¶ 56.

2488 *See* ¶ 63 *supra*; Kraakman Opinion, ¶ 56.

2489 *See* ¶¶ 225-277 *supra*; Kraakman Opinion, ¶¶ 36-42.

yielded substantial profits on which Claimants also evaded Russian taxes, all violations of Russian and Cypriot criminal laws.[2490]

(vi) Bank Menatep's managers' use of non-transparent structures to siphon funds from Yukos' subsidiaries.[2491]

(vii) The engineering of an elaborate and deceptive scheme to evade hundreds of billions of Rubles in Russian taxes.[2492]

1590. Even this brief summary of examples of the wrongdoing underlying Claimants' ownership, use, and control of Yukos shows that Claimants are basing their damages claim on a foundation of illegal conduct. At bottom, they seek an astronomical amount of purely hypothetical lost profits that is predicated on "investments" that were made with the proceeds derived from their victims, including the Russian state, which they repeatedly defrauded, and other investors, whom they repeatedly abused. Any such damages are nothing more than the fruit of a poisonous tree, and an award of damages on that basis must not be allowed.

B. In Any Event, Claimants Are Not Entitled To Damages Caused By Their Own Conduct Or The Conduct Of Persons Or Entities Attributable To Them

1591. It is well-established that the conduct of Claimants and persons or entities attributable to them is to be taken into account in assessing the form and extent of reparation. The principle of contributory fault codified in Article 39 of the International Law Commission's 2001 Articles on State Responsibility requires that damages caused by willful or negligent conduct of the victim of an internationally wrongful act be discounted in determining any reparation:

2490 *See generally*, Rosenbloom Report; Polyviou Report. *See also* Lys Report, 43, 63, 65, 75, 86, 87, 95, 103, 107.

2491 Although Claimants had engaged in this scheme since long before 2000, they only received tax assessments from the Russian Federation for the years 2000 to 2003. *See* ¶¶ 364, 412.

2492 *See* ¶¶ 225-277 *supra*.

> "In the determination of reparation, account shall be taken of the contribution to the injury by wilful or negligent action or omission of the injured State or any person or entity in relation to whom reparation is sought."[2493]

1592. As explained in the International Law Commission's Commentary on Article 39, "[t]*his is consonant with the principle that full reparation is due for the injury – but nothing more – arising in consequence of the internationally wrongful act*."[2494]

1593. The relevance of Claimants' conduct in determining reparation is widely recognized in literature and jurisprudence. Professor Wendel for example states:

> "Every domestic legal system assesses the conduct of the claimant before he is granted a compensation award. Such conduct might bar his claim in total (clean hands doctrine) or may at least reduce the compensation award (contributory negligence). Needless to say whether as 'general principles of international law' or as customary international law, the general law of State responsibility may more or less have absorbed this approach into public international law."[2495]

2493 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 109 (Exhibit RME-1031).

2494 *Ibid.*, 110, ¶ 2.

2495 PHILIPP WENDEL, STATE RESPONSIBILITY FOR INTERFERENCES WITH THE FREEDOM OF NAVIGATION IN PUBLIC INTERNATIONAL LAW (2007), 156 (Exhibit RME-1175). *See also* PATRICK DAILLIER, MATHIAS FORTEAU, ALAIN PELLET, DROIT INTERNATIONAL PUBLIC (8th ed. 2009), 874 ¶480 (Exhibit RME-1176): "[L]'exigence des mains propres (*clean hands*) ou, plutôt, son pendant négatif, le principe selon lequel on ne peut tirer avantage de son propre fait illicite doit être considéré comme une condition de recevabilité d'une réclamation ou un élément à prendre en considération pour la réparation du dommage […]." "[T]he condition of clean hands [...] or, rather, its negative pair, the principle according to which one cannot take advantage of one's own unlawful act has to be considered a condition of admissibility of a claim or an element to be considered for the reparation of damage [...]." [unofficial translation]; David J. Bederman, *Contributory Fault and State Responsibility*, 30 Va. J. Int'l L. 335 (1990), 355 (Exhibit RME-1177): "International courts have considered three broad classes of conduct in cases of contributory fault. The first is where the claimant engaged in an unlawful or otherwise prohibited act at the time the claim arises. The second type of cases is where the victim's conduct is merely negligent or imprudent. The third category is where the claimant's behavior was exemplary before and during the commission of the wrongful occurrence, but she later fails to take reasonable measures to avoid the consequences of that tort. Any of these kinds of contributory fault can serve as a ground either for denying the claim or for a proportional reduction of any award."

1594. The *Ad Hoc* Committee in *MTD v. Chile* accepted and applied this principle limiting damages for breach of investment protections as follows:

> "It may be noted that the Respondent does not challenge the decision on contribution as a manifest excess of powers, and rightly not. In the words of Article 39 of the ILC's Articles on Responsibility of States for Internationally Wrongful Acts of 2001:
>
> […]
>
> Part II of the ILC Articles, in which Article 39 is located, is concerned with claims between States, though it includes claims brought on behalf of individuals, e.g., within the framework of diplomatic protection. There is no reason not to apply the same principle of contribution to claims for breach of treaty brought by individuals."[2496]

In its review of the amount of damages awarded to MTD, the *Ad Hoc* Committee emphasized that a reduction by half of the amount of damages was warranted in the case of imprudent conduct, leaving open the possibility that damages should be reduced further in the case of illegal conduct:

> "The Committee agrees with the Respondent that some further reasons for a 50:50 split of damages could have been offered at this stage. But the Tribunal had already analysed the faults on both sides in some detail, holding both to be material and significant in the circumstances. As is often the case with situations of comparative fault, the role of the two parties contributing to the loss was very different and only with difficulty commensurable, and the Tribunal had a corresponding margin of estimation. Furthermore, in an investment treaty claim where contribution is relevant, the respondent's breach will normally be regulatory in character, whereas the claimant's conduct will be different, a failure to safeguard its own interests rather than a breach of any duty owed to the host State. In such circumstances, it is not unusual for the loss to be shared equally."[2497]

1595. The *MTD* award upheld by the *Ad Hoc* Committee found Chile liable for breach of the fair and equitable treatment standard in the Malaysia-Chile bilateral investment treaty, but determined that claimants should bear 50% of the damages suffered, disallowing the residual value of their investment:

2496 *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID ARB/01/7, Decision on Annulment (Mar. 21, 2007), ¶ 99 (Exhibit RME-1178).

2497 *Ibid.*, ¶ 101. [emphasis added]

> "The Tribunal decided earlier that the Claimants incurred costs that were related to their business judgment irrespective of the breach of fair and equitable treatment under the BIT. As already noted, the Claimants, at the time of their contract with Mr. Fontaine, had made decisions that increased their risks in the transaction and for which they bear responsibility, regardless of the treatment given by Chile to the Claimants. They accepted to pay a price for the land with the Project without appropriate legal protection. A wise investor would not have paid full price up-front for land valued on the assumption of the realization of the Project; he would at least have staged future payments to project progress, including the issuance of the required development permits."[2498]

1596. Specifically, the *MTD* tribunal held that any damages resulting from the conduct and financial situation of a business partner chosen by claimants is to be borne by claimants:

> "The Tribunal notes that the Claimants had not accepted Mr. Fontaine's offer because it is not a full cash offer and are concerned about the uncertain financial situation of Mr. Fontaine. This is of no relevance to this Tribunal, since the risk of having chosen Mr. Fontaine as a partner should not be borne by the Claimants. Chile had no participation in his selection nor has it been claimed that the financial difficulties of Mr. Fontaine can be attributed to Chile."[2499]

1597. Other investment treaty awards have also reduced or denied damages based on imprudent conduct of or attributable to the investor.[2500] In *MTD v. Chile*, as in other cases, imprudent conduct by the investor or its investment was deemed sufficient to significantly reduce the amount of damages awarded in accordance with the general understanding that "*Bilateral Investment*

2498 *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID ARB/01/7, Award (May 25, 2006), ¶ 242 (Annex (Merits) C-969); *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID ARB/01/7, Decision on Annulment (Mar. 21, 2007), ¶ 40 (Exhibit RME-1178).

2499 *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID ARB/01/7, Award (May 25, 2006), ¶ 245 (Annex (Merits) C-969).

2500 *Azurix Corp v. Argentina*, ICSID ARB/01/12, Award (July 14, 2006), ¶ 426 (Annex (Merits) C-979): "[I]n the Tribunal's view, no well-informed investor, in March 2002, would have paid for the Concession the price (and more particularly, the Canon) paid by Azurix in mid–1999, irrespective of the actions taken by the Province and of the economic situation of Argentina at that time."; *Bogdanov and others v. Moldova*, SCC, Award (Sept. 22, 2005), § 5.2 ¶ 84 (Exhibit RME-1179): "The Arbitral Tribunal does not find that the Respondent is liable for payment of damages corresponding to the entire loss, and that the Local Investment Company must be deemed partially responsible for the loss because it did not ensure that the Privatization Contract contained an appropriately precise regulation of the compensation."

Treaties are not insurance policies against bad business judgments."[2501] *A fortiori*, illegal conduct of Claimants and illegal conduct that is attributable to them materially reduces or excludes any award of damages resulting from an internationally wrongful act.[2502]

1598. Likewise, other arbitral tribunals and mixed claims commissions have on various occasions disallowed or discounted damages based on imprudent or illegal conduct of or attributable to the claimant. In the *Delagoa Bay Railway* case concerning the amount of compensation due as a result of Portugal's rescission of a railway concession, the arbitrators held:

> "Toutes ces circonstances qui peuvent être alléguées à la charge de la Compagnie concessionnaire et à la décharge du gouvernement portugais atténuent la responsabilité de ce dernier et justifient, comme il va être exposé plus loin, une réduction de la réparation à allouer. Elles excluent notamment d'emblée l'allocation de dommages et intérêts exemplaires et de nature pénale, tels que, à la rigueur en eût pu réclamer une personne victime d'un traitement arbitraire absolument immérité."[2503]

2501 *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID ARB/97/7, Award (Nov. 13, 2000), ¶ 64 (Annex (Merits) C-955); *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, ICSID ARB/01/7, Award (May 25, 2004), ¶ 178 (Annex (Merits) C-969): "The BITs are not an insurance against business risk."; *Eudoro Armando Olguín v. Republic of Paraguay*, ICSID ARB/98/5, Award (July 26, 2001), 18 ICISD Rev. 169 (2003), 188-189 ¶ 73 (Exhibit RME-1096).

2502 *E.g., Claim of the British Ship "I'm Alone" v. United States (Canada v. United States)*, Arbitration under the Convention of January 1924 to Aid in the Prevention of the Smuggling of Intoxicating Liquors into the United States, Joint Final Report of the Commissioners (Jan. 5, 1935), 3 U.N.R.I.A.A. 1615, 1617-1618 (Exhibit RME-1180): "We find as a fact, that, from September, 1928, down to the date when she was sunk, the *I'm Alone*, although a British ship of Canadian registry, was *de facto* owned, controlled, and at the critical times, managed, and her movements directed and her cargo dealt with and disposed of by, by a group of persons acting in concert who were entirely, or nearly so, citizens of the United States, and who employed her for the purposes mentioned [liquor smuggling]. […] The Commissioners consider that, in view of the facts, no compensation ought to be paid in respect of the loss of the ship or the cargo."

2503 "All these circumstances that can be invoked at the concessionary Company's charge and at the Portuguese Government's discharge attenuate the latter's liability and justify, as will be exposed below, a reduction of the reparation to be granted. They notably immediately exclude the granting of exemplary and punitive damages, as might have been claimed by the victim of an entirely undeserved arbitrary treatment." [unofficial translation]. *Delagoa Case*, Final Award (Mar. 29, 1900), 30 Nouveau Rec. (2nd Ser.) 329 (1904), 407 (Exhibit RME-1181) [emphasis added]; *see also Guillermo Colunje (Panama) v. U.S.*, United States and Panama Mixed Claims Commission, Decision (June 27, 1933), 6 U.N.R.I.A.A. 342, 344 (Exhibit RME-1182); *Teodoro Garcia and M.A. Garza*, Mexico-United States (General Claims Commission), Decision (Dec. 3, 1926), 4 U.N.R.I.A.A. 119, 123 (Exhibit RME-1183): "The record leaves no

1599. Similarly, in a series of cases brought by American nationals before the United States-Mexico Claims Commission against Mexico based on the seizure of two ships engaged in an illegal expedition and the detention of their crews and passengers, the umpire dismissed claims for damages brought by claimants who had knowingly taken part in the illegal enterprise:

> "The Government of the United States can not [*sic*] equitably ask of the Mexican Government compensation for the losses, pecuniary or of time, suffered by the claimant; for the enterprise, whilst it was illegal, was evidently of a speculative character, and those losses were due to the claimant's having knowingly taken part in it."[2504]

1600. In summary, Claimants cannot escape the consequences of their illegal conduct or illegal conduct attributable to them, whether at the jurisdictional and admissibility stage, the merits stage or the damages stage. As stated by Mark Kantor in his book VALUATION FOR ARBITRATION:

> "Although egregious issues such as fraud, misrepresentation, corrupt payments or unlawful conduct on the part of the injured party are usually presented as a defense to liability in the first place, those circumstances may also form the basis for an [*sic*] contributory fault attack on the amount of damages to be paid by the breaching party. Notably, allegedly unlawful conduct on the part of an investor is an issue that arises repeatedly in investment

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doubt but that the claimants, at least [the father], realized their acting in contravention of laws and regulations which had been effective since about two years. Though this knowledge on their part can not [*sic*] influence the answer to the question, whether the shooting was justified or not, it ought to influence the amount of damage to which they are entitled."; *Réné Michau v. Germany*, French-German Mixed Arbitral Tribunal (3rd Section), Award (Apr. 3, 1922), 2 Rec. des Dec. des Trib. Arb. Mixtes 29 (1923), 31 (Exhibit RME-1184): "Att., en ce qui concerne le montant du dommage, que le gouvernement allemand ne peut être rendu responsable de la perte des objets suivants, […], car le fait d'avoir emballé dans les malles lesdits objets précieux, qu'il était facile et logique de porter sur soi, doit être considéré comme une grave imprudence de la part du requérant;" "Whereas, as regards the amount of damages, the German government cannot be made liable for the loss of the following objects, [...], as the fact of having wrapped the said precious objects, which it would have been logical to transport on one's body in trunk boxes, has to be considered a grave imprudence on the part of the claimant;" [unofficial translation].

[2504] *Zerman Expedition: John McCurdy v. Mexico*, No. 214, U.S.-Mexico Mixed Claims Commission, *in* HISTORY AND DIGEST OF THE INTERNATIONAL ARBITRATIONS TO WHICH THE U.S. HAS BEEN A PARTY, Vol. 3 (John Bassett Moore, ed. 1898) 2768, 2769 (Exhibit RME-1185). This case was followed by the umpire in *Joseph Bogy*, No. 228, *A. Brown Chapman*, No. 234, and *Robert G. Baldwin*, No. 258. *Ibid*.

> treaty disputes – in the jurisdiction phase, on the merits and again to determine quantum."[2505]

1601. Thus, under the controlling legal standard, any award of damages to Claimants by the Tribunal would be misplaced, because Claimants themselves, directly and through their control of Yukos, bear responsibility for what they claim to be the lost value of their Yukos investment. Quite apart from their willful misconduct in engaging in the underlying tax fraud, once the Russian Tax Ministry had clearly rejected the "tax optimization" schemes Yukos utilized (under Claimants' control), Yukos chose to pursue a series of self-defeating steps that compounded its tax liabilities, showed that it lacked any genuine and meaningful intention to satisfy them, and led to its self-destruction. In addition to those discussed in A above, further examples include the following:

(i) Yukos failed to take steps to prepare to make a substantial tax payment, even though it knew that once an assessment was made, Russian law would allow not more than ten days to pay. Instead, Yukos chose to pay an unprecedented 2003 giga-dividend -- both authorized and collected primarily by Claimants as Yukos shareholders -- that limited its ability to pay the impending tax bill.[2506]

(ii) Yukos failed to amend its 2001-2003 tax returns after it knew that the "tax optimization" scheme had been challenged by the tax authorities, even though doing so would have mitigated its exposure to tax assessments for those years.[2507]

(iii) Yukos failed to pay Yukos' year 2000 tax assessment in April 2004 when it came due, despite its knowledge that interest, fines, and enforcement fees would result from non-payment.[2508]

2505 MARK KANTOR, VALUATION FOR ARBITRATION (2008), 111 (Exhibit RME-1186).

2506 *See* ¶¶ 349-352 *supra.*

2507 *See* ¶¶ 369-371 *supra.*

2508 *See* ¶¶ 381-397 *supra.*

(iv) Yukos made tainted settlement offers to the tax authorities in the summer of 2004, most notably the repeated offer of Sibneft shares, despite the fact that Yukos' title to those shares was disputed.[2509] Such offers can only be viewed as an attempt to obstruct the Tax Ministry's enforcement efforts, and not as a good faith effort to satisfy Yukos' ongoing obligations.

(v) Yukos' management and Claimants repeatedly claimed insolvency, but refused to file for bankruptcy for Yukos in Russia despite a statutory imperative to do so. Properly making such a filing would have prevented the auction of YNG shares and suspended further enforcement proceedings.[2510]

(vi) Yukos and Claimants sabotaged the 2004 auction of YNG by taking steps to reduce the number of bidders who would participate in the auction and the financing available to them, despite the fact that Yukos itself asked for the public auction. This sabotage took several forms, including:

(a) Repeated, public threats of a "*lifetime of litigation*" against any entity that purchased, or financed the purchase of, the auctioned shares;[2511] and

(b) A sham bankruptcy filing in the United States, intended to trigger the automatic stay provision under Texas bankruptcy law, which, together with the improper TRO, prevented participation in the auction of known bidders, including Gazpromneft, and all sources of Western finance.[2512]

2509 *See* ¶¶ 420-430 *supra*.

2510 *See* ¶¶ 440-449 *supra*.

2511 *See* ¶¶ 492-494 *supra*.

2512 *See* ¶¶ 497-506 *supra*.

(vii) Yukos transferred foreign assets into two Dutch Stichtings, which were then used to further encumber Yukos' operations and benefit the Oligarchs and Claimants, rather than settle Yukos' substantial tax and non-tax liabilities.[2513]

(viii) Yukos willfully failed to repay SocGen and used the Stichtings to frustrate SocGen's enforcement efforts outside of Russia, which led SocGen to initiate bankruptcy proceedings in Russia.[2514]

(ix) Yukos lied to PwC, and through PwC to its creditors and the investing public who relied upon the Yukos' financial statements that PwC certified with stark misrepresentations about Yukos' misconduct including several central aspects of that misconduct that are material to these proceedings, such as the Oligarchs' payment of kickbacks to facilitate their gaining control of Yukos and its illegal "tax optimization' scheme." ¶¶ 705-738.

1602. Individually and cumulatively, this misconduct -- including both wrongful actions and wrongful failures to act -- and not the Russian Federation's taxation and enforcement measures, led to Yukos' dissolution. Yukos and Claimants had repeated opportunities to mitigate the damage caused by Yukos' tax violations. However, at every turn -- due either to malice or merely egregious, self-dealing mismanagement -- the Yukos management that Claimants installed as the stewards of their investment refused to behave responsibly, until finally Yukos ceased to exist. Having effectively caused Yukos' bankruptcy, Claimants cannot now claim damages for that consequence of their own wrongdoing. To permit such a recovery would only reward the "*wilful or negligent action*[s] *or omission*[s] *of*" Yukos and Claimants,[2515] which cannot be supported under international law.

2513 *See* ¶¶ 528-539 *supra.*

2514 *See* ¶¶ 551-559 *supra.*

2515 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 109 (Exhibit RME-1031).

C. In Any Event, Claimants Are Not Entitled To Damages That Have No Sufficient Causal Link With Specific Measures In Violation Of The ECT

1603. It is essential that Claimants demonstrate that the damages they claim were caused by a violation of the Russian Federation's obligations under the ECT. They have not demonstrated such a connection here. As a result, Claimants are not entitled to any award of damages.

1. Damages May Not Be Recovered Absent A Sufficient Causal Link

1604. The basic rule of reparation codified in Article 31 of the ILC Articles on Responsibility of States for Internationally Wrongful Acts embodies the requirement of a sufficient causal link between the conduct of a State responsible for an internationally wrongful act and the reparation claimed. Pursuant to Article 31(1), a State responsible for an internationally wrongful act "*is under an obligation to make full reparation for the injury caused by the internationally wrongful act*."[2516] "*Injury*" is defined in Article 31(2) as including "*any damage, whether material or moral, caused by the internationally wrongful act of a State*."[2517]

1605. The ILC's Commentary to Article 31 explains:

> "Paragraph 2 addresses a further issue, namely the question of a causal link between the internationally wrongful act and the injury. It is only '[i]njury ... caused by the internationally wrongful act of a State' for which full reparation must be made. This phrase is used to make clear that the subject matter of reparation is, globally, the injury resulting from and ascribable to the wrongful act, rather than any and all consequences flowing from an internationally wrongful act."[2518]

2516 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 91 (Exhibit RME-1031). [emphasis added]

2517 *Ibid.* [emphasis added]

2518 *Ibid.*, p. 92, ¶ 9. *See also* Report of the International Law Commission on the Work of its Fifty-Second Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2000), 27 ¶ 97 (Exhibit RME-1187): "The view was expressed that the obligation of reparation did not extend to indirect or remote results flowing from a breach, as distinct from those flowing directly or immediately. It was further stated that the customary requirement of a sufficient causal link between conduct and harm should apply to compensation as well as to the principle of reparation. Similarly, the view was expressed that only direct or proximate

1606. The requirement of a sufficient causal link reflects a well-established rule of customary international law. For example, in *Administrative Decision No. II*, the United States-Germany Mixed Claims Commission held that Germany's duty to compensate U.S. citizens injured as a consequence of the war is limited to loss that is the "*proximate* result *or* consequence" of illegal conduct attributable to Germany:

> "The proximate *cause* of the loss must have been in legal contemplation *of* the act of Germany. The proximate *result* or *consequence* of that act must have been the loss, damage, or injury suffered. The *capacity* in which the American national suffered—whether the act *operated* directly on him, or indirectly as a stockholder *or otherwise*, whether the subjective nature of the loss was direct or indirect—is immaterial, but the *cause* of his suffering must have been the act of Germany or its agents. This is but an application of the familiar rule of proximate cause—a rule of general application both in private and public law—which clearly the parties to the Treaty had no intention of abrogating."[2519]

1607. In accordance with the principles set forth in *Administrative Decision No. II*, several opinions of the United States-Germany Mixed Claims Commission dismiss claims for damages on the ground that the acts complained of were not the proximate cause or result of the damages claimed. For example, in *United States Steel Products Company*, the Commission held:

> "The proximate *cause* of the loss must have been in legal contemplation *of* the act of Germany. The proximate *result* or *consequence* of *that act* must have been the loss, damage, or injury suffered. […] But where the causal connection between the act complained of and the loss is broken, or so involved and tangled and remote that it can not [*sic*] be clearly traced, there is no liability."[2520]

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consequences and not all consequences of an infringement should give rise to full reparation."

2519 *Administrative Decision No. II*, United States and Germany Mixed Claims Commission (Nov. 1, 1923), 7 U.N.R.I.A.A. 23, 29 (Exhibit RME-1188). [italics in original]

2520 *United States Steel Products Company (United States) v. Germany, Costa Rica Union Mining Company (United States) v. Germany, and South Porto Rico Sugar Company (United States) v. Germany (War-Risk Insurance Premium)*, United States and Germany Claims Commission, Decision (Nov. 1, 1923), 7 U.N.R.I.A.A. 44, 55 (Exhibit RME-1189). [italics in original]

1608. As set forth at ¶¶ 1096 to 1104 above, a sufficient causal link between the total or substantial loss of the investment and the measures complained of is already a necessary predicate for a finding of a "*measure*[] *having effect equivalent to expropriation*" and thus a violation of Article 13 ECT. As stated by the Iran-U.S. Claims Tribunal in *Otis v. Iran*:

> "For Otis to be successful in its Claim before this Tribunal, it is necessary for it to prove, firstly, that its property rights had been interfered with to such an extent that its use of those rights or the enjoyment of their benefits was substantially affected and that it suffered a loss as a result, and, secondly, that the interference was attributable to the Government of Iran. The Tribunal must therefore examine the acts of interference Otis complains of and determine whether any or all are attributable to the Government of Iran and whether any or all, by themselves or collectively, constitute a sufficient degree of interference to warrant a finding that a deprivation of property has occurred."[2521]

The Iran-U.S. Claims Tribunal held that the claimant had failed to establish that the injury was "*caused by conduct attributable to the Government of Iran*" because its shareholding in Otis Iran was impaired by a "*multiplicity of factors*" and dismissed the claim.[2522]

1609. Similarly, the International Court of Justice dismissed the United States' claim that the requisition order of the Mayor of Palermo had deprived the U.S. shareholders of ELSI of their right to control and manage ELSI, in violation of Article III(2) of the Friendship, Navigation and Commerce Treaty between the United States and Italy, because the causal connection between the requisition and the deprivation of control and management was uncertain and speculative:

> "[O]ne feature of ELSI's position stands out: the uncertain and speculative character of the causal connection, on which the Applicant's case relies, between the requisition and the results attributed to it by the Applicant. There were several causes acting together that led to the disaster to ELSI. No doubt the effects of the requisition might have been one of the factors involved. But the underlying cause was ELSI's headlong course towards insolvency;

2521 *Otis Elevator Company v. Iran,* Iran-U.S. Claims Tribunal, Case No. 284, Award (April 29, 1987), 14 Iran-U.S.C.T.R. 283 (1987), 293 ¶¶ 28-29 (Exhibit RME-1113). [emphasis added]

2522 *Ibid.*, 299 ¶ 47.

> which state of affairs it seems to have attained even prior to the requisition."[2523]

1610. The jurisprudence of the Iran-U.S. Claims Tribunal and investment treaty tribunals is in accord. For instance, in *Jack Rankin v. Iran*, the Iran-U.S. Claims Tribunal dismissed a claim for damages brought by a U.S. national who left Iran after the Revolution because the claimant failed to establish that the anti-American policy of the new Iranian Government held to be in breach of the Treaty of Amity, Economic Relations and Consular Rights and customary international law was a "*substantial causal factor*" in the claimant's departure from Iran:

> "The Tribunal recognizes the difficulties of determining motivation in circumstances that occurred long ago and that involved a multiplicity of factors, many subjective. Nevertheless, the question of causation cannot be ignored, as the Respondent can be held liable for damages only if wrongful actions attributable to it were a substantial factor in causing the damages."[2524]

> "Consequently, the Tribunal finds that the Claimant has not satisfied the burden of proving that the implementation of the new policy of the Respondent, as possibly exemplified by Dr. Yazdi's statement, was a substantial causal factor in his departure from Iran. Neither has the Claimant satisfied the burden of proving that his decision to leave was caused by specific acts or omissions of or attributable to the Respondent."[2525]

1611. In *Gami v. Mexico*, the tribunal dismissed a claim for breach of Article 1105 NAFTA on the ground that "[i]*t is impossible to conclude that the failures in the Sugar Program were both directly attributable to the government and*

2523 *Case Concerning Elettronica Sicula S.P.A. (ELSI) (United States of America v. Italy)*, Judgment (July 20, 1989), 1989 I.C.J. Reports 15, 62 ¶ 101 (Annex (Merits) C-942).

2524 *Jack Rankin v. The Islamic Republic of Iran*, Case No. 10913, Award (3 Nov. 1987), 17 Iran-U.S. C.T.R. 135, ¶ 34 (Exhibit RME-1190). [emphasis added]

2525 *Ibid.*, ¶ 39 [emphasis added]. *See also Hoffland Honey Co. v. National Iranian Oil Co.*, Case No. 495, Award (Jan. 26, 1983), 2 Iran-U.S. C.T.R. 41 (1984), 41-42 (Exhibit RME-1116): "NIOC's sales of oil were 'measures affecting property rights' within the meaning of Article II(1) of the Claims Settlement Declaration only if those sales were the proximate cause of the injuries to its bees […] [W]e think it is clear from the pleadings and the evidence attached thereto that proximate cause has not been alleged. The sales of oil were a 'cause' of Hoffland's loss only in the sense that had there been no oil, and thus no chemicals, the loss would not have occurred. The sales were thus a 'cause, but not the proximate cause."

directly causative of GAMI's alleged injury."[2526] The GAMI tribunal stated that no damages would have been due even if GAMI had succeeded on liability.[2527]

1612. Another example of an investment treaty award dismissing a claim for damages caused by "*a variety of factors*" and thus lacking a sufficient causal link with conduct of the host State found to be in breach of an investment treaty is *Metalclad v. Mexico*, where the tribunal held:

> "Metalclad also seeks an additional $20–25 million for the negative impact the circumstances are alleged to have had on its other business operations. The Tribunal disallows this additional claim because a variety of factors, not necessarily related to the La Pedrera development, have affected Metalclad's share price. The causal relationship between Mexico's actions and the reduction in value of Metalclad's other business operations are too remote and uncertain to support this claim. This element of damage is, therefore, left aside."[2528]

1613. Similarly, the tribunal in *Myers v. Canada* stated in its First Partial Award:

2526 *GAMI Investments, Inc. v. The Government of the United Mexican States,* UNCITRAL Arbitration, Final Award (Nov. 15, 2004), ¶ 110 (Exhibit RME-1137).

2527 *Ibid*., ¶¶ 84-85.

2528 *Metalclad Corp. v. United Mexican States*, ICSID ARB(AF)/97/1, Award (Aug. 30, 2000), ¶ 115 (Annex (Merits) C-954). *See also Tradex Hellas S.A. v. Republic of Albania*, ICSID ARB/94/2, Award (Apr. 29, 1999), 14 ICSID Rev. 197 (1999), 238 ¶ 165 (Annex C-1317) (Exhibit RME-1114) (dismissing the expropriation claim on the ground that Albania's conduct did not cause the loss of claimant's investment: "[E]ven if the villagers felt encouraged to such occupations by Decision 452 and the Berisha speech, that would not be a sufficient basis to attribute such occupations to the State of Albania, and no other evidence has been provided as a basis for such an attributability."); *Ronald S. Lauder v. Czech Republic*, UNCITRAL, Final Award (Sept. 3, 2001), 52 ¶ 234 (Annex (Merits) C-959): "The question therefore arises if the breach by the Respondent of its Treaty obligations gives rise to any damages to be paid to the Claimant. It is most probable that if in 1993 Mr. Lauder's investment in the Czech television could have been made directly in CET 21, the Licence holder, the possible breach of any exclusive agreements in 1999 could not have occurred in the way it did. Even if the breach therefore constitutes one of several '*sine qua non*' acts, this alone is not sufficient. In order to come to a finding of a compensable damage it is also necessary that there existed no intervening cause for the damage. In our case the Claimant therefore has to show that the last, direct act, the immediate cause, namely the termination by CET 21 on 5 August 1999 (and the preceding conclusions by CET 21 of service agreements with other service providers) did not become a superseding cause and thereby the proximate cause. In other words, the Claimant has to show that the acts of CET 21 were not so unexpected and so substantial as to have to be held to have superseded the initial cause and therefore become the main cause of the ultimate harm."

> "CANADA has submitted, and the Tribunal accepts, that the following principles also apply:
>
> - the burden is on SDMI to prove the quantum of the losses in respect of which it puts forward its claims;
>
> - compensation is payable only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached; the economic losses claimed by SDMI must be proved to be those that have arisen from a breach of the NAFTA, and not from other causes;"[2529]

The tribunal re-emphasized the sufficient causal link requirement in its Second Partial Award:

> "In its First Partial Award the Tribunal determined that damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the *proximate* cause of the harm."[2530]

1614. The burden of establishing a sufficient causal link between the damages claimed and particular measures alleged to be in breach of a specific

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2529 *S.D. Myers Inc. v. Government of Canada*, UNCITRAL, Partial Award (Nov. 12, 2000), 40 I.L.M. 1408 (2001), 1444 ¶ 316 (Exhibit RME-1161). [emphasis added]

2530 *S.D. Myers Inc. v. Government of Canada*, UNCITRAL, Second Partial Award (Oct. 21, 2002), ¶ 140 (Exhibit RME-1191) [italics in original; other emphasis added]. *See also LG&E Energy Corp. et al. v. Argentine Republic*, ICSID ARB/02/1, Award (July 25, 2007), ¶ 45 (Exhibit RME-1192): "Accordingly, the issue that the Tribunal has to address is that of the identification of the '*actual loss*' suffered by the investor '*as a result*' of Argentina's conduct. The question is one of '*causation*'[…]" [italics in original]; *Saipem SpA v. People's Republic of Bangladesh*, ICSID ARB/05/7, Award (June 30, 2009), ¶ 213 (Annex (Merits) C-999): "There is no disagreement between the parties that compensation can only cover losses caused by the acts attributed to the State (*see* also Article 31(2) of the ILC Draft Articles on State Responsibility)." [italics in original]; *United Parcel Service of America, Inc. v. Government of Canada*, UNCITRAL, Award (June 11, 2007), ¶ 37 (Exhibit RME-1039): "Canada separates damage and causation in its analysis. These are not separate aspects of a claim of damage. Rather, these are inseparable, as damage must flow from some cause."; *Desert Line Projects LLC v. The Republic of Yemen*, ICSID ARB/05/17, Award (Feb. 6, 2008), ¶ 274 (Exhibit RME-1193): "According to the common principles applying to such a petition, the Respondent should then establish the substantiality and the amount of its prejudice, the type of liability, and the causation between the type of liability and the alleged prejudice."

ECT obligation, to the exclusion of other causes, is on Claimants. As stated by the tribunal in *UPS v. Canada*:

> "[A] claimant must show not only that it has persuasive evidence of damage from the actions alleged to constitute breaches of NAFTA obligations but also that the damage occurred as a consequence of the breaching Party's conduct […]."[2531]

Or as stated by Professor Kantor:

> "Compensation is, of course, payable only for the consequences of injuries caused by the breaching party's conduct. The injured claimant, therefore, has the burden of demonstrating that the claimed quantum flowed from that conduct. Shelves of books and papers contain discussions of the fundamental role the principle of 'causation' plays in determining both liability and compensation. […] The claimant must satisfy the tribunal that the causal relationship is sufficiently close (*i.e.*, not 'too remote') to satisfy the applicable standard of causation."[2532]

2531 *United Parcel Service of America, Inc. v. Government of Canada*, UNCITRAL, Award (June 11, 2007), ¶ 38 (Exhibit RME-1039).

2532 MARK KANTOR, VALUATION FOR ARBITRATION (2008), 105-106 (Exhibit RME-1186) [emphasis added]. *See also* Bernard Graefrath, *Responsibility and damages caused: relationship between responsibility and damages*, 185 Rec. des Cours 9 (1984-II), 94-95(Exhibit RME-1194): "The basis for any decision of whether a damage may be regarded as the consequence of the violation of a law is uninterrupted and surveyable causality. […] In normal cases of international delicts there is a general interest to limit the scope of consequences that should be covered by damages. In order to avoid growing to infinity, one usually speaks of 'proximate cause,' 'adequate causality,' 'ordinary cause of events,' 'the cause must not be too remote or speculative,' there must 'be a sufficiently direct causal relationship' and also the term 'foreseeability' is used to describe a causal relationship which is normal. Again it is a principle of private law that is applied, the principle of *proxima causa*. A loss is regarded as a normal consequence of an act, if it is attributable to the act as a proximate cause." [italics in original]; David J. Bederman, *Contributory Fault and State Responsibility*, 30 Va. J. Int'l L. 335 (1989-1990), 349 (Exhibit RME-1177): "Causation has two aspects. The first, already alluded to, is factual causation. This requires a determination of whether the state's wrongful act or omission constituted a necessary link in the chain of circumstances leading to the claimant's injuries. The second element is legal or proximate causation, which involves analysis of whether the claimant's injury was a foreseeable consequence of the state's act or omission. In the context of contributory fault, the determination of proximate cause also demands an inquiry into whether the claimant's own conduct led foreseeably to the state action which caused his injury."; Abby Cohen Smutny, *Some Observations on the Principles Relating to Compensation in the Investment Treaty Context*, 22 ICSID Rev. 1 (2007), 4 (Exhibit RME-1195): "Like rules that exist in national systems, the principles regarding causation in international law are designed to require reparation only when the injury is not 'too remote' or 'inconsequential.' Terms such as 'proximate causation' and 'foreseeability' are often employed to convey the sense that 'but for' causation is not sufficient to give rise to liability. The law requires a sufficient link or *nexus* between the wrongful act and the injury before any obligation to make reparations for that injury will be imposed. Rules of causation thus

1615. As set forth below, Claimants have failed to meet their burden of establishing that any of the specific measures complained of was directly causative of Claimants' alleged injury. Such failure prevents any recovery.[2533]

2. Claimants Have Failed To Establish That The Measures Alleged To Be In Breach Of The ECT Resulted In A Total Or Substantial Deprivation Of Their Investments

1616. Even if one accepted that Claimants have suffered a total or substantial deprivation of their investments, and even if one accepted that the Russian Federation had violated its obligations under the ECT, it would remain for Claimants to demonstrate that the Russian Federation's alleged breaches of the ECT were the cause of that deprivation. Claimants have failed to do so.

1617. The standard theoretical framework economists typically use to calculate damages is an "ex ante" one: damages are assessed "*based on the harm actually incurred, or expected to be incurred, measured at that time as a result of the relevant 'bad acts,'*" and then brought to present value with pre-judgment interest.[2534] This approach is preferred because it "*provides a consistent, economically rigorous framework that can be used to quantify harm, whether caused by a single action or by several actions.*"[2535] For example, "[i]f *the damages are caused by a series of harmful actions, as is alleged in this matter, each violation can be treated as a new action and the corresponding incremental damage can be estimated at the time of the*

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operate to incorporate a sense of proportionality into the obligation to make reparation for wrongful acts as they require tribunals to make determinations about the reasonableness of requiring one party or the other to bear the burden of losses when they occur." [italics in original]

2533 Meg Kinnear, *Damages in Investment Treaty Arbitration*, *in* ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES (Katia Yannaca-Small, ed. 2010), 554 (Exhibit RME-1196): "Reparation is due only for loss that has a sufficient causal connection to the breach found by the tribunal. This basic principle is expressed in various ways, for example, in the requirement that the loss claimed be the proximate cause of the damage, that such loss not be too remote or speculative, or that it be the direct and foreseeable result of the breach." *See also Ibid.*, 556: "The investor bears the burden of proving causation, quantum and recoverability at law of the loss claimed. […] Failure to meet the burden of proof will prevent any recovery."

2534 Expert Report of Professor James Dow, 2011 ("Dow Report"), ¶ 11-12.

2535 *Ibid.*, ¶ 14.

action, […] [t]*he incremental damage figures for each violation can then be added together to obtain a total damage figure*."[2536]

1618. Instead of using this approach, however, the Kaczmarek Report relied upon by Claimants employs an "*ex post*" one, estimating a hypothetical value for Yukos (or parts of Yukos) on an arbitrary valuation date of November 21, 2007, had the alleged treaty violations not occurred.[2537] An "*ex post*" approach is vulnerable to error, and is therefore not preferred, because it necessarily requires an estimation of damages *"based on hindsight, using information that would not have been known at the time of the violation,"*[2538] and *"provides no principled basis for choosing a valuation date."*[2539]

1619. The Kaczmarek Report's damages calculations are all flawed in three core respects:

(i) First, the Kaczmarek Report fails to connect any of the alleged treaty violations to a specific amount of damages. Each of the scenarios analyzed in the Kaczmarek Report involves multiple alleged treaty violations, but provides only a single value on the valuation date with no explanation of the way in which individual alleged violations contribute to this value, and no mechanism for determining the incremental damages allegedly caused by any specific alleged violation.[2540] As a result, these values are dependent on the Tribunal finding that all of the alleged "bad acts" in each scenario were indeed treaty violations and caused harm on the arbitrary date Claimants selected, and do not accommodate the

2536 *Ibid.*, ¶ 14.

2537 *Ibid.*, ¶ 9.

2538 *Ibid.*, ¶ 13.

2539 *Ibid.*, ¶ 31.

2540 *Ibid.*, ¶¶ 15, 18-24.

situation where the Tribunal finds that fewer than all of the scores of alleged "bad acts" were violations.[2541]

(ii) Second, the Kaczmarek Report fails to consider whether any element of Claimants' alleged losses may have been caused (in whole or in part) by any factor other than the alleged treaty violations.[2542] Specifically, the Kaczmarek Report does not take into account the way in which Claimants' own actions led to Yukos' demise.[2543] As Professor Dow explains, "*A proper damages assessment must take into consideration all causal factors that may have led to the damages being claimed. It is not sufficient to assume that the only possible reductions in Yukos' value necessarily resulted from the Russian Federation's Actions without considering how and to what extent Yukos' own actions impacted that value.*"[2544] As a result, the Kaczmarek Report does not provide a reliable measure of damages resulting from alleged treaty violations.[2545]

(iii) Third, the Kaczmarek Report's use of November 21, 2007 as its valuation date results in overestimating damages in each scenario it analyzes, because the price of oil was significantly higher on this date than it was at the time any of the alleged violations occurred.[2546] While the use of this date clearly maximizes any damages calculation,[2547] it is not economically justifiable, as it is unconnected to any of the alleged violations, which occurred largely in 2004, and almost all by 2006.[2548]

2541 *Ibid.*, ¶¶ 18-24.

2542 *Ibid.*, ¶ 25.

2543 *Ibid.*

2544 *Ibid.* [emphasis added]

2545 *Ibid.*

2546 *Ibid.*.

2547 *Ibid.*, ¶ 33: "By using November 21, 2007 as the Valuation Date, the Kaczmarek Report estimates almost the highest possible damages figure its methodology can deliver.".

2548 *Ibid.*, ¶¶ 29-33.

1620. As a result of these three core flaws, Claimants' damages valuations in each scenario considered in the Kaczmarek Report amount to little more than very flawed estimations of Yukos' value on an arbitrary date, years after most of the alleged violations occurred (and coinciding with oil prices significantly higher than those present at that time), and untethered to any specific alleged treaty violation.[2549] As such, Claimants have not established that their damages are causally linked to any alleged violation of the ECT.

3. Claimants Have Made No Attempt To Establish That The Judgments Of The Moscow And Chukotka Courts That Granted The Claims Brought By Gemini Holdings And Nimegan Trading Caused The Damages Claimed

1621. As set forth at ¶¶ 870 to 878 above, Claimants' Article 10 and 13 ECT claims are based exclusively on measures "*with respect to Taxation Measures*," subject to the exception of the Sibneft de-merger allegations. All measures complained of with the exception of the court judgments relating to the Sibneft de-merger are thus outside the scope of the ECT pursuant to Article 21(1) ECT except as otherwise provided in Article 21.

1622. The expropriation claw-back in Article 21(5) ECT is limited to "*taxes*," however, to the exclusion of all other Taxation Measures, including those aimed at the enforcement and the effective collection of taxes. As discussed at ¶¶ 870 to 878 above, the core of Claimants' claims is based on allegations concerning tax collection measures as opposed to "*taxes*" themselves. In particular, Claimants' claims based on interest, penalties, the arrest and prosecution of members of Yukos management for, *inter alia*, tax evasion, the freezing of Yukos' assets and shares of Yukos, the YNG auction, and the bankruptcy auctions are not claims concerning "*taxes*" and thus not covered by the claw-back in Article 21(5) ECT.

1623. Claimants have failed to particularize and quantify the damages resulting from the court decisions that granted the claims brought by Gemini

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[2549] Expert Report of Brent C. Kaczmarek, CFA, September 15, 2010 ("Kaczmarek Report"), ¶ 71: "[O]ur approach to calculating Claimants' loss involves a valuation of YukosSibneft shares that Claimants would have held on 21 November 2007."; Dow Report,¶¶ 28-33.

Holdings and Nimegan Trading and "*taxes*" alleged to be in violation of Articles 10(1) and 13(1) ECT. Indeed, Claimants allege that they would continue to enjoy their rights as Yukos shareholders but for the freezing of Yukos' assets.[2550] Their damages claim must therefore be dismissed.

4. In Any Event, Claimants Have Made No Attempt To Establish That The Measures Alleged To Be In Breach Of Article 13(1) ECT Caused The Damages Claimed

1624. Even if the claw-back in Article 21(5) ECT covered measures aimed at the effective collection of taxes and Claimants could base their Article 13(1) ECT claim on such measures, *quod non*, Claimants have failed to establish that the measures alleged to be in breach of the ECT were directly causative of the damages they claim. As such, Claimants' damages claim must fail.

1625. Claimants lay out a myriad of actions allegedly taken by the Russian Federation, implicating all branches of government, "at all levels,"[2551] and that allegedly constitute, "individually and cumulatively," a violation of 13(1) ECT.[2552] But, as discussed in detail in Section C.2 above, Claimants have made no attempt to link any of the expropriatory measures they allege to a specific amount of damages caused by such a measure.

1626. Instead, Claimants' damages claims are based on an all-or-nothing approach, which, as was the case in *GAMI v. Mexico*, is fatal to their claims:

> "But also with respect to the Article 1105 claim it must be noted that GAMI has not sought to quantify the alleged prejudice arising from particular alleged acts or omissions.
>
> GAMI's approach seems to be all or nothing. But no credible cause-and-effect analysis can lay the totality of GAMI's disappointments as an investor at the feet of the Mexican Government. […] GAMI can assert only that maladministration of the Sugar Program caused it *some* prejudice. But the prejudice must be particularised and quantified. GAMI has not done so. […]

2550 Claimants' Memorial on the Merits, ¶¶ 978-979, 986.

2551 *Ibid.*, ¶¶ 551, 568, 655, 1003.

2552 *Ibid.*, ¶ 552.

> At any rate the Tribunal would have been in no position to award damages even if it had found a violation of Article 1105."[2553]

1627. Indeed, as discussed in C.2., Claimants' chosen approach to presenting their alleged damages makes it impossible to separate out which elements of the alleged damages were allegedly caused by which specific alleged measures. In other words, were the Tribunal to find certain measures -- but not others -- violative of Article 13(1), it would not be possible, based on Claimants' assessment of damages, to award damages at all.

1628. The fundamental failings of the Kaczmarek Report are not cured by the three alternative scenarios Claimants asked Mr. Kaczmarek to consider, to which Professor Dow refers as the "*Method of Collection*" scenarios. As with the Kaczmarek Report's overall valuation effort, and as discussed in more detail in C.2, above, the Method of Collection scenarios simply give purported valuations as of an arbitrary date based on the assumption that all of an unspecified plethora of treaty violations occurred. The valuations are not tied causally to specific treaty violations, and they cannot account for the Tribunal finding that any of the conduct assumed as a basis for each respective scenario was either not an ECT violation or not actionable.[2554]

1629. In any event, as Professor Dow explains in detail, the scenarios themselves fail on their own terms and do not provide the Tribunal with any meaningful guidance for determining an amount of damages that Claimants may have actually suffered.

1630. In the first Method of Collection scenario, Claimants assert that the 2004 auction of YNG should have yielded a higher price. As Claimants would have it, YNG should have sold for US$ 28 billion based on the Kaczmarek Report's valuation of YNG as of the time of the auction, which they contend would have allowed Yukos to pay all of its outstanding taxes by the end of

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2553 *GAMI Investments, Inc. v. The Government of the United Mexican States*, UNCITRAL, Final Award (Nov. 15, 2004), ¶¶ 84-85 (Exhibit RME-1137). [italics in original]

2554 Dow Report, ¶¶ 21-23.

2005.[2555] However, as Professor Dow explains, the calculations supporting that valuation are undermined by at least three obvious and significant errors.[2556] Specifically, the Kaczmarek Report applied an incorrect inflation rate, an incorrect export duty rate, and an incorrect mineral extraction tax rate. Correcting any of these errors results in a valuation of YNG that would result in a sales price that would be too low to allow Yukos to have paid its taxes as forecast by Claimants and the Kaczmarek Report. Adjusting for all of them yields a valuation of YNG of approximately US$ 12.5 billion, which, under the Kaczmarek Report's own assumptions, would have been significantly less than what Yukos would have required to pay its taxes by the end of 2005.[2557]

1631. In the second Method of Collection scenario, Claimants assert that the Russian Government would have -- in their terms, should have -- allowed for a more than five-year repayment scheme, in which the Government would have effectively financed Yukos' payment of its tax assessments over time out of operating cash flows.[2558] This scenario has a number of fatal flaws that make it untenable. First, it ignores that Russian law did not permit the Tax Ministry to enter into such arrangements.[2559] Second, it is premised on faulty assumptions about what Yukos and the Russian Federation would have expected in 2004 about Yukos' ability to pay its taxes within five years. The Kaczmarek Report bases its discussion in this scenario on oil prices as they later actually developed between 2004 and 2007, plus forecasts from the perspective of 2007. However, the Kaczmarek Report itself explains (in a different context) that when the decision to enter the proposed five-year scheme would have been made in 2004, oil prices were expected to be considerably lower than what the report uses in

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2555 Kaczmarek Report, ¶¶ 521-548, 553-556, 557-569.

2556 Dow Report, Part 3.1.

2557 *Ibid.*

2558 Kaczmarek Report, ¶ 550.

2559 Dow Report, ¶ 62. The Tax Ministry could grant a respite or payment spreed of up to only six months to make payment, but only if there were no pending proceedings against the taxpayer relating to violations of the tax law. Russian Tax Code, Art. 64 (Exhibit RME-558) and Art. 62(1) (Exhibit RME-557). For discussion of the restructuring of Rosneft's tax liabilities, *see* Konnov Report, ¶ 86.

this scenario.[2560] Applying the Kaczmarek Report's methodology and own forecasts from the perspective of 2004, it would have taken Yukos 43 years to satisfy its tax obligations from its future expected cash flows.[2561] Accordingly, there is no basis for Claimants' and the Kaczmarek Report's assumption that the Russian Government would or should have extended such financing, and no basis to premise a damage claim on such an unrealistic hypothetical.

1632. In the third Method of Collection scenario, Claimants assert that Yukos could have paid its taxes out of a variety of funding sources, including in part by taking a loan for US$ 16 billion from a private bank.[2562] The evidence on which Claimants and the Kaczmarek Report rely to support this assertion demonstrates that Yukos would not have been able to take such a massive loan, as Professor Dow explains.[2563] Moreover, in assuming that Yukos would be able to take this loan, the Kaczmarek Report fails to consider the overwhelming evidence that it is highly unlikely any lender would have been prepared to extend such a massive amount to Yukos. For instance, the Kaczmarek Report ignores the fact that, at the time of the envisioned loan in 2004 or 2005 (the Kaczmarek Report is not specific as to when exactly it assumes the loan would be taken), Yukos' bonds had a sub-investment grade credit rating, indicating that lenders would have been unlikely to view it as a good credit risk.[2564] Nor does it take account of the fact that Yukos had been required to post cash collateral for a loan of one-tenth that size.[2565] These are but examples. Because the scenario is not only speculative, but absurd, it provides no basis for a damages award.

2560 Dow Report, ¶¶ 63-73.

2561 *Ibid.*, ¶ 70.

2562 Kaczmarek Report, ¶¶ 557-564.

2563 Dow Report, Parts 3.3.1, 3.3.2.

2564 *Ibid.*, ¶¶ 79-84.

2565 *Ibid.*, ¶ 78.

5. In Any Event, Claimants Have Likewise Made No Attempt To Establish That The Measures Alleged To Be In Breach Of Article 10(1) ECT Caused The Damages Claimed

1633. If Article 21(1) ECT were inapplicable and Claimants could invoke alleged violations of Article 10(1) ECT, *quod non*, as with their damages claims under Article 13(1) ECT, Claimants have made no attempt to link any of the countless measures alleged to have constituted unfair or inequitable treatment and/or unreasonable or discriminatory measures that impaired the management, maintenance, use, enjoyment, or disposal of the Yukos shares with any reduction in the value of Claimants' shareholdings.

1634. As emphasized in the relevant literature, the requirement of a sufficient causal link between the impugned measures and the damages claimed is of even greater importance in the context of violations of the fair and equitable treatment standard than in an expropriation context. In his recent article *Compensation: A Closer Look at Cases Awarding Compensation for Violation of the Fair and Equitable Treatment Standard*, Professor Hobér concludes after a comprehensive analysis of investment treaty awards that have awarded compensation for breach of the fair and equitable treatment standard as follows:

> "[I]t would seem that the issue of causality has the potential of creating more problems in this context than in relation to compensation for expropriation. In two cases discussed – *MTD* and *Azurix* – compensation has been reduced on the ground that the investor was unable to demonstrate that the damage has been caused by the host State's violation of the fair and equitable treatment standard. The other side of the same coin is found in another three cases – *LG&E*, *Nykomb*, and *Petrobart* – where the tribunals have concluded that the loss of future profits was too uncertain to warrant compensation. Put differently, the investors in question were not able to prove the causal link between the violation of the fair and equitable treatment standard and the alleged loss of future profits. One explanation is that violation of the fair and equitable treatment standard, typically, does not automatically result in the elimination of the investment, as is mostly the case with expropriation, but rather results in a decline in the business in question or in other negative impact on it."[2566]

2566 Kaj Hobér, *Compensation: A Closer Look at Cases Awarding Compensation for Violation of the Fair and Equitable Treatment Standard*, *in* ARBITRATION UNDER INTERNATIONAL INVESTMENT

1635. In particular, in order to claim damages for any of the countless alleged due process violations in the numerous court, enforcement, and administrative proceedings at issue, Claimants have the burden to show that the decisions of the Russian courts would or could have been different as a matter of Russian law had the alleged due process violations not occurred. Most recently, the tribunal in *Frontier Petroleum Services v. Czech Republic* dismissed a claim that due process violations in Czech bankruptcy proceedings violated the fair and equitable treatment standard in the Canada-Czech and Slovak Federal Republic BIT on the ground that the claimants had failed to establish that the decisions of the bankruptcy courts would have been different in the absence of the alleged due process violations:

> "Thirdly, and importantly, from the perspective of causation, it is not likely that the decisions of the bankruptcy courts would or could have been different as a matter of Czech law, had Claimant been accorded an opportunity to be heard.
>
> In short, the refusal of the bankruptcy courts to recognise and enforce the first and second orders granted in the Final Award on the ground that doing so would be contrary to Czech public policy appears consistent with Czech law. Hence it is open for this Tribunal to find in light of all the evidence, and it does so find, that the courts would not have come to a different conclusions had they given Claimant a hearing. This failure to provide a hearing had no bearing on the final outcome."[2567]

The same is true here; Claimants have utterly failed to establish that the impugned Russian court decisions would have been different as a matter of Russian law, had the alleged due process violations not occurred.

AGREEMENTS: A GUIDE TO THE KEY ISSUES (Katia Yannaca-Small, ed. 2010), 598-599 (Exhibit RME-1197). *See also*, *LG&E Energy Corp.et al. v. Argentine Republic*, ICSID ARB/02/1, Award (July 25, 2007), ¶¶ 34-36 (Exhibit RME-1192); Meg Kinnear, *Damages in Investment Treaty Arbitration*, *in* ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES (Katia Yannaca-Small, ed. 2010), 561 (Exhibit RME-1196): "Concepts such as causation, remoteness, and mitigation take on enhanced relevance in the nonexpropriatory context, where there are no treaty standards governing assessment of loss."

2567 *Frontier Petroleum Services (FPS) v. Czech Republic*, P.C.A.—UNCITRAL, Award (Nov. 12, 2010), ¶¶ 411, 413 (Exhibit RME-1198).

1636. Because Claimants make no attempt to connect causally their alleged damages to their alleged Article 10(1) violations, no damages are recoverable for the same reasons as those detailed above.

6. Claimants Are Not Entitled To Speculative Or Uncertain Damages, Which Is Fatal To Claimants' Claims

1637. In addition to all of the failings described above, Claimants' damages claims are based on inherently incorrect or speculative assumptions, and, as such, are not recoverable under the ECT.

1638. Claimants' three headings of claims for compensation are all based on lost profits: the equity value of Claimants' stake in YukosSibneft, or in Yukos in the alternative, using a Discounted Cash Flow analysis;[2568] the stream of dividends in YukosSibneft, or in Yukos in the alternative;[2569] and the increase in value of Claimants' shares resulting from the "likely occurrence of the New York Stock Exchange Listing."[2570]

1639. Pursuant to the rule of customary international law codified in Article 36(2) of the ILC's Articles on Responsibility of States for Internationally Wrongful Acts, compensation "*shall cover any financially assessable damage including loss of profits insofar as it is established*."[2571]

1640. The ILC's Commentary to Article 36(2) states:

> "*Paragraph 2* of article 36 recognizes that in certain cases compensation for loss of profits may be appropriate. International tribunals have included an award for loss of profits in assessing compensation […] Nevertheless, lost profits have not been as commonly awarded in practice as compensation for accrued losses. Tribunals have been reluctant to provide compensation for claims with inherently speculative elements. When compared with tangible assets, profits (and intangible assets which are income-based) are relatively vulnerable to commercial and political risks,

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2568 Claimants' Memorial on the Merits, ¶¶ 929-936, 971-976, 995-998.

2569 *Ibid.*, ¶¶ 950-953, 974, 994.

2570 *Ibid.*, ¶ 958.

2571 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 28 (Exhibit RME-1031). [emphasis added]

and increasingly so the further into the future projections are made. In cases where lost future profits have been awarded, it has been where an anticipated income stream has attained sufficient attributes to be considered a legally protected interest of sufficient certainty to be compensable. This has normally been achieved by virtue of contractual arrangements or, in some cases, a well-established history of dealings."[2572]

1641. As stated in the ILC's Commentary to Article 36(2), arbitral tribunals have consistently refused to award lost profits that are speculative or uncertain.[2573] For example, the tribunal in *Wena v. Egypt* rejected the DCF

2572 Report of the International Law Commission on the Work of its Fifty-third Session, *in* YEARBOOK OF THE INTERNATIONAL LAW COMMISSION, Vol. II(2) (2001), 104 ¶ 27 (Exhibit RME-1031). [emphases added]

2573 *Metalclad Corp v. United Mexican States*, ICSID ARB(AF)/97/1, Award (Aug. 30, 2000), ¶¶ 119-121 (Annex (Merits) C-954) (dismissing a claim for lost profits because claimant's landfill was never operative: "Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis. […] However, where the enterprise has not operated for a sufficiently long time to establish a performance record or where it has failed to make a profit, future profits cannot be used to determine going concern or fair market value. […] The Tribunal agrees with Mexico that a discounted cash flow analysis is inappropriate in the present case because the landfill was never operative and any award based on future profits would be wholly speculative."); *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, ICSID ARB/84/3, Award on the Merits (May 20, 1992), ¶¶ 188-189 (Annex (Merits) C-945) (rejecting application of the DCF method to value a project that was in its infancy: "In the Tribunal's view, the DCF method is not appropriate for determining the fair compensation in this case because the project was not in existence for a sufficient period of time to generate the data necessary for a meaningful DCF calculation. At the time the project was cancelled, only 386 lots – or about 6 percent of the total – had been sold. All of the other lot sales underlying the revenue projections in the Claimants' DCF calculations are hypothetical. The project was in its infancy and there was little history on which to base projected revenues. In these circumstances, the application of the DCF method would, in the Tribunal's view, result in awarding 'possible but contingent and undeterminate damage which, in accordance with the jurisprudence of arbitral tribunals, cannot be taken into account.'"); *PSEG Global Inc and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Şirketi v. Republic of Turkey*, ICSID ARB/02/5, Award (Jan. 19, 2007), ¶¶ 310-311 (Annex (Merits) C-982): "The second heading of claim for compensation is based on the lost profits approach put forth by the Claimants. The Tribunal is mindful that, as the award in *Aucoven* noted, ICSID tribunals are 'reluctant to award lost profits for a beginning industry and unperformed work.' This measure is normally reserved for the compensation of investments that have been substantially made and have a record of profits, and refused when such profits offer no certainty. The Respondent convincingly invoked in support of its objections to this approach the awards in *AAPL* and *Metalclad*, which required a record of profits and a performance record, just as the awards in *Wena*, *Tecmed* and *Phelps Dodge* refused to consider profits that were too speculative or uncertain. The Respondent also convincingly noted that in cases where lost profits have been awarded, such as *Aminoil*, this measure has been based on a long history of operations."; *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID ARB/87/3, Final Award (June 27, 1990), 30 I.L.M. 580 (1991), 624 ¶ 106 (Exhibit RME-1199) (dismissing a claim for lost profits because "neither the 'goodwill' nor the 'future profitability' of Serendib could be reasonably established with a sufficient degree of certainty."); *Shufeldt Claim (U.S.A. v. Guatemala)*, Decision of the Arbitrator

method to determine the market value of the expropriated investment and established such value by reference to Wena's proven investment in an Egyptian hotel venture because an award for lost profits would have been speculative:

> "The Tribunal agrees with Egypt that, in this case, Wena's claims for lost profits (using a discounted cash flow analysis), lost opportunities and reinstatement costs are inappropriate - because an award based on such claims would be too speculative. […]
>
> Like the *Metalclad and SPP* disputes, here, there is insufficiently 'solid base on which to found any profit or for predicting growth or expansion of the investment made' by Wena."[2574]

1642. In the same vein, the tribunal in *Eastern Sugar v. Czech Republic* dismissed a claim for lost profits as "*overly speculative*,"[2575] noting that "[i]*t is always difficult to assess lost profits*" and that "[o]*ne cannot simply rely on a business plan*."[2576]

1643. Damages claims predicated on speculative assumptions must be rejected. As stated by the Iran-U.S. Claims Tribunal in *Amoco v. Iran*:

> "The Claimant and its experts assert that the DCF method is widely used in business practice. The Tribunal has no reason to doubt the correctness of such a contention. According to the Claimant's own statements, this method is most usually employed in one of two situations: the purchase or merging of an enterprise, when no market price is available, and the decision to make a new and large investment.
>
> […] It remains for the investor to judge the reliability and probability of these forecasts, and to make up his mind, weighing

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(July 24, 1930), 2 U.N.R.I.A.A. 1079, 1099 (Annex C-208) (Exhibit RME-1200): "The *damnum emergens* is always recoverable, but the *lucrum cessans* must be the direct fruit of the contract and not too remote or speculative."; *Rudloff Case*, U.S.-Venezuela Mixed Claims Commission, Decision of Claim on its Merits, 9 U.N.R.I.A.A. 255, 258-259 (Exhibit RME-1201) (dismissing a claim for lost profits that could have been obtained from a concession because the damages claimed were "necessarily conjectural" and the claimant was "unable to prove with reasonable certainty that he could or would have obtained it.").

2574 *Wena Hotels Limited v. Egypt*, ICSID ARB/98/4, Award (Dec. 8, 2000), 41 I.L.M. 896 (2002), 918 ¶¶ 123-124 (Annex (Merits) C-956).

2575 *Eastern Sugar BV (Netherlands) v. Czech Republic*, SCC 088/2004, Partial Award (Mar. 27, 2007), ¶ 356 (Exhibit RME-1202).

2576 *Ibid.*, ¶ 355.

them in relation to the amount and conditions of the financing he must dedicate to the proposed investment."[2577]

"It goes without saying that the Tribunal is not in the position of a prospective investor. Rather the Tribunal must determine, *ex post facto*, the most equitable compensation required by the applicable law for a compulsory taking, excluding any speculative factor. Its first duty is to avoid any unjust enrichment or deprivation of either Party."[2578]

"One of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. […] It does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of damages is certain. […] Such projections can be useful indications for a prospective investor, who understands how far it can rely on them and accepts the risks associated with them; they certainly cannot be used by a tribunal as the measure of a fair compensation."[2579]

2577 *Amoco International Finance Corporation v. The Government of the Islamic Republic of Iran, et al.*, Iran-U.S. Claims Tribunal, Case No. 56, Partial Award (July 14, 1987), 15 Iran-U.S.C.T.R. 189 (1988), 256-257 ¶¶ 221-222 (Annex (Merits) C-939).

2578 *Ibid.*, 257 ¶ 225. [emphasis added]

2579 *Ibid.*, 262 ¶¶ 238-239 [emphases added]. *See also* Ignaz Seidl-Hohenveldern, *L'évaluation des dommages dans les arbitrages transnationaux*, 33 Annuaire français de droit international 7 (1987), 17 (Exhibit RME-1203): "Le droit international n'admet pas davantage de dommages-intérêts spéculatifs ou incertains." "Neither does international law allow for speculative or uncertain damages." [unofficial translation]. *Ibid.*, 24-25 : "Si on regarde cette liste de faits futurs que le taux d'escompte doit prendre en considération, on comprend bien la méfiance des juristes devant les calculs d'experts-comptables choisis par les parties qui, tout en arrivant a des résultats fort disparates, assurent pourtant que les facteurs qu'ils emploient anticipent d'une façon exacte ces événements futurs. Ces calculs contiennent tant d'éléments de conjecture qu'ils paraissent aux non-initiés à la science comptable guère moins spéculatifs et tout aussi obscurs que les prophéties de Nostradamus. C'est pour cette raison que la sentence Amoco ne veut pas accepter cette méthode trop spéculative comme base d'une décision judiciaire. Il est vrai que cette méthode est utilisée souvent pour l'évaluation du prix d'achat d'une entreprise. Un acheteur d'une part serait surtout intéressé par les profits qu'il pourrait tirer de l'entreprise et il serait d'autre part plus avisé qu'un juriste en évaluant la force persuasive des taux d'escompte utilisés par les experts." "If one looks at this list of future facts that the discount rate needs to take into consideration, one very well understands the mistrust of lawyers against the calculations of accounting experts chosen by the parties who, while arriving at very disparate results, nevertheless ascertain that the factors they use anticipate in an exact manner these future events. These calculations contain that many conjectural elements so as to appear to laymen no less speculative and as obscure as the prophecies of Nostradamus. It is for this reason that the Amoco award does not want to accept such too speculative a method as a basis for a judicial decision. It is true that this method is often used to evaluate the acquisition price of a company. A buyer on the one hand would above all be interested by the profits he would obtain from the company and he would be on the other hand more prudent than a lawyer, evaluating the persuasive force of discount rates used by the experts." [unofficial translation].

1644. Claimants' lost profits calculations are grounded in highly speculative assumptions and thus cannot serve as a basis for damages under the ECT.

1645. First, Claimants' lost profits calculations are entirely based on scenarios that are speculative and uncertain, including, for example: (i) the hypothetical value of a merged YukosSibneft, a company that never existed as an operationally integrated entity and thus has no record of profits; (ii) an absurd after-the-fact value for YNG; (iii) the hypothetical possibility of Yukos (or YukosSibneft) being listed on the NYSE; and (iv) the hypothetical value of a surviving Yukos having paid its tax debts through speculative -- indeed, as shown above, impossible -- means.[2580]

1646. Even the Kaczmarek Report does not attempt to assert that any of these scenarios would have been reasonably probable but for the alleged conduct of the Russian Federation -- indeed, the fact that so many possibilities are contemplated belies any assumption that a single one of them was ever reasonably probable. That Claimants' own damage estimates cover a range of 300% shows how uncertain and speculative a process in which they seek to have the Tribunal engage.[2581] "[T]*he failure of the Kaczmarek Report to examine fundamental assumptions that form the foundation of the rest of the modeling – such as the success of the YukosSibneft operations – makes the entire Kaczmarek Report and its conclusions inherently speculative and unreliable.*"[2582]

1647. Finally, the many errors from which the Kaczmarek Report suffers call into question its reliability as a whole. Based on all of the deficiencies he found, Professor Dow concludes that "*the Kaczmarek Report's 'damages' are fatally flawed and that the entire Kaczmarek Report is unreliable.*" [2583]

2580 Kaczmarek Report, ¶¶ 7, 19, 20, 24.

2581 *See* Dow Report, ¶ 24.

2582 Dow Report, ¶ 92.

2583 *Ibid.*, ¶ 93; *see also ibid.* ¶ 90: "*The number, severity and obviousness of the flaws in the Kaczmarek Report's calculations (all of which operate to inflate damages) cast doubt on the reliability of the spreadsheets that underpin all of the calculations in the Kaczmarek Report.*"

7. Claimants Are Not In Any Event Entitled To Double-Recovery

1648. Claimants have already received substantial value from their ill-gotten investments, in the form of dividends paid by Yukos to Claimants, taxes avoided through the abuse of the Russia-Cyprus Tax Treaty, and the value of assets still held in the two Dutch Stichtings, which Claimants control and from which they benefit. As a result, any damages award would need to take these funds into account so as to avoid double-recovery.

1649. For example, as discussed at length at ¶¶ 172 to 189, above, as well as in the Lys Report, both Hulley and VPL received substantial dividend payments from Yukos between 2000 to 2003. Specifically, Hulley received at least eight dividend payments from Yukos, totaling RUB 64.4 billion in pre-tax income.[2584] VPL received RUB 9.6 billion in pre-tax income from Yukos dividend payments from 2001 to 2003.[2585] These dividend payments, as well as additional profits Hulley earned through its sale of Yukos shares to YUL, and other Yukos affiliates were then transferred to YUL through dividend payments from Hulley and VPL. From 2002 to 2004, Hulley paid dividends to YUL totaling over US$ 3.8 billion.[2586] Moreover, from 2002 to 2005, VPL paid dividends of approximately US$ 251 million to YUL.[2587] Ultimately, these dividend payments enriched the Claimants and completed the transfer of illegally inflated profits to the Oligarchs themselves, removing assets from the reach of the Russian Tax Ministry.

1650. Additionally, because of Hulley's and VPL's extensive abuses of the Russia-Cyprus Tax Treaty, discussed at ¶¶ 154 to 199, Claimants received substantial value from Yukos in the form of reduced taxes applied to its dividend payments. Under the Tax Treaty, the dividends paid to Cypriot entities such as Hulley and VPL were taxed at a low rate of 5%, instead of the otherwise-applicable 15% rate applied to dividends paid by Russian companies to Russian

2584 Lys Report, ¶ 94 and Exhibit attached thereto.

2585 *Ibid.*, ¶ 99, Exhibit 35. As noted by Prof. Lys, the 2003 interim dividend was paid to VPL in 2004. *Ibid.*

2586 Lys Report, ¶ 98, Exhibit 23.

2587 Lys Report, ¶ 106, Exhibit 27.

shareholders.[2588] The illegal application of this favorable tax rate resulted in US$ 296 million of additional value received by Claimants on their Yukos holdings.

1651. Moreover, Claimants still control sizeable assets that were stripped from Yukos in order to shield them from tax liability and the bankruptcy proceedings. One of the key elements of Yukos' strategy to remove its assets from Russia was the formation of two Dutch Stichtings, as discussed in detail at ¶¶ 528 to 539. Substantial non-Russian assets were transferred out of Yukos and into these Stichtings, which Claimants control and from which they benefit. Although the exact value of these assets is not known to the Russian Federation, Claimants' own submission deliberately "*exclude*[d] *the value of assets associated with Yukos but located outside of Russia.*"[2589] Claimants' efforts to ignore or hide the value of such assets they controlled highlights rather than eliminates the risk of double-recovery.

1652. Finally, as set forth at ¶¶ 824 to 837, Claimants, as Yukos shareholders, are pursuing claims before the ECHR for compensation in the amount of US$ 104.497 billion for the alleged expropriation of Yukos.[2590] Both the ECHR case and this case are predicated on the same set of facts and fundamental basis -- namely, that the Russian Federation allegedly expropriated Yukos and that Claimants are therefore entitled to reparation[2591] -- and both cases seek a similar recovery (Claimants in this case demand US$ 103.622 billion).[2592] Essentially, Claimants are presenting this same case before the ECHR, which deprives the Tribunal of jurisdiction pursuant to Article 26(3)(b)(i) ECT. Further, Mr. Gardner, the shareholders' representative before the ECHR, has requested that any award by the ECHR be placed into Stichting Yukos International "*for*

2588 *See* Russia-Cyprus Tax Treaty (Annex (Merits) C-916); *see also* Rosenbloom Report, ¶¶ 22, 38.

2589 Kaczmarek Report, n.1.

2590 *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Applicant's Representative's Application for Just Satisfaction (May 4, 2009), ¶ 45 (Exhibit RME-980).

2591 *Ibid.*, ¶ 1.

2592 Claimants' Memorial on the Merits, ¶ 1056.

distribution of any funds received by it […] *to shareholders of Yukos Oil Company.*"[2593] Any such award must also be taken into account to avoid a double-recovery.

1653. Accordingly, in light of the foregoing, Claimants have not established their entitlement to any damages at all.

[2593] *Yukos Oil Co. v. Russian Federation*, ECHR, Application No. 14902/04, Applicant's Representative's Application for Just Satisfaction (May 4, 2009), ¶¶ 63 (Exhibit RME-980).

IX. CONCLUSION

1654. For the foregoing reasons, the Russian Federation respectfully requests that the Tribunal issue an Award:

(a) Dismissing Claimants' claims on the grounds that the Tribunal lacks jurisdiction to entertain them;

(b) In the alternative, dismissing Claimants' claims on the grounds that they are inadmissible;

(c) In the alternative, dismissing Claimants' claims on the merits in their entirety;

(d) In the alternative, declaring that Claimants are not entitled to the damages they seek, or to any damages;

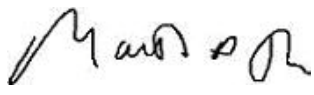
(e) Ordering Claimants to pay the Russian Federation's costs, expenses, and attorney's fees;

(f) Granting such further relief against Claimants as the Tribunal deems fit and proper.

Dated: April 4, 2011

Respectfully submitted,

CLEARY GOTTLIEB STEEN & HAMILTON LLP

by 

Matthew D. Slater, a member of the Firm

BAKER BOTTS LLP

Attorneys for Respondent the Russian Federation