The Hague Court of Appeal
Hearing 24 September 2019
Cause-list number: 200.197.079/01

PLEADING NOTES RE DAMAGE

PROF. M.E. KOPPENOL-LAFORCE

in the matter of:

the **Russian Federation**, respondent, originally claimant in the setting aside proceedings and defendant in the arbitrations

versus:

Hulley Enterprises Limited, **Veteran Petroleum Limited** and **Yukos Universal Limited**, appellants, claimants in the arbitrations (hereinafter: "**HVY**")
counsel: M.A. Leijten and A.W.P. Marsman

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DISTINGUISHED MEMBERS OF THE COURT OF APPEAL,

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1. The manner in which the Tribunal has determined the damages results in three separate grounds for setting aside. Those include (i) failure to comply with the mandate, (ii) the lack of reasoning, or well-founded reasoning and (iii) violation of the principle of hearing both sides of the argument by rendering a surprise decision. This oral argument is focused on the surprise decision. The Russian Federation of course maintains all it has previously put forward regarding the setting aside of the damage decisions in the Yukos Awards.

2. Essentially, the criticism amounts to the following. The Tribunal (a) went its own way, (b) went outside the limits of the party debate and the provisions of the ECT, (c) constructed its own method of damage calculation, which (d) was internally inconsistent and which, moreover, was based on methods already rejected by the Tribunal, however (e) without having heard the parties about this in advance.

3. The Tribunal immediately makes it easy for this Court of Appeal, given that it recognises that **it used its own method, not put forward by the parties**. This also becomes clear from the references in paragraphs 1790, 1817 and 1823 of the Final Awards to "*the Tribunal's methodology*". This exceeds the discretion (of the court and arbitral tribunals) to assess and estimate loss, as provided for in, for instance, Article 6:97 DCC.

4. The Tribunal should not have decided the case on an issue never presented to or by the Parties. Rather the Tribunal surprised the Parties with this surprise decision. The Tribunal should have given the Parties the opportunity to express their views about its own damage calculation method, which method deviated from the method HVY had put forward and which had not been discussed between the Parties.[1]

5. The fact that the parties have held a debate on related subjects does not excuse the fact that it can be a surprise decision. What is essential is whether a subject has been dealt with in a particular context.[2] As is the case with the regular court, surprise decisions are not allowed in arbitration either.[3] The principles of hearing both sides of the argument and equality of arms is among the most fundamental principles of Dutch procedural law (Article 19 DCCP, Article 1036(2) DCCP and Article 6 ECHR).[4] The

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1 The Tribunal should also have given parties the possibility to express their opinion about the three risks that are mentioned in margin numbers 1804-1810 of the Final Awards (**Exhibit RF-2 = iPad-2.g**) to determine the hypothetical dividends. In that case a calculation error in the appraisal of the hypothetical equity value of Yukos in the amount of at least US$ 1.42 billion would have been avoided. See Summons, § 454; Reply, §§ 385-388; Report Prof. Dow (**Exhibit RF-85= iPad-2.g**), §§ 116 and Appendix B.2. In a comparable case involving a surprise decision in respect of the damage, an arbitral award was recently set aside by the *Cour d'appel* in Paris; see **Exhibits RF-211 and RF-213= iPad-21.b**. Similarily in Fraport v. Philippines, chaired by Yves Fortier, the ad hoc committee set aside the Tribunal's Award for violation of a fundamental rule of due process when the Tribunal failed to permit both parties to address the evidence. (Fraport AG Frankfurt Airport Services Worldwide v. The Republic of the Philippines, ICSID Case No. ARB/03/25, Decision on Annulment of 23 December 2019, paragraphs 200-227, providing that a party's right to present its case "includes the right . . . to make submissions on evidence presented by its opponent" and that failure to accord this right is a "serious departure from the fundamental rule of procedure entitling the parties to be heard," which subjects an award to annulment.)

2 Cf. Supreme Court 28 September 2018, ECLI:NL:HR:2018:497, where the Supreme Court set aside the fact that the court had rendered a conditional decision with regard to the termination of its own motion (without the employer having asked for it) and which therefore had not been debated in that context, due to a violation of Article 19 DCCP.

3 See Amsterdam Court of Appeal 6 December 2007, ECLI:NL:GHAMS:2007:BC4592, TvA 2009/20 and Amsterdam District Court 15 March 2006, ECLI:NL:RBAMS:2006:AV7057, in which the arbitrators had made a correction to the obligation to pay damages on account of their own fault, while the parties had not debated the matter and had not had a chance to express an opinion on it.

4 See among other things: ECtHR 22-01-2019, ECLI:CE:ECHR:2019:0122JUD006504813 (Rivera Vazquez and Calleja Delsordo/Switzerland). In that case, the ECtHR considers that the principle of hearing both sides of the argument and equality of arms are fundamental elements of the right to a fair trial, as stipulated in the Article 6(1) ECHR. The principle of hearing both sides of the argument requires that the court does not base its opinion on facts or rights which were not discussed during the proceedings and which lead to an outcome which neither party could reasonably have foreseen.

violation of these fundamental principles is serious and must lead to the setting aside of the arbitral awards.

6. HVY's assertions entailing that the Tribunal (i) has wide discretion to determine damages; (ii) to determine the extent of the damage if there are uncertainties and asset value that the Russian Federation has had much time to defend itself in the quantum phase, ignore the actual point in dispute - the unacceptability of a surprise decision - and are therefore irrelevant.[5] The Tribunal imposed a damages award of incredible magnitude using a methodology never suggested or addressed by either party.

7. HVY had claimed the following damage items: (i) the equity value of their share in Yukos (70.5%) on 21 November 2007 (the date of expropriation set by HVY), or at least the date of the judgment; (ii) dividends as from 30 September 2003 until 21 November 2007, or at least the date of the judgment; and (iii) interest.[6]

8. Article 13 ECT prescribes mandatorily that the reference date for the damage calculation is "*at the time immediately before the Expropriation*". The Tribunal determined that the date of expropriation was 19 December 2004.[7] This date had indeed not been advocated by the parties and thus no calculation for the equity value or missed dividends had been submitted by HVY for this date. The Tribunal assumed that it could choose between the value on the date of expropriation (i.e. 19 December 2004) and – in violation of article 13 ECT - the date of its award (established at 30 June

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Either party must be given a reasonable opportunity to present its case under circumstances that do not place it in a significantly less favourable position than the other party or parties.

5 SoD, § 162; SoD § II, 504.

6 Summons § 391.

7 Final Awards, margin numbers 1760-1762 (**Exhibit RF-2 = iPad-2.g**).

2014).[8] This date was mentioned by HVY, had a significant impact on valuation, but HVY had also never submitted a calculation for this date either.

9. Thus the Tribunal calculated the equity value on both dates that it considered were at its choice (19 December 2004 and 30 June 2014) itself. It did this with an arbitrary and inconsistent use of the calculations of HVY's expert (Mr Kaczmarek of the Navigant agency). Given that Kaczmarek had made the calculation for the date of 21 November 2007 as argued by HVY,[9] the Tribunal decided to calculate that value from 21 November 2007 back to 19 December 2004 and then forth to 30 June 2014. This exercise however had never been part of the Parties debate.

10. For this calculation the Tribunal used a standard that was not used by the Parties for this purpose either: the RTS Oil & Gas Index.[10] This is an index for Russian oil and gas companies, similar to the Dutch AEX-index.

11. The Tribunal wrongly tried to justify its choice for this RTS Index on the basis of mere ad hoc references and references made by parties to the RTS Index in different contexts.[11] The calculation of the equity value by HVY had been based on a totally different method; the RTS was not part of that.

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8 Final Awards, paras.1763-1769, footnote 2351 (**Exhibit RF-2 = iPad-2.g**). In an article previously written by Mr Valasek it has been argued, on the basis of the same sources, that the assessment of damages should take as a starting point the date of the award. **Exhibit RF-210= iPad-21.b**, p. 248 et seq. The Russian Federation contests this given the crystal clear text of Article 13 ECT. The Tribunal has violated its mandate. See a.o. DoA, § V,D,d.

9 Final Awards, margin number 1696 (**Exhibit RF-2 = iPad-2.g**).

10 Final Awards, margin number 1788 (**Exhibit RF-2 = iPad-2.g**); Summons, §§ 418-419; Reply, §§ 389-390. The RTS Index is extremely whimsical, because it depends on the price of oil. Had the judgment been delivered six months later, the amount would have been approximately US$ 3 billion less. See the graph in Reply, § 465.

11 See Final Awards, margin number 2383 for the references (**Exhibit RF-2 = iPad-2.g**). None of the references concerns a claim of parties on the RTS Index for the determining of the equity value of Yukos (as a whole) for the period 2004 – 2014. Summons, §§ 417-419; Reply, §§ 389-397.

12. Towards the end of the Arbitrations, HVY attempted to advocate a number of alternative calculations that would support their 2007 valuation. Then HVY determined the equity value of Yukos Oil in 2007 with reference to the RTS Index. However, the Tribunal did not allow these calculations in the debate , because they were submitted too late and the Russian Federation could no longer respond. [12] HVY's attempt to read this rejection by the Tribunal in such a way that the use of the RTS Index was not kept out of the debate by the Tribunal[13] must fail.[14] The Tribunal has refused all these documents, including the use of the RTS Index. It goes without saying that subsequently the Tribunal could not use that same RTS Index for its own calculations.

13. The Tribunal also had to calculate the missed dividend. For this purpose, the Tribunal used the so-called DCF model that had been used by HVY's expert Kaczmarek in the context of the valuation. However, the Tribunal had previously rejected that DCF-model because Kaczmarek had clearly calculated towards a predestined end result.

14. In its calculation based on that method Kaczmarek assumed the full distribution of the profit. So 100% of the profit was distributed as dividend in his model. However, the use of that DCF method for the missed dividend could not therefore coincide with the use of the RTS Index for the asset value calculation. In fact, the RTS Index was based on the assumption that the companies included therein only paid out 40% of their profits as dividends. The remaining 60% were reinvested in the company.

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12 Final Awards, margin number 1786 (**Exhibit RF-2 = iPad-2.g**): "*These figures were only introduced by [HVY] at a very late stage of the proceedings (…) and could therefore not be properly addressed by [the Russian Federation]" […] "Accordingly, the Tribunal finds that none of these secondary valuation models can serve as a suitable independent basis for determining the value of Yukos.*"

13 HVY's Submission dated 26 February 2019, § 537.

14 RF's Submission dated 25 June 2019, §§ 357-363.

This leads to a higher equity value at those companies than if they had paid out 100% of their profit as a dividend, based on Kaczmarek's DCF model.

15. So in the end HVY got the best of two worlds: (i) a high asset value compensation via the calculations of the RTS Index, although the specific companies paid out only 40% of their profit as a dividend[15] and added 60% to their equity value, and (ii) a high compensation for missed dividends given that it was based on the assumption that 100% of the profit would be paid out in dividends.

16. The Tribunal's own calculation standard is therefore a pure surprise decision. Briefly put, the Tribunal's own calculation standard fell outside of the party debate and was contrary to the most fundamental concept of due process: the right of the parties to present their case. There is also no (well-founded) reasoning, as to why a method explicitly rejected by the Tribunal because the Russian Federation could no longer respond thereto, could still be the "backbone" of the valuation.

17. Therefore, the Yukos Awards must be set aside pursuant to Article 1065(1)(c) and/or (d) and/or (e) DCCP.

The consequences are severe

18. Had the Tribunal reverted to the parties and allowed them to comment on that methodology it had developed autonomously, the Tribunal would not have made the following errors as is described in the expert report of Prof.

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15 **Exhibit RF-85 = iPad-2.g**, §§ 57-79; see also Appendix A.1 (Comparison of Dividend Yields) and A.2 (Total Cumulative Returns Since 21 November 2007 As Implied By The Tribunal Award).

Dow[16] and in the presentation of Ms Paisley, who independently provided commentaries on the Yukos Awards.[17]

19. The Tribunal's own calculation led to an exaggeration of the amount in hypothetically missed dividends, as HVY's own expert (Kaczmarek) also indicated:

> "As a practical matter, we recognize that not all of the free cash flows to equity generated by YukosSibneft would have been issued as dividends to the shareholders, and a portion of this free cash flow would have been invested in positive net present value (NPV) initiatives (…)."[18]

Indeed it is wrong and not realistic to assume a 100% distribution of the profits.

20. There is a so-called "inverse relationship" between equity value and dividend. One can spend a dollar of profit only once; either by distributing it as dividend or by investing it in the business as a result of which the value of the company increases. If that dollar is both spent and deemed to have remained in the company, there is actually a double count of that dollar.

21. On appeal and then in its "Submission" dated 26 February 2019, HVY put a lot of effort into refuting the "inverse relationship" and that double count. HVY has submitted a new expert report by Giles[19] in which it is argued in great detail that the experts of the Russian Federation, professor Dow and Hermes, agree with Giles that there was not really a double count. Apart from the fact that HVY deliberately misquotes Professor Dow, Giles

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16 **Exhibit RF-85= iPad-21.g**, §§ 57-79; see also Appendix A.1 (Comparison of Dividend Yields) and A.2 (Total Cumulative Returns Since 21 November 2007 As Implied By The Tribunal Award).

17 See **Exhibit RF-214= iPad-21.b**, slide 13.

18 First Kaczmarek Report, § 392, footnote 488 (**Exhibit RF-03.1.C-2.1**); Summons, § 422, 440; Reply, § 440.

19 Exhibit HVY-D13 = iPad-98.a, Second Expert Report of Giles dated 19 February 2019; HVY's Submission dated 19 February 2019, §§ 526-529 and 549-551.

confuses two aspects. He confuses revenue growth with equity value.[20] Revenue growth may occur while the equity value does not necessarily change. This has nothing to do with the simple statement that equity value reduces if dividend is distributed and increases if part of the dividend is kept in cash.

22. The Tribunal allowed this "automatic compensation" to be lost by developing its own standard containing ingredients not discussed with the Parties and which the Tribunal itself had already rejected.[21]

23. The consequence of the Tribunal's own calculation standard is a double count in the damages of more than US$ 20 billion, or 40.4% of the total damages awarded by the Tribunal! For the substantiation of this inconceivable US$ 20 billion mistake I refer to the expert report of Prof. Dow[22], the Summons[23] and the Reply. See for example the graph "Dividend Yields" in the Summons, § 445.[24]

24. In short, this highly detrimental inconsistency is a direct consequence of the inadmissible failure to allow the parties to express their views about the method developed by the Tribunal. This violation of fundamental due process on such a material issue all the more justifies the setting aside of the Yukos Awards due to failure to comply with the mandate and violation of public policy (Article 1065 (1)(e) DCCP).

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20 RF's Submission dated 25 June 2019, §§ 345-351 and 364-365.

21 RF's Submission dated 25 June 2019, §§ 352-356.

22 **Exhibit RF-85 = iPad-2.g**, §§ 71-79.

23 Summons, §§ 434-449; Reply §§ 398-406 , Annex I, §§ 30-76.

24 The fundamental error in the method used by the Tribunal also becomes clear from the fact that the damages that the Tribunal attributed to HVY (equity value and dividend) allegedly implies a return on their investments of 28% during the period 2007 – 2014 while an investor in the RTS Index had made a loss of 8% for the same period. See Summons, §§ 448-449, Reply, Annex I § 76, and Report of Prof. Dow (**Exhibit RF-85 = iPad-2.g**), §§ 57-79. See graph "Dividends", id., p. 27 and "Cumulative Returns" id., p. 29. See also **Exhibit RF-214 = iPad-21.b**, slide 13.