The Yukos Case: The New Dimension in Money Laundering Cases

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The Yukos Case: The New Dimension in Money Laundering Cases

Volume I [The Thesis]

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Statement.

The work contained herein is the candidate's own. Assistance received from the thesis supervisor, Professor Peter Alldridge as well as from anonymous reviewers is gratefully acknowledged. I am particularly grateful to Mr Khodorkovsky, without whom this dissertation would have never been written in principle. I am also grateful to the members of the Yukos community abroad, and Mr Khodorkovsky's and Mr Lebedev's lawyers, whose help has been absolutely invaluable with the data on the Yukos-related cases, including the data published on their web site regarding the Khodorkovsky Affair. I am also indebted to the Russian business newspapers Kommersant and Vedomosti, which published my articles and comments, and promoted me as an expert on the Yukos case. I also extend my gratitude to the journalists who, through their discussions, helped me to understand the Yukos Affair in even greater depth.

Dmitry Gololobov

Abstract.

The Yukos case is known for its unprecedented character and complexity as a Russian corporate, tax and money laundering case. It continues to raise political and legal problems, both domestically and internationally, and has already become a symbol of the contemporary Russian political regime. This dissertation analyses in detail the criminal and corporate aspects of the case, and focuses mainly on the reasons for, and the development and implications of the embezzlement and money laundering case, which is known as the backbone of the Yukos Affair.

The thesis is primarily based on a comparative analysis of the international academic findings, case law and the Russian data on the case. The dissertation also discusses in detail the political nature of the Yukos Affair, whilst attempting to show the substantive aspects of case.

The findings of the dissertation highlight new types of risk that result from the politically motivated application of Russian anti money laundering legislation to the activities of the international corporate groups, which has been enacted on the basis of the internationally recognised principles.

The paper also describes the nexus between the corporate tax evasion schemes, which have been widely used in Russia, and money laundering risks for corporations. Such a situation creates potentially unavoidable criminal risks for all corporate groups that have functioned in Russia over the recent decade. The thesis shows that the corporations, which invest directly and indirectly in the Russian economy, must be aware of the politically driven corporate criminal risks, which quite commonly are not reflected in the corporate disclosure data, and remain unnoticed by the investors.

The paper is unique as reflects the personal experiences of the author as the long–term leading lawyer to the Yukos group and as the consultant on the Yukos-related cases.

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List of Abbreviations.

ADR	American Depositary Receipts
AO	Akchionernoe Obshestvo (Joint Stock Company)
ASNK	Anglo-Sibirskaya Neftyanaya Kompaniya (Anglo Siberian Oil Company)
BP	British Petroleum
CB	Commercial Bank
CC RF	Criminal Code of the Russian Federation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CPC RF	Criminal Procedural Code of the Russian Federation
FA	Financial Act
ECHR	European Convention of Human Rights or European Court of Human Rights
EU	European Union
FIG	Financial-Industrial Group
FNPR	Federatchia Nezavisimych Profsouzov (Federation of Independent Trade-Unions)
FIU	Financial Intelligent Unit
FSB	Federal Security Bureau
GAAP	General Accepted Accounting Principles
GAAR	General Anti-Avoidance Rule
GDP	Gross Domestic Product

GML	Group Menatep Limited
GPO	General Prosecutors Office
IPO	Initial Public Offering
IMS	Initial Majority Shareholdings
JSC	Joint Stock Company
JSCCT	Joint Stock Company of the Closed Type
KGB	Komitet Gosudarstvennoi Bezopasnosti (Committee of State Security)
LFS	Loans-For-Shares
LLC	Limited Liability Company
MEBO	Management and Employees Buy Out
MP	Mass Privatisation
Mt	Metric Ton
NEWEX	New European Exchange
NIUIF	Nauchno- Issledovatelskii Institut Udobrenii i Insectofugitchidov (Professor Ya.V.Samoylov Research Institute of Fertilizers and Insecto-Fungicides)
NK	Neftynaya Kompaniya (Oil Company)
NGO	Non- Governmental Organisation
OAO	Otkritoe Akchoinernoe Obshestvo (Open Joint Stock Company)
CJSC	Closed Joint Stock Company
OECD	Organisation for Economic Co-operation and Development
OJSC	Open Joint Stock Company
PACE	Parliamentary Assembly of the Council of Europe

PwC	PriceWaterhouseCoopers
RF	The Russian Federation
RICO	Racketeer Influenced and Corrupt Organisations Act
RSFSR	Rossiiskaya Sovetskaya Federativnaya Sochialistitcheskaya Respublka (Russian Soviet Federal Socialist Republic)
SPE	Special Purpose Entity
SPV	Special Purpose Vehicle
TNK	Tyumen Oil Company
TRO	Temporary Restraining Order
TV	Television
VIOC	Vertically Integrated Oil Company
VNK	Vostochnaya-Neftynaya Kompaniya (Eastern Oil Company)
VSNK	Vostochno-Sibirskaya Neftyanaya Kompaniya (East Siberia Oil Company)
UK	United Kingdom
UN	United Nations
U.N. GAOR	United Nations General Assembly Official Record
U.S.	United States
U.S.D.	United States Dollar
USSR	Union of the Soviet Socialist Rebublics
ZATO	Zakritoe Administrativno- Territorialnoe Obrazovanie (Closed Administrative Area / Restricted Access Territory)
ZAO	Zakritoe Akchionernoe Obshestvo (Closed Joint Stock Company)

Main Legislative Acts and Acts of Judiciary of the Russian Federation, Cited in the Dissertation.

The title and other details of the act	The abbreviations, used in the thesis
Ugolovnyi Kodeks RF [UK] [Criminal Code of the Russian Federation] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1994 № 32 Item 3301	**CC RF**
Grazdanskii Kodeks RF (Tchast 1) [Civil Code of the Russian Federation (Part 1)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1994 № 32 Item 3301	**Civil Code**
Nalogovyi Kodeks RF (Tchast 1) [Tax Code of the Russian Federation (Part 1)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1998 № 31 Item 3824	**Tax Code**
Ugolovno-Protsessualnyi Kodeks RF [Criminal-Prosedural Code of the Russian Federation] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2001 № 52 Item 4921	**CPC RF**
Federal'nyi Zakon Rossiiskoi Federatsii ot 21 Marta 1991 № 943-1 'O nalogovikh organakh v RF' (s ism. i dop.) [The Law RF of 21 March 1991 № 943-1 'On Tax Authorities of the Russian Federation' (amended)] Vedomosti S"ezda Narodnykh Deputatov Rossiiskoi Federatsii I Verkhovnogo	**The Law on Tax Authorities**

Soveta Rossiiskoi Federatsii [Bulletin of the Congress of People's Deputies of the Russian Federation and Supreme Council of the Russian Federation] 1991 № 15 Item 492

Federal'nyi Zakon Rossiiskoi Federatsii ot 14 Iyulya 1992 № 3297-1 'O zakrytom administrativno-territirial'nom obrazovanii' (s ism. i dop.) [Federal Law RF of 14 July 1992 № 3297-1 'On Closed Administrative-Territorial Entities' (amended)] Vedomosti Sez''da Narodnykh Deputatov Rossiiskoi Federatsii i Verkhovnogo Soveta Rossiiskoi Federatsii [Bulletin of the Congress of People's Deputies of the Russian Federation and Supreme Council of the Russian Federation] 1992 № 33 Item 1915

ZATO Law

Federal'nyi Zakon Rossiiskoi Federatsii ot 13 Iyunya 1996 № 208-FZ "Ob aktsionernykh obscestvakh" (s ism. i dop.) [Federal Law RF of 13 June 1996 No 208-FZ "On Joint Stock Companies" (amended)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1996 № 1 Item 1

The Law on Joint Stock Companies

Federalyi Zakon Rossiiskoi Federatsii ot 7 Avgusta 2001 № 115-FZ 'O protivodeistvii legalizatsii (otmyvaniyu) dokhodov, poluchennykh prestupnym putem i protivodeistvii terrorizmu' (s ism. i dop.) [The Federal Law RF of 7 August 2001 № 115-FZ 'On countering the legislation on illegal earnings, money laundering and the financing of terrorism' (amended)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2001 № 33 Item 3418

Law on ML

Federal'nyi Zakon Rossiiskoi Federatsii ot 7 Avgusta 2001 № 121-FZ 'Ob izmenenii zakonodatel'nykh aktov RF v

The Amendments to CC RF

svyazi s prinyatiem Federal'nogo Zakona 'O protivodejstvii legalizatsii (otmyvaniyu) dokhodov, poluchennykh prestupnym putem i protivodejstvii terrorizmu' (s ism. i dop.) [Federal Law RF № 121-FZ of 7 August 2001 'On amending the legislative acts of the Russian Federation in connection with the enactment of the Federal Law on countering the legislation of earnings received in an illegal way (money laundering)' (amended)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2001 № 33 Item 3419

The Main Conditions

Osnovnye usloviya ispol'zovaniya magistralnykh nefteprovodov, nefteproducktoprovodov i terminalov v morskikh portakh dlya vyvoza nefti, nefteproduktov za predely tamozennoi territorii RF (s ism. i dop.) [The Main Conditions, regulating access to the oil-main pipelines and terminals in sea-ports for oil export operations (amended)] Odobrenny Postanovleniem Pravitelstva RF ot 31 Deakhabrya 1994 № 1466 [Approved by the Government Decree № 1466 of 31 December 1994] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1995 № 2 Item 162

The title and other details of the act of judiciary	The abbreviations, used in the thesis
Opredelenie Konstitutsionnogo Suda Rossiiskoi Federatsii ot 27 Maya 2003 No 9-P "O konstitutsionnosti statii 199 Ugolovnogo Kodeksa RF" [Resolution of the Constitutional Court of Russia of 27 May 2003 No 9-P "On the constitutionality of section 199 (tax evasion) of the Criminal Code of Russia"] Vestnik Konstitutsionnogo Suda Rossiiskoi Federatsii [VCS] [Bulletin of the Constitutional Court of Russian Federation] 2003 № 4	**Res of CC RF № 9-P**
Opredelenie Konstitutsionnogo Suda Rossiiskoi Federatsii ot 22 Yanvarya 2004 No 41-O [Resolution of the Constitutional Court of the Russian Federation of 22 January 2004 № 41-O] Ekonomika i Zizn [Economy and Life] 2004 № 20	**Res of CC RF № 41-O**
Opredelenie Konstitutsionnogo Suda Rossiiskoi Federatsii ot 14 Iyulya 2005 № 9-P "O konstitutsionnosti polozenii stat'i 113 Nalogovogo Kodeksa" [Resolution of the Constitutional Court of Russian Federation of 14 July 2005 № 9-P "On verification of constitutionality of the provisions of article 113 of the Tax Code of the Russian Federation] Sobranie Zakonodatel'stva RF [SZ RF] [Russian Federation Collection of Legislation] 2005 № 30 Item 3200	**Res of CC RF № 9-P (II)**
Opredelenie Konstitutsionnogo Suda Rossiiskoi Federatsii ot 16 Oktyabrya 2007 No 329-O "Ob otkaze v rassmotrenii zayavlenya o narushenii konstitutsionnykh prav i svobod stat'yei 176.4 Nalogovogo Kodeksa" [Resolution of the Constitutional Court of Russian Federation of 16 October 2007 No. 329-O "On the refusal to consider a complaint of Export Service LLC concerning the violation of constitutional	**Res of CC RF № 329-O**

rights and freedoms established by section 176.4 of the Tax Code"] <www.garant.ru > accessed 20 January 2008

Res of SC (USSR) № 4

Postanovlenie Plenuma Verkhovnogo Suda SSSR ot 4 Iyulya 1972 № 4 "O sudebnoi praktike po delam o khiscenii gosudarstvennogo i obshestvennogo imuscestva" [Resolution of Plenum the Supreme Court of the Union of the Soviet Socialist Republics of 11 July 1972 № 4 "On the court policy on the theft (embezzlement) of the statutory and public property"] Sbornik Postanovlenii Verkhovnogo Suda SSSR 1924-1977 (Chast 2) [Sbornik VS] [The Supreme Court of the USSR Reporter 1924-1977 (part 2)]

Res of SAC № 53

Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda ot 26 Oktyabrya 2006 № 53 "On otsenke arbiraznimi sudami obosnovannosti poluchenya nalogoplatelscikami nalogovoi vygody" [Resolution of the Plenum of the Supreme Arbitration Court of RF of 26 October 2006 № 53 "On assessment by arbitration courts of tax benefits validity"] Vestnik Vysshego Arbirazhnogo Suda RF [Vestn VAS] 2006 № 12

Res of SAC № 22

Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda ot 10 Aprelya 2008 № 22 "O nekotorykh voprosakh praktiki rassmotreniya sporov, svyazannykh s primeneniem stat'i 169 Grazdanskogo Kodeksa RF" [Resolution of the Plenum of the Supreme Arbitration Court of RF of 10 April 2008 № 22 "On some aspects of application of article 169 of the Civil Code of RF"] <arbitr.ru>accessed 23 May 2008

Res of SC № 23

Postaovlenie Plenuma Verkhovnogo Suda Rossiiskoi Federatsii ot 18 Noyabrya 2004 № 23 "O sudebnoi praktike po delam o nezakonnom predprinimatel'stve i legalizatsii

(otmyvanii) deneznikh sredstv ili inogo imuscestva, priobretennogo prestupnym putem" [The Resolution of the Plenum of the Supreme Court of the Russian Federation Plenary Session of 18 November 2004 № 23 "On the court policy on the illegal entrepreneurship and legalization cases"] Byulleten Verkhovnogo Suda Rossiiskoi Federatsii [BVS] [Bulletin of the Supreme Court of the Russian Federation] 2005 № 1

Postanovlenie Plenuma Verkhovnogo Suda Rossiiskoi Federatsii ot 28 Dekabrya 2006 № 64 "O praktike primeneniya sudami ugolovnogo zakonodatelstva ob otvetstvennosti za nalogovye prestupleniya" [The Resolution of the Plenum of the Supreme Court of the Russian Federation Plenary Session of 28 December 2006 № 64 "On the court policy on the application of the criminal law on the tax crimes"] Byulleten' Verkhovnogo Suda Rossiiskoi Federatsii [BVS] [Bulletin of the Supreme Court of the Russian Federation] 2007 № 3 **Res of SC № 64**

Postanovlenie Plenuma Verkhovnogo Suda Rossiiskoi Federatsii ot 27 Dekabrya 2007 № 51 "O sudebnoii praktike po delam o moshennichestve, prisvoenii i rastrate" [The Resolution of the Plenum of the Supreme Court of the Russian Federation Plenary Session of 27 December 2007 № 51 "On the court policy on fraud, misappropriation and embezzlement cases"] Byulleten' Verkhovnogo Suda Rossiiskoi Federatsii [BVS] [Bulletin of the Supreme Court of the Russian Federation] 2008 № 2 **Res of SC № 51**

Chapter 1.

Introduction.

1.1. Problem Statement and Importance of the Study.

The Russian transitional period (1991-2003) is known for its widely condemned privatisation deals and post-privatisation schemes, which led to the creation of the "oligarchy" clans.[1] Several powerful financial groups have subsequently formed the centres of potential financial and industrial growth in the contemporary Russian economic system.[2] These groups participated in the sharing of statutory prosperity, worth hundreds of billions, that was inherited from the collapsed Soviet Union.[3] Some of these groups successfully survived the stormy post-privatisation and the collapse caused by the 1998 financial crisis, followed by Yeltsin's resignation and Putin's "restoration", and emerged as contemporary business conglomerates, powerful enough to compete with the world's industrial majors.[4]

Regardless of the formal adherence of these companies to internationally required advanced accounting and governance standards, some powerful Russian financial groups

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[1] See eg H-H Schroder, 'El'tsin and the Oligarchs: The Role of Financial Groups in Russian Politic between 1993 and July 1998' (1999) 51 (6) Europe-Asia Stud 957-88; D Hoffman, *The Oligarchs: Wealth and Power in the New Russia* (Public Affairs, New York 2002).

[2] See eg S Guriev and A Rachinsky, 'The Role of Oligarchs in Russian Capitalism' (2005) 19 (1) J Econ Perspect 20; S Poukliakova, *Corporate Governance in a Transitions Economy: Business Groups in Russia* (PhD thesis, Simon Fraser University 2005).

[3] See eg W Tompson, 'Privatisation in Russia: Scope, Methods and Impact' (2003) <www.bbk.ac.uk/polsoc/staff/academic/bill-tompson/privatisation-in-russia1992-2002>accessed 1 March 2007; E Medova and L Tischenko, 'Lawless Privatization?' (2006) Judge Business School University of Cambridge Working Paper № 29 <http://www-cfap.jbs.cam.ac.uk/publications/files/WP%2029.pdf>accessed 23 June 2007.

[4] See eg Y Latynina, 'Goodbye Oligarchs, Hello Feudal Capitalism' (2004) 8 December The Moscow Times.com 10 <http://www.moscowtimes.ru/stories/2004/12/08/007.html>accessed 17 July 2007; L Harding, 'The Richer They Come ... Can Russia's Oligarchs Keep Their Billions - and Their Freedom?' (2007) 2 July Guardian <http://www.guardian.co.uk/print/0,,330117550-103680,00.html>accessed 17 August 2007; G Pitts, 'Deripaska on Top, as Oligarchs Collide' (2007) 31 July The Globe and Mail <http://www.theglobeandmail.com/servlet/story/LAC.20070731.ROLIGARCHS31/TPStory/Business>accessed 31 July 2007.

have encountered unexpected problems arising from the application of various questionable tax optimisation and financial schemes, which facilitated their rapid growth. Widespread application of such schemes was possible due to the willful blindness of an emerging market state, concerned only with swift economic growth.[5] As transitional states often do not have established democratic traditions or judicial systems, nothing prevents them from applying redistributive justice to companies and their questionable schemes.[6]

Emerging corporate groups from countries with transition economies penetrate international production and securities markets, fighting for positions of success and prosperity. A route to this expansion was a series of Russian IPOs in London, which has led to the internationalisation of the Russian risks related to the privatisation of the 1990s and its aftermath.[7] Although the obvious attractions of investing in Russia are difficult to ignore, the international business community is now significantly dependent on embedded risks, the nature of which it does not completely understand.[8]

The Yukos case should be regarded as a landmark case that shows the scope, complexity and dangers that the Russian risk poses to the international political and business community. The Yukos case is considered to be the biggest case of corporate fraud and money laundering in recent Russian history.[9] It raises a number of legal

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[5] See V Korchagina, 'Sibneft's Owners Nation's Worst-Kept Secret' *Mos Times* (Moscow 11 April 2000) 11; J Whalen and G Chazan, 'Russia Considers Probe into Oil Industry's Taxes – Official Accuses Companies of Evading Payments' *Asian Wall St J* (Hong Kong 31 July 2000) A24; M Mironov, 'Economics of Spacemen: Tax Evasion and Firm Performance. Evidence from Russian Banking Transaction Data' (2006) 30 June University of Chicago Working Papers 26 <http://home.uchicago.edu/~mmirono1/ research/spacemen.pdf> accessed 4 April 2007.

[6] See eg EA Posner and A Vermeule, 'Transitional Justice as Ordinary Justice' (2003-2004) 117 Harv L Rev 762-825; T Allen, 'Restitution and Transitional Justice in the European Court of Human Rights' (2006-2007) 13 Colum J Eur L 1-46.

[7] See eg A Ostrovsky, 'Russia's IPO Rush' (2005) <http://www.fcsm.ru/eng/document.asp?ob_no=18520>accessed 20 April 2007; M Ermakova, 'London and Moscow Exchanges to Cooperate on IPOs' (2006) 1 March Herald Tribune <http://www.iht.com/articles/2006/02/28/bloomberg/bxlse.php> accessed 25 April 2007.

[8] See eg C Hecker, 'Dispelling Russian IPO Myths' (2006) August Control Risks <http://www.schinnerer.com/risk_mgmt/kidnap_ransom/perspective_aug06.pdf>accessed 24 December 2007; J Mackintosh, 'FSA to Act on Foreign IPO Concerns' (2007) 5 April FT.com <http://www.ft.com /cms/s/0/21f053e0-e312-11db-a1c9-000b5df10621.html>accessed 23 June 2007.

[9] D Gololobov, 'The Yukos Money Laundering Case: A Never-Ending Story' (2007) 28 (4) Mich J Int'l L 711-64.

problems never previously addressed,[10] and is one of the most exceptional corporate and accounting cases in recent times.

A major Russian oil company, Yukos, was first privatised then acquired and headed by the Menatep Group. Yukos overcame post-privatisation problems by using the same questionable tax optimization and financial strategies employed by other oligarchy groups.[11] Those strategies were implicitly accepted as usual practice by the contemporary legal, bureaucratic bodies and by the business community. The Yeltsin Government, seeing no other way of dealing with threatening regional financial and social problems, gave its consent to these practices in the form of willful blindness towards Menatep and others.[12] However Yukos continued on a new trajectory. Having dealt with its tax debts and the social problems of its employees, Yukos decided to develop new corporate strategies as well as increasing production.[13] As a result, the Company became the first top ranking Russian oil-production company to have successfully applied international standards of accountability, transparency and disclosure. This boosted its capitalization and made it the leading company in the corporate governance sphere; The "Yukos phenomenon" had been created.[14] The Company became the undisputed leader of the Russian ADR's market and its depositary shares were traded on several international stock exchanges.

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[10] See eg E Shamseeva, 'Yukos's Affairs and the Yukos Case' (2003) <http://bd.english.fom.ru /report/map/shamseeva/ed032836>accessed 5 March 2007; A Goriaev and K Sonin, 'Prosecutors and Financial Markets: A Case Study of the Yukos Affair' (2004) New Economic School/CEFIR and CEPR Working Papers <www.departments.bucknell.edu/management/apfa/Stockholm%20Papers /Goriaev.pdf> accessed 15 October 2007; U Klaus, 'The Yukos Case under the Energy Charter Treaty and the Provisional Application of International Treaties' (2005) Policy Papers on Transnational Economic Law 8 <http://www2.jura.uni-halle.de/telc/policy_papers.html>accessed 17 March 2007.

[11] See eg Y Iji, 'Corporate Control and Governance Practices in Russia' (2003) University College London, School of Slavonic and East European Studies Working Paper No 33 1-37 <http://www.ssees.ac.uk/publications/working_papers/wp33.pdf>accessed 5 April 2007; K Korotov and others, 'Mikhail Khodorkovsky and Yukos. Man with a Ruble' (2003) INSEAD Cases for Learning <http://www.sovest.org/gb/Yukos_a_case_study.pdf>accessed 3 April 2007; M Chudnovsky, *Privatizing Russia: Case Study of Yukos Oil Company* (Europe: East and West Undergraduate Research Symposium 2004) <http://www.ucis.pitt.edu/ursymposium/2004/Publication%20FINAL.pdf>accessed 15 December 2006.

[12] See eg F Louvard, K Joffroy and L Rogleff, 'Privatisation in Russia' (1995) 23 Int'l Bus Law 260-67; S Hedlund, 'Property without Rights: Dimensions of Russian Privatisation' (2001) 53 (2) Europe-Asia Stud 213-37; Tompson, 'Privatisation in Russia: Scope, Methods and Impact'.

[13] See eg Yukos, 'Yukos Wins Four Good Corporate Governance Awards' (2001) <http://www.yukos.com/ vpo/news.asp?year=2001&month=12>accessed 10 April 2007.

[14]See MS Salter, 'OAO Yukos Oil Company' (2001) Harvard Business School Cases N9-901-021 <http://harvardbusinessonline.hbsp.harvard.edu>accessed 10 July 2001; L Aron, 'The Yukos Affair' (2003)

The combination of international corporate standards with Russian business practices and political ambition, led Khodorkovsky and Yukos into conflict with the powerful "Siloviki" group headed by President Putin. The "Siloviki" used state bureaucratic and judicial resources, to attack Yukos and its core shareholders.[15] The attack was successful, through its use of creative application of criminal law and the retrospective treatment of Yukos's tax and cash flow optimisation strategies. As a result of the vast tax claims, the main production unit was sold and the Company was declared bankrupt.[16] The core shareholders and managers left the country, and their attempts to start an international campaign against Putin's regime had limited success.[17]

The Yukos' case involves:

a) Some corporate cases: asset stripping, corporate fraud, and misappropriations of assets;

b) A large number of different tax avoidance cases, and;

c) Money laundering to the amount of $ 27 bn.

The corporate tax and money laundering story provides the basis of all the cases collectively called "the Yukos case". This case was based on the fact that Russian law does not recognise corporate groups and consolidated company schemes. As a result, the government was able to re-brand Yukos the legal Integrated Company into "Yukos the illegal Organised Group".[18] The Yukos case is of great significance for the wider business

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Fall American Enterprise Insitutes for Public Policy Research <www.aei.org>accessed 7 March 2007; ICFAL, 'Yukos: The Fall of a Russian Oil Giant' (2004) Economics Case Studies Collection 2 <http://icmr.icfai.org/casestudies/catalogue/Economics/ECOA114.htm>accessed 21 March 2007.

[15] See eg F Hill, 'Putin, Yukos and Russia' (2004) 1 December The Globalist <http://www.theglobalist.com/StoryId.aspx?StoryId=4276>accessed 12 July 2007; S Eizenstat, 'Putin Inc. / after the Yukos Affair' *Wall St J* (New York 14 July 2006) 2.

[16] See D Gololobov, 'Pyatiletka Yukosa: Tupikovoe Delo [The Yukos' Five-Year Plan: A Deadlock Case]' (2007) 26 July Vedomosti <http://www.vedomosti.ru/newspaper/article.shtml?2007/07/26/129922>accessed 26 July 2007; Gololobov, 'The Yukos Money Laundering Case'.

[17] See Russian Press Center, 'Exiled Russian Oligarchs: Battle for Moscow 2008' (2007) <http://www.russianpresscenter.com/report_may_2007.pdf>accessed 20 July 2007.

[18] See – 'Ugolovno-Pravovoi Analiz Deistvii, Sovershennykh Rukovoditelyami I Sobstvennikami Gruppy "Menatep-Rosprom-Yukos" v Protsesse Predprinimatel'skoi Deyatel'nosti [The Criminal Analysis of the Actions Committed by the Yukos Group]' (2003) <http://www.compromat.ru/main/hodorkovskiy/ugo.htm> accessed 20 July 2006; L Sigal, 'Organisovannaya Predprnimatel'skaya Gruppa [Organised Business Group]' (2005) 20 July Russkii Zhurnal [Russian Journal] <http://www.russ.ru/layout/set/print//politics/docs/organizovannaya_predprinimatel_skaya_gruppa>accessed 5 March 2006.

community: in emerging economies difficulty surrounds the recognition of the "corporate groups /consolidated company" concept. In addition emerging economy governments tend to use money laundering charges as an instrument to solve their economic problems. These combined factors may result in further, unexpected, Enron-sized, international money laundering scandals.

When examining the collapse of Yukos, scholarly attention should focus on the complex problems related to the concept of the modern corporate group, and issues of white-collar crime in the context of post-transitional justice.[19] The Yukos case highlights a number of interrelated domestic and international legal problems which need urgent solutions. Amongst them are:

- The problem of predicate offence in corporate groups' operational schemes;
- The nexus between money laundering and tax evasion in corporate groups;
- The involvement of auditors and other gatekeepers in money laundering schemes;
- The politically motivated enforcement of money laundering legislation;
- The application of the "Rule of Law" in Russia as a country with a transitional economy.

The solutions to these problems are sure to create precedents for similar criminal cases in the future.

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[19] See JAE Pottow, 'Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions To "Local Interests"' (2005-2006) 104 Mich L Rev 1899-950, 1899.

1.2. Research Questions.

The Yukos case demonstrated that corporate groups emerging from transition economies are subject to unexpected risks, even when they adhere to internationally recognised rules. The nature and limitations of these risks remain unclear to the international community.[20] The Yukos case has shown that advanced legal standards and rules can both help and hinder.[21]

Firstly, such standards and rules can hinder by playing the role of "false friend". They assure potential investors and creditors that companies that comply with advanced standards and rules are attractive options for investment, and are protected to a certain extent, from potential market disasters.[22] Thus, a compliant company is likely to become a favourite of the securities market and the risks will remain hidden, lurking as a potential danger for shareholders. Neither further improvement of the regulatory framework, nor additional pressure on gatekeepers will improve the situation significantly, since emerging corporate groups are always able to retain sophisticated consultants and auditors who prepare their papers in full compliance with even the most advanced regulations.[23]

The second hindrance lies in that advanced standards and rules are being applied in situations where uncertainty surrounds the concept of white-collar crime [24] and where there

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[20] See Goriaev and Sonin, 'Prosecutors and Financial Markets'; A Goriaev and K Sonin, 'Is Political Risk Company - Specific? The Market Side of the Yukos Affair' (2005) CEPR Discussion Papers № 5076 <http://www.cepr.org/pubs/dps/DP5076.asp>accessed 20 August 2005.

[21] See D Gololobov and J Tanega, 'Yukos Risk: The Double Edged Sword' (2007) 3 (2) NYU J L & Bus 557-648.

[22] See eg S Allen, E Satskov and J Henderson, *Yukos: Growth Prospects Outweigh Risks* (Company Profile 2001) 52 <http://www.russiaenergy.co.uk/assets/applets/Yukos_2001.pdf>accessed 20 May 2007; B Misamore, 'Goldman Sachs Global Energy Conference' (2003) <yukos.com/new_ir/pdf/Jan_2003.pdf> accessed 20 January 2006.

[23] See S Guriev, 'Enron, Yukos and the Gatekeepers' (2004) 2 December The Moscow Times.com <http://www.themoscowtimes.com/stories/2004/12/02/005.html>accessed 10 December 2005; D Schor, 'The Yukos Affair: Rectifying the Past or Polluting the Future?' (2006) <http://www.thebirchonline.org/schor.htm>accessed 14 February 2007.

[24] GS Moohr, 'An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime' (2003) 55 Fla L Rev 937-76, 959-60.

are general problems with criminal procedures and post-transitional redistributive justice.[25] This serves to create new opportunities for the government to apply certain legislative provisions to suppress political opponents or purely for economic reasons, such as re-privatisation or the re-distribution of property.[26] This may happen even when advanced standards and rules are adopted in formal compliance with the international framework. This was the case with Russian money laundering legislation.

In the situation when the first paradigm directly conflicts with the second, a question, critically important for the prevention of further money laundering scandals, is raised: *How could a big international corporate group, known for its adherence to transparency and advanced corporate governance principles, be involved in money laundering schemes?* Such scandals are ruinous for corporations and their investors and compromise relevant laws at the same time. The ongoing events with other Russian oil and gas companies confirm that this question needs a detailed and timely answer.[27]

Many commentators consider the events taking place in the Russian oil and gas industry since 2000 as politically driven. It has been suggested that this political drive aims to put large-scale industrial property into the hands of the pro-Putin "Silovarchs", thus creating a new international political regime in which Russia will play the role of the energy superpower master.[28] Yet the complex and controversial decisions taken by different judicial authorities during the legal campaign against Yukos-related individuals[29]

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[25] See eg The Wall Street Journal, 'Russian Justice' (2007) 7 February Wall St J 1; Washington Post, 'Potemkin Justice; Mr. Putin's Legal System at Work' *Wash Post* (Washington 8 February 2007) 1.

[26] See eg Hill, 'Putin, Yukos and Russia'; The Economist, 'After Yukos: The Far-Reaching Legacy of the Yukos Affair' (2007) 10 May Economist.com <http://www.economist.com/business/PrinterFriendly.cfm?story_id=9167397>accessed 10 May 2007.

[27] See L Harding, 'From Russia with $3 Billion. Another Putin Opponent May Have Fled to London' (2007) 30 August Guardian Unlimited <http://www.guardian.co.uk/russia/article/0,,2158599,00.html?gusrc=rss&feed=12>accessed 30 August 2007; I Reznik, 'Lichnoe Delo Gutsirieva [Gutseriyev's Personal Case]' (2007) 30 July Vedomosti <http://www.vedomosti.ru/newspaper/article.shtml?2007/07/30/130103>accessed 30 July 2007.

[28] See Eizenstat, 'Putin Inc. / after the Yukos Affair'; SL Myers and AE Kramer, 'From Ashes of Yukos, New Russian Oil Giant Emerges' (2007) 27 March NYtimes.com <http://www.nytimes.com/2007/ 03/27/ world/europe/27russia.html?ex=1179201600&en=6c8d95179683dbce&ei=5070>accessed 10 May 2007; The Economist, 'The Making of a Neo-KGB State' (2007) 23 August Economist.com <http://www.economist.com/world/displaystory.cfm?story_id=9682621>accessed 24 August 2007.

[29] See eg A Ostrovsky, 'Russia Accuses Former Yukos Chiefs of Asset Theft' *The Financial Times* (London 18 August 2006) 20; F Gibb, 'British Lawyer Accused over Collapse of Yukos' (2007) 24 April Timesonline <http://business.timesonline.co.uk/tol/business/law/article1695805.ece>accessed 10 May 2007.

and the ongoing professional debates[30] show that politicising the case does not provide a proper answer to the question: *What are the reasons that led to the scandal and collapse of the company, and what are the implications for corporate groups and the AML regime*? This research aims to identify the legal grounds of the Yukos embezzlement and money laundering case. It will be analysed within the context of the Yukos affair as a complex, multidimensional and politicised series of events that have had a significant impact on the Russian political and economic system and have created international precedents.[31]

1.3. Methodology.

1.3.1. Basic Principles Pertaining to the Subject of the Research.

1.3.1.1. The Political Aspect of the Research.

The Yukos case stems from the conflict between the oligarchy business traditions, advanced international corporate governance and accounting principles, and politically motivated persecution as an instrument of state policy.[32] Moreover the case, which is still ongoing, was launched and investigated in Russia: a country with a post-transitional economy, dominated by state giants, weak democratic traditions and a corrupt rule of law which has been macerated by extensive democratic rhetoric. The judicial system of Russia

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[30] See eg P Clateman, 'Legal Obeseravations on the Yukos Affair: Part V' (2005) 17 January Johnson's Russia List <http://www.cdi.org/russia/johnson/Yukos-auction.pdf>accessed 20 January 2006; W Kononczuk, *The "Yukos Affair", Its Motives and Implications* (Prace OSW / CES Studies 2006); Schor, 'The Yukos Affair: Rectifying the Past or Polluting the Future?'.

[31] See eg Aron, 'The Yukos Affair'; L Shevtsova, 'Implications of the Yukos Scandal for Russian Domestic Politics' (2003) <http://www.carnegieendowment.org/events/index.cfm?fa=eventDetail&id=643>accessed 15 March 2007.

[32] See Shamseeva, 'Yukos's Affairs and the Yukos Case'; M Delyagin, *The Yukos Case as a Mirror on the "Dictatorship of Squalor"* (2005) <www.khodorkovsky.info/docs/Delyagin_4_19_05.pdf->accessed 20 May 2007; V Volkov, 'Standard Oil and Yukos Cases' (2005) September - October Pro et Contra 66-91.

is recognized as being based on Stalinist-rooted principles and managed by the Kremlin.[33] It would therefore be misleading to assume that the application of international doctrines, concepts, theories and standards would produce the same effect in Russia as it does in Anglo-American jurisdictions or EU countries.

Any analysis of corporate groups in Russia, on the level of strategic major corporations, should take into account the political situation and relationship of business groups with the ruling regime. The same concept is applicable to criminal law, which is highly politicized. Its application in the sphere of white-collar crime is politically driven and criminal law is widely used as an apolitical instrument for the management of the economic system. For the purpose of this study the events will be analysed in the context of their political background.

1.3.1.2. The General Uncertainty Surrounding Issues of White-collar Crime and Justice in Transition and Post Transition Economies.

An assumption relevant to the Yukos affair in general, and the Yukos tax case in particular has been made by Geraldine Moohr in her article on the role of criminal law in the prevention of white-collar crime in the post-Enron era. She says on the nature of white-collar crime: "Compared to other forms of criminal activity, white-collar crime is famously written in shades of gray. In this realm, conduct that is immoral or harmful is not always criminal fraud, while conduct that is not obviously immoral or harmful may be criminal fraud."[34]Another writer supports Moohr's point by remarking: "One of the chief distinctions between white-collar crime and other crimes is that often neither the accused nor the prosecutor knows whether a criminal act has occurred, even after conduct has been identified."[35] Moohr also points out that laws are broadly written in nonspecific, general

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[33] See eg Russian Axis, *The Judicial System of the Russian Federation: A System-Crisis of Independence* (Russian Axis, London 2004); The Wall Street Journal, 'Russian Justice'.

[34] Moohr, 'An Enron Lesson' 959-60.

[35] PH Bucy, 'Corporate Ethos: A Standard for Imposing Corporate Criminal Liability' (1991) 75 Minn L Rev 1095-184, 1147.

terms in order to capture a broad range of conduct. The result is that such laws fail to provide notice that certain conduct is criminal.[36]

This assumption overlaps with Tom Allen's conclusion in his research on the problem of restitution and transitional justice, based on the recent decisions of the European Court of Human Rights. He writes: "The majority in the Grand Chamber maintained that taking without compensation was not unfair because the property owners should have "expected the unexpected" in the period immediately following the transition."[37]

He adds that although the Grand Chamber believed that the ordinary principles of justice to be relevant in the transitional context; the circumstances may be different.[38] So, according to Allen's conclusion corrective or distributive justice in the post-transition period is generally unpredictable.

Apart from the recognized strong political issues, the Yukos tax case has two dimensions of uncertainty:

(a) As being classified as white collar crime, and;

(b) As a case directly aimed at redistribution of the assets acquired through the period of privatisation and transition in Russia.

The lack of practice in commercial and tax fraud cases in Russia increases the level of legal uncertainty that crystallizes in the Yukos case.[39] As a result, some assumptions made in the present study will inevitably have a streak of uncertainty, predisposed by the nature of the case.

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[36] Moohr, 'An Enron Lesson' 960.

[37] Allen, 'Restitution and Transitional Justice in the European Court of Human Rights' 41.

[38] ibid.

[39] See eg S Crompton, 'How Risky Is Russia?' (2004) 2004 Int'l Fin L Rev 24-25.

1.3.1.3. The Influence of the Public Relations (PR) Strategies.

The case is subject to the influence of different partisan PR strategies, which are indirectly or directly supported by the state and statutory-owned business conglomerates or the core shareholders and former management of Yukos.[40] As a result the case is presented to the political and business community from diametrically opposed angles, which makes any independent assessment difficult.[41] The principle of multiple-aspect analysis has to be applied in order to avoid using biased data. For an acute analysis of each significant occurrence pertaining to the case, information from at least three different sources, representing different political views will be obtained.

1.3.1.4. Personal involvement in the researched case.

My personal involvement in the Yukos case has two dimensions: as one of the leading lawyers to the company and the head of the Yukos legal team in 2004, and as a person targeted by the Russian judiciary. Therefore the following issues may be raised: (i) the use of privileged or confidential data in the course of research and (ii) the utilization of biased data which may result in biased conclusions and distort the study.

1.3.1.3.1. Usage of the privileged or confidential data.

No privileged or confidential data has been ever used for my research, although I, as a former employee and service provider to the Yukos group had a legitimate access to it. Since 1995 I have had an acccess to the following types of data:

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[40] See www.khodorkovsky.info, www.robertamsterdam.com.

[41] See eg B Volkhonsky, S Farizova and A Ahundov, 'Yuri Chaika Wants Europe in Court' (2005) 3 November Kommersant Online <http://commersant.com/p623478/r_1/Yuri_Chaika_ Wants_Europe_ in_Court>accessed 7 September 2007; N Sergeev, 'Leonid Nevzlin Gets Polonium and Mercury' (2006) 28 December Kommersant Online <http://www.kommersant.com/p733651/r_527/ Nevzlin_Gets_Polonium> accessed 30 August 2007.

1.3.1.4.2. Data, obtained by me in the course of my employment.

Since 1995 and until 2002 I was employed by the various companies in the Rosprom/Yukos Group and signed usual undertakings which prohibited me in accordance with the Law of Commercial Secrets[42] to use any information, obtained in the course of my employment, for any other purposes except ones mentioned in my contracts. However, this undertaking in accordance with article 139 of the Civil Code could not, in any case, cover publicly available data and expired in three years after the termination of my employment. Moreover, the data received in the course of my employment has little relevance to the Yukos case as this case was launched in 2003.

1.3.1.4.3. Privileged data, obtained in a course of providing legal services to the Yukos Group.

Since 2002, when I obtained advocate status and joined an advocate settlement, I was retained by the holding company of the Yukos Group, and owed the company duties of confidentiality and care in accordance with the applicable Russian laws. Article 8 of the Law on Advocacy[43] provides that only information related to the legal assistance of a particular client can be classed as privileged. The Russian law on advocacy and the Code of Ethics[44] do not prohibit advocates from using publicly available data, including officially published acts of courts of law, and information obtained not in the course of providing legal assistance, for publications and commentaries.[45] My contracts with Yukos also did not provide for any requirements for preserving privileged information other than

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[42] See Federal'nyi Zakon Rossiiskoi Federatsii ot 26 Iyulya 2004 № 98-FZ 'O kommercheskoi taine' (s ism. i dop.) [The Federal Law RF of 26 July 2004 № 98-FZ 'On commercial secrets" (amended)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2004 № 32 Item 3283.

[43] See Federal'nyi Zakon Rossiiskoi Federatsii ot 31 Maya 2002 № 63-FZ 'Ob advokature I advokatskoii deyatelnosti v Rossiiskoi Federatsii' (s ism. i dop.) [The Federal Law RF of 31 May 2002 № 63-FZ 'On advocacy" (amended)] Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2002 № 23 Item 2102.

[44] See <http://www.fparf.ru/laws/normativ_akt_fpa/kodex_etika.htm>

[45] See eg commentaries at <http://www.bestlawyers.ru>

specified by the law. Therefore, Russian law and my previous relationships with the Yukos group do not prevent me from conducting research and publishing on the Yukos-related cases.

1.3.1.4.4. Owing any duty of confidentiality to the State.

In accordance with Art 161 of CCP, advocates, involved in criminal defence, may be obliged to sign a special undertaking, prohibiting them disclosure of the information, obtained in the course of investigation to anyone else. I has never directly been involved as a defence attorney in any criminal investigation, related to Yukos, I have not signed such an undertaking. Consequently I owe no duty of confidentiality to the State or any statutory organisation regarding the Yukos-related cases.

1.3.1.4.5. The problem of biased data and conclusions in the thesis.

My position as both the consultant and direct participant may give raise to some suspicions that the data, used in the research, and the conclusions can be biased.

There is an assumption that scientific research cannot rely on biased data, nor on collectors who participate in the area being studied, nor on those who have an interest in the outcome. This is to avoid biased results and a bias towards obtaining a desired conclusion. However, there is no basic tenet of scientific research that the methodology must be unbiased:

> No human being is even approximately free from these subjective influences; the honest and enlightened investigator devises the experiment so that his own prejudices cannot influence the result. Only the naive or dishonest claim that their own objectiveness is a sufficient safeguard.[46]

My position as one of the leading lawyers to Yukos provided me with exceptional experience and insight into problem. Moreover, any ethnically based research, including

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[46] See W E. Bright, *An Introduction to Scientific Research* (Dover, New York 1991) 41.

research on Russia predisposes a profound understanding of regional history, problems and realities. Considering the unique character of the Russian criminal judiciary and political cases, any researcher with significant legal experience should posess a certain degree of involvement. This involvement may be either in the activities of particular legal firms that provide assistance in such cases, or directly as an employee or a consultant to a organisation subject to investigation. A long track record of books and memoirs, published by prominent Russian lawyers, directly confirms this hypothesis.[47]

Also, one of the ways of dealing with biased data is utilization of multiple informants or collateral sources. Respectively, the methodological principle in this body of research is to employ multiple data sources to achieve convergent verification of the relevant hypotheses. For the better accomplishment of this goal most sources are either in English or with translations, available on-line. One of the reasons, which allows me to claim a certain degree of independence in my study is that my conclusions in the PhD thesis and my previous publications do not correspond either to the official position of the prosecution and courts, nor with the position of the defendants and their lawyers.

All these factors confirm that this thesis represents a comparatively independent research, not substantially distorted by biased data or conclusions.

1.3.2. Qualitative Method and Ethical Issues.

A descriptive single case study design is used for the research,[48] which aims to study a group of criminal and civil cases known as the Yukos case, with emphasis on the embezzlement and money laundering case.

Case study is a valuable method of research with distinctive characteristics that make it ideal for many types of investigations.[49] A frequent criticism of case study methodology

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[47] See eg S Ariya, *Mozaika [Mosaic]* (De-Yure, Moscow 2001)

[48] A Strauss and B Glaser, *The Discovery of Grounded Theory: Strategies for Qualitative Research* (Aldine, Chicago 1967); R Yin, *Case Study Research: Design and Methods* (2nd edn, Sage Publishing, Beverly Hills 1994); G Walsham, 'Interpretive Case Studies in Is Research: Nature and Method' (1995) 4 (2) Eur J of Information Systems 74-81; P Darke, G Shanks and M Broadbent, 'Successfully Completing Case Study Research: Combining Rigour, Relevance and Pragmatism' (1998) 8 Inform Syst J 273-89.

is that dependence on a single case renders it incapable of providing a generalizing conclusion.[50] Therefore the limitations of the single-case design have been taken into account and the author has conducted careful investigation to avoid misrepresentation and maximize the investigator's access to the evidence.

The research method will be qualitative, incuding personal observation, analysis of the reports, minutes and historical data.[51] Taking into consideration the author's personal involvement in the case and, to avoid using biased data, the publicly available opinions of independent Russian and international lawyers and consultants will be used.

1.3.3. Other Methodological Issues and Data Collection.

The application of the comparative method is determined by the nature and the aims of the research. The corporate governance, accounting, tax optimisation and anti-money laundering practice applied from 1999-2003, and the legal techniques used by the Russian authorities in the "Yukos case" will be compared with the international regulations, judicial practice and theoretical findings. Due to political sensitivity, the criminal character of the case, the peculiarities of the Russian judiciary, and the significant threat to the potential interviewees, no interviews for this thesis will be conducted.

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[49] W Tellis, 'Introduction to Case Study' (1997) 3 (2) The Qualitative Report <http://www.nova.edu/ssss/QR/QR3-2/tellis1.html>accessed 20 March 2006.

[50] See eg G Trasler, 'Strategic Problems in the Study of Criminal Behaviour' (1963-1964) 4 Brit J Criminology 422-42, 432; PG Schrag, 'Policy, Procedures, and People: Governmental Response to a Privately Initiated Nuclear Test Monitoring Project as a Case Study in National Security Decision-Making' (1988-1989) 21 NYU J Intl L & Pol 1-146, 131; WD Coleman and S Wayland, 'The Origins of Global Civil Society and Nonterritorial Governance: Some Empirical Reflections' (2006) 12 Global Governance 241-62, 257. See in general J Hamel, S Dufour and D Fortin, *Case Study Methods* (Sage Publications, Newbury Park, CA 1993); R Yin, *Applications of Case Study Research* (Sage Publishing, Beverly Hills, CA 1993).

[51] On the qualitative method see eg J Lofland and LH Lofland, *Analyzing Social Settings: A Guide to Qualitative Observations and Analysis* (2nd edn, Sage, London 1984); MQ Patton, *How to Use Qualitative Methods in Evaluation* (Sage, London 1987); AL Strauss, *Qualitative Methods for Social Sciences* (Cambridge John New York 1987); RA Morrow and DD Brown, *Critical Theory and Methodology* (Sage, London 1994).

The collection of secondary data will be primarily based on the researcher's personal library of more than three hundred titles on issues surrounding the research topic, the researcher's personal archives and Russian and international legal firms' working papers.[52]

1.4. Scope of the Study.

1.4.1. The Russian Transition Experience.

There are several limitations on the study based on the substance of the case. The dissertation deals with a number of problems with are rooted in Russian history, mostly from when the former Soviet Union collapsed and the country went through a period of transition from pseudo-socialism to state capitalism. It is recognized as a period of political, economic and legal uncertainty.[53] One of the distinctive features of the transition was the wholesale privatisation of former socialist property. Privatisation gave birth to new economic structures including financial-industrial groups, which determined the landscape of Russian politics and economics in the last decade of the twentieth century.[54] The Menatep Group, Bank Menatep and the Yukos Oil Company should be seen as structures emerging from this transitional period and as being inextricably linked to privatisation and its problems.[55] Russian privatisation, its history, stages and implications comprise an independent, highly politicized and thoroughly researched problem which will be

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[52] See eg SM Saunders, AJ Pappalardo and MP Logan, 'Analysis of the Criminal Charges against and the Trial of Mikhail B. Khodorkovsky and Platon Lebedev' (2005) 25 <khodorkovsky.ru/docs/2620__analysis.pdf>accessed 29 May 2006; R Amsterdam and D Peroff, 'White Paper on Abuse of State Authority in the Russian Federation - the New Politically Driven Charges against Michail Khodorkovsky' (2007) <http://www.robertamsterdam.com/Abuse%20of%20State%20Authority%20in%20the%20Russian%20Federation.pdf>accessed 7 February 2007.

[53] See eg Hedlund, 'Property without Rights: Dimensions of Russian Privatisation'; Medova and Tischenko, 'Lawless Privatization?'.

[54] See eg A Barnes, 'Russia's New Business Groups and State Power' (2003) 19 (2) Post-Soviet Aff 154–86; Guriev and Rachinsky, 'The Role of Oligarchs in Russian Capitalism'.

[55] See Iji, 'Corporate Control and Governance Practices in Russia'; Chudnovsky, *Privatizing Russia: Case Study of Yukos Oil Company*; A Latta, 'Khodorkovsky, Menatep, and Yukos' (2004) 11 April The Moscow News.com <http://www.mn.ru/english/issue.php?2004-11-2 >accessed 23 September 2007.

highlighted in this thesis only to provide a general understanding of the genesis of the Menatep-Rosprom-Yukos group.

1.4.2. The New Regime Paradigm.

The above approach will be used to research the emergence of Putin's regime, its relationship with the oligarchs, the rise of the Siloviki group, and the re-creation of Russia as a super-power state.[56] All these factors will be analysed only in the light of their direct effect on the Yukos affair. As the research does not aim to review the socio-legal aspects of the late transition and the rise of Putin; only the main characteristics and theories pertaining to relevant legal and political phenomenon will be provided.

1.4.3. The Yukos Affair Limitations.

The study attempts to provide a comprehensive and fair picture of the Yukos affair. It focuses on the embezzlement and money laundering case according to the aims of the study. Some minor cases, not significant for a comprehensive picture of the main case, may be ignored or referenced in a summarised form.[57] Some lengthy and highly politicized legal disputes that have not crystallized in any recognized precedents, will be highlighted in an abridged form or simply referenced to the relevant sources.[58]

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[56] See MA Smith, 'The Putinite System' (2003) Conflict Studies Research Centre Publications № E111 <http://www.csrc.ac.uk>accessed 20 April 2006; G Kasparov, 'Putin's Gangster State' (2007) 30 March Wall St J Online <http://online.wsj.com/article/SB117522235247454187.html?mod=rss_opinion_main>accessed 10 May 2007; D Treisman, 'Putin's Silovarchs' (2007) 51 (1) Orbis 141-53.

[57] See eg L Rychkova and M Lepina, 'The Prosecutor Doesn't Believe He's Innocent' (2005) 28 July Kommersant Online <http://commersant.com/page.asp?id=596770>accessed 20 July 2007.

[58] See eg *Bundesgerich [Bger] [Federal Court] 13 August 2007* <http://relevancybgerch/php/aza>accessed 20 September 2007.

1.4.4. The Russian Data Sources.

One of the key points of the research is the extensive use of Russian data, including relevant recent statutes and case law, never previously analysed and commented upon in international or Anglo-American academic sources.[59] Detailed observation of recent developments and trends in contemporary Russian law and legal research is out of the scope of this dissertation, therefore comments on the points which are unclear for a person untrained in Russian law will mostly be limited to references to the available international and Russian electronic sources. The general availability of the main Russian legal databases in English[60] will be considered. [61]

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[59] See eg *Postanovlenie Prezidiuma Vysshego Arbitrazhnogo Suda po zayavleniyu NK Yukos ot 4 Oktyabrya 2005 № 8665/04 [The Decision of the VAS RF on the case FTS v Yukos of 4 October 2005 № 8665/04]* Vestnik Vysshego Arbiraznogo Suda RF [Vestn VAS] 2005 № 2.

[60] See eg Law of Russia in English / System GARANT <http://www. garant.ru>.

[61] On the problem of legal translation see eg SMF Geeroms, 'Comarative Law and Legal Translation: Why the Terms Cassation, Revision and Appwal Should Not Be Translated' (2002) 50 Am J Comp L 201; B Pozzo (ed), *Ordinary Language and Legal Language* (Giuffrč, Milan 2005); MI Ahmad, 'Interpreting Communities: Lawyering across Language Difference' (2007) 54 UCLA L Rev 999-1076.

1.4.5. Personal Data Protection.

This research deals with criminal cases related to particular individuals, some of whom are officially recognized as political prisoners or political refugees.[62] Although, the general data on criminal cases is publicly assessable, the use of personal details pertaining to the individuals charged or sentenced in the Yukos case will be limited. The cases will be represented in a form sufficient for comprehensive interpretation of their substance.

1.4.6. The Continuous Nature of the Case.

One of the main characteristics of the case is its continuing nature. Several important legal proceedings that may have a significant impact on the case, are still ongoing or pending.[63] Therefore, although the dissertation aims to provide a vision of the subsequent events, these prognoses may turn out to be incorrect or misleading. Taking into consideration the politicized character of the case, some subsequent events may be regarded as critical for the content of the research. Thus at certain points several parts of the research may need significant reconsideration.

1.5. Thesis Outline.

The introduction will specify the problem statement. The subchapters will focus on the methodology and limitations of the study and are particularly important for this

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[62] See eg MosNews, 'Russian Court Jails Former Yukos Manager for 14 Years' (2005) 5 March Mosnews.com <http://www.mosnews.com/news/2005/12/01/yukosmanager.shtml>accessed 12 September 2007.

[63] See eg E Zapodinskaya, 'Khodorkovsky and Lebedev Turn to European Court' (2006) 22 March Kommersant Online <http://www.kommersant.com/p659616/Khodorkovsky_and_Lebedev_Turn_to_European...>accessed 20 March 2007; D Sidorov and G Sysoyev, 'Khodorkovsky Forecasts Progress and Verdict of Future Trial' (2007) 7 February Kommersant Online <http://www.kommersant.com/p-10056/Khodorkovsky_trial/>accessed 2 March 2007.

research, as it is based, in significant part, on actual court filings and data, which can be partly confidential or privileged. The chapter explains the restrictions regarding the use of the data. The introductory chapter also contains three other subsections: a section on the concept of international corporate groups and the concept of a consolidated company; an overview of the history of the Yukos Group in the context of the recent history of Russian corporate developments from 1990 until the present time; and a section on the problems related to application of the Rule of Law concept in Russia.

The **second chapter** describes the "The Yukos Case" and consists of two parts:

1. The "First Khodorkovsky Case", based on the allegations brought personally against Mikhail Khodorkovsky, the CEO and the core shareholder of the Company and his friend Platon Lebedev, and;

2. A number of cases against other individuals, shareholders, managers and employees of the Company.

This chapter does not discuss the core problem of the research, i.e. the allegations of embezzlement and money laundering brought against Yukos managers and employees. The key goal of this chapter is to explain the structure of the case and to define several basic terms used. The chapter also explains the correlation between "The Yukos Case", the "First Khodorkovsky Case", the Second Khodorkovsky Case, etc.

The **third chapter** also consists of two parts. The first part provides an analysis of the existing concepts of political motivation and its correlation with criminal law in general. The second part describes the problem of political persecution in the Yukos and Khodorkovsky cases. The chapter focuses on the position and arguements of the defenders of Yukos and Khodorkovsky, including PACE and the U.S. Senate, and represents the arguements of the opposition. It also explains the position of Amnesty International, which has refused to grant Khodorkovsky political prisoner status.

The **next chapter** is divided in three parts. The first part represents an overview of the structure of Yukos's operational schemes and tax minimization methods, in context of the general Russian tax optimisation strategies used in the 90s. The second part focuses on different aspects of the Yukos tax avoidance/evasion case, including its international aspect and the implications for contemporary judicial practice. It summarises the new doctrines

creatively applied by the Russian courts in the Yukos tax case. The **fourth chapter** deals with the international dimension of the tax optimisation problem, reviewing the main western and international doctrines of tax avoidance and tax evasion, with the purpose of further comparison with those applied in the Yukos tax case. The chapter contains an extensive conclusion, comparing the internationally recognized model of tax avoidance and tax evasion with models applied in the Yukos case.

The **fifth chapter** is focused on the embezzlement and money laundering case, resulting from the application of Yukos' tax optimisation strategies, cash flow\business operations and optimisation schemes. The Yukos money laundering case is also known as "The Second Khodorkovsky case", as the main charges have been brought against Mikhail Khodorkovsky personally as the CEO, core shareholder and as the actual controlling person of the Company and the Menatep Group. The purpose of this chapter is the description and analysis of the characteristics of the money laundering offence pertaining to the Yukos corporate group's business schemes, with emphasis on the elements of the offence that may be prevalent and therefore could represent a problem for all international corporate groups.

The first subchapter describes the framework of the money laundering case highlighting the actual role of the cash flow and tax optimisation schemes, the application of which led to the collapse of the Yukos Empire. A separate subchapter discusses the problem of transfer pricing as the form of embezzlement, and as a predicate offence in the Yukos money laundering case. One of the subchapters provides an overview of the history of Russian money laundering legislation and assesses its compliance with international treaties. The fourth subchapter analyses the structure of the charges in the Yukos tax evasion and money laundering case. This subchapter highlights the parallels between the money laundering charges and normal business operations of a consolidated business group. The next subchapter investigates the nexus between Yukos' tax optimisation schemes and money laundering.

The **conclusion to the dissertation** is a comprehensive analysis of the findings of all the chapters and summarises the answers to the research questions of the thesis.

1.6. The Concept of "Corporate Group" in the Dissertation.

The paradox of the Yukos case is connected to the problems stemming from the theory of so-called "corporate groups" or "multinational enterprises". The limitations of this study do not allow for comprehensive research on this theory but several remarks outlining the concept of a modern corporate group will be made.

1.6.1. Application of the U.S. Legislation in Respect of the Yukos Group.

Application of U.S. common law and statutes to the activities of the Yukos corporate group is justified not only because of cross-border application of the U.S. law in general and of securities laws in particular, but due to the special ties between Yukos Oil Company and the U.S. jurisdiction, based on the following reasons:

- The company launched a Level 1 ADR (American Depositary Receipt) programme, in March 2001.[64] Yukos was subject to several requirements of the U.S. securities laws and regulations.[65]

- The reports audited by PwC, issued by the Company pertain to the years 1997-2002. The Company prepared and published the annual and quarterly accounts in compliance with the U.S. GAAP.[66]

- In 2004 the company made an attempt to file for Chapter 11 with the U.S. bankruptcy court. Although the case was dismissed, the Court's findings confirmed Yukos' close relationship with the U.S. jurisdiction.[67]

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[64] F-6EF Registration of American Depository Receipt Shares Filing Number: 333-104052 03619238 <http://www.sec.gov>accessed 15 May 2007.

[65] See *Re Yukos Oil Company Securities Litigation* No 04 Civ 5243 (WHP) 2006 WL 800736 (SDNY 30 March 2006).

[66] See the reports available at: <http://www.yukos.com/New_IR/Financial_reports.asp>

- Approximately 24% of the common stock of Yukos is owned by entities, many of which are United States residents, which purchased their stock through public market sources.[68]

- Yukos U.S.A. Inc., a subsidiary of Yukos has been incorporated under the laws of Texas.[69]

- A number of the security class actions have been filed in the U.S. again several Yukos' managers and its core shareholders.[70]

These circumstances show that although Yukos Oil Company formally resided in Russia and its corporate and operational activity was primarily regulated by Russian laws, a significant part of the Yukos Group's corporate activities, including issues relating to the liability of its managers and auditors, are subject to the U.S. laws and the jurisdiction of the U.S. courts.[71] These circumstances have also influenced the findings of U.S. academics when reviewing theoretical concepts of corporate groups.

1.6.2. Introduction of Corporate Groups.

In the modern economy, a business of large or moderate size is typically conducted not by a single corporation but by a group of affiliated companies under the control of a

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[67] On the U.S. Yukos bankruptcy filing see MM Winkler, 'Arbitration without Privity and Russian Oil: The Yukos Case before the Houston Court' (2006) 27 (1) UPaJ Int'l EconL 115-53, 115-54.

[68] Misamore's Affid *Re Yukos Oil Company* 2005 WL 517959 (Bankr SD Tex 2005) 5.

[69] *Re Yukos Oil Company* 16.

[70] See eg *Re Yukos Oil Company Securities Litigation.*

[71] Eg *Riches v Khodorkovsky et al* (3:07-cv-05654-MJJ).

parent corporation.[72] Multinational enterprises are the most talked about business associations in the contemporary "globalizing" world.[73] Blumberg points out:

> In the modern world, parent corporations operate multinational groups of enormous dimensions through multi-tiered corporate structures of "incredible complexity" composed of dozens or hundreds of subsidiaries organised under the laws of scores of countries collectively conducting assigned segments of a single business under the "control" of the parent corporation. To the public and to economists, the multinational corporation is a single enterprise, "the firm".[74]

Commenting on the growth of multinationals, Muchlinski attributed their legal evolution to the possession of technological advantages and large firm size, whilst recognising the primacy of economic reasons.[75]

1.6.3. Multinational and Uni-national Groups.

Multinational companies, whilst sharing common features, differ from the uni-national enterprises.[76] Multinationals operate their assets, and use control, over borders, whilst domestic companies remain within their borders.[77] Muchlinski summarises the following features of multinational companies distinguishing them from domestic companies: they have the capacity to locate productive facilities across national borders, and thus can exploit local factor inputs. They also have the capacity to trade across frontiers in factor inputs between affiliates, to exploit their know-how in foreign markets

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[72] PI Blumberg, 'The Corporate Personality in American Law: A Summary Review' (1990) 38 Am J Comp L 49-69, 326; PI Blumberg, 'The Transformation of Modern Corporation Law: The Law of Corporate Groups' (2005) 37 (3) Conn L Rev 605-17, 605.

[73] P Muchlinski, *Multinational Enterprises and the Law* (2nd edn, Oxford University Press, New York 2007) 3.

[74] PI Blumberg, 'Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity' (2001) 24 Hastings Int'l & Comp L Rev 297-319, 303.

[75] Muchlinski, *Multinational Enterprises and the Law* 33-43.

[76] ibid 7.

[77] ibid.

without losing control over it, and to organise their managerial structure globally according to the most suitable mix of divisional lines of authority.[78]

The research on the genesis of the Yukos group shows that although the group represented a multinational company in substance by having some assets in different jurisdictions, the majority of its trading and production operations and its main profit–generating activities were located in Russia. This actually determined the framework of the Yukos case. Therefore this research will deal primarily with the concept of a corporate group, rather than the concept of a multinational company.

1.6.4. The Corporate Group Concept and Definition of a Group.

Western legal systems mainly focus on individuals, their rights and liabilities. To deal with this institutional weakness, traditional law in a growing number of areas is being supplemented by a doctrine of enterprise law that focuses on the business enterprise as a whole, not on its fragmented components.[79] According to Lutter, the main regulatory tasks of group law are very simple: first, to close the gap between reality and law by treating the economic unity as a legal unity (the group should then be regulated as a 'super-corporation', which should be vested with an independent legal personality). Secondly, the life of this new legal subject should be regulated by endowing it internally with its own regulatory organs whilst externally rearranging its relationships with third parties.[80]

In principle, company in a group is a separate legal entity with its own rights, liabilities and assets. There are several basic principles of the company's separate personality: (a) each company has a distinct legal personality, with separate rights and obligations, regardless of company's ownership;[81] (b) the shareholders of each company

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[78] ibid 8.

[79] Blumberg, 'The Transformation of Modern Corporation Law: The Law of Corporate Groups' 606.

[80] M Lutter, *The Law of Groups of Companies in Europe: A Challenge for Jurisprudence* (Kluwer, Deventer 1983) 11.

[81] Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Completing the Structure' (2000) Better Business Framework Paper № 00/1335 178 <http://www.berr.gov.uk/bbf/co-act-2006/clr-review/page25080.html>accessed 16 November 2006.

have limited liability, regardless of who they are;[82] (c) the creditors of each company have claims against that company only;[83] and, (d) the director of a company must act in its interests.[84] However, in a corporate group these features should be perceived through the prism of the group concept.

The two essential characteristics of corporate groups are recognised by the legislation of most countries with common law and civil law: (a) common or interlocking shareholdings[85] and (b) unified management or control.[86] A paradox at the heart of corporation law, according to Antunes, is that on one hand, it is conceived of and designed on the model of the corporation as an autonomous, closed and sovereign legal entity; but on the other hand, it has gradually admitted and legitimised a number of institutional devices of intercorporate control, likely to destroy such autonomy and sovereignty.[87] The key to group structure is the existence of a shareholder or shareholders who have the ability to control the general meetings of all the companies within the group.[88] The word "group" is generally applied to a number of companies associated by common or interlocking shareholdings, allied to unified control or capacity to control.[89] The definition of the "corporate group" may differ significantly depending on jurisdiction.[90] According to the OECD Guidelines multinational enterprises:

> Usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another.[91]

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[82] ibid.

[83] ibid.

[84] ibid.

[85] See eg Muchlinski, *Multinational Enterprises and the Law* 56.

[86] PI Blumberg, 'The American Law of Corporate Groups' in SP Joseph McCahery, Colin Scott (ed), *Corporate Control and Accountability* (Clarendon Press, Oxford 1992) 305-43, 332.

[87] EJ Antunes, *Liability of Corporate Groups: Anatomy and Control in Parent- Subsidiary Relationships in the U.S., German and the EU Law* (Kluwer Law and Taxation Publishers, Boston 1994) 122.

[88] Blumberg, 'The American Law of Corporate Groups' 305-43.

[89] *Walker v Wimborne* (1976) 137 CLR 1 529.

[90] See Antunes, *Liability of Corporate Groups*.

[91] OECD, *The OECD Guidelines for Multinational Enterprises* (OECD, Paris 2000) 17-18.

The U.S./UK and EU legislative and case law models of corporate groups differ in several material aspects, and the international treaties do not provide a sufficient regulatory framework to the problem.[92] Consequently, it is hardly possible to produce a universal, comprehensive model of a corporate group, which may be used to test different corporate foundations for their compliance with general characteristics of corporate groups.[93] Hadden remarked on this problem of corporate groups:

> Neither of the two simplest approaches to the legal status of corporate groups—the maintenance of the traditional view that each constituent company in the group must retain an entirely separate legal personality, and the recognition of the group as a legal entity in its own right which submerges that of its constituent companies—is likely to prove either workable or acceptable.[94]

However, the impossibility of creating of a universal model of a corporate group, does not exclude the option of listing its core elements of organisational and operational structure or the creation of an outline concept of a corporate group. According to Blumberg, the American law of corporate groups rests on a series of different statutory and common-law standards, which define its theoretical, regulatory and case law framework.[95] His findings, supplemented by the findings of Antunes, Muchlinski and others, enable us to create a list of the areas in which these "standards" determine the regulatory and the case law framework specific to corporate groups, thus distinguishing them from sole corporations. These areas, although regulated differently in different jurisdictions, bear certain similarities and they may be understood as "pillars" which form a rough conceptual model for a corporate group. Therefore any corporate group, either multinational or uni-national, should exist within the following conceptual framework:

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[92] See Antunes, *Liability of Corporate Groups* 283-87. See also J Hort (ed), *Groups of Companies in European Law* (Walter de Gruyter, Berlin 1982).

[93] See T Hadden, 'Regulating Corporate Groups: An International Perspective' in M Cahery (ed), *Corporate Control and Accountability* (Clarendon Press, Oxford 1992) 343.

[94] ibid.

[95] PI Blumberg, 'The American Law of Corporate Groups' in ibid 305-43, 309.

1.6.4.1. Unitary Business Doctrine: Management and Control.

The corporate group contains two central and somewhat contradictory features of modern corporation law: corporate autonomy and corporate control.[96] Thus a corporate group should be understood as a cluster of legally independent entities (affiliated corporations) that submit to common economic directions exercised by one of them (parent company).[97] Unified management is responsible for the existence of a unitary business policy for the whole corporate group.[98] Unified management policy undermines centralization of management decisions in a high-tier subsidiary (the head company). It covers corporate group planning, supervision of subsidiaries, consolidated accounting service.[99] Therefore, the essential characteristics of a corporate group pertaining to the concept of Autonomy and Control are: 1) economic unity of the group; 2) united management; 3) united economic doctrine and policy and 4) the conflicting situation between the united management/ economic doctrine and the fiduciary duties of the directors of the subsidiaries and the interests of their shareholders, in the case of not wholly owned groups.[100]

1.6.4.2. Corporate Groups' Structure: Centralization and Decentralization.

Centralisation and decentralisation are the 'two basic organisational principles' or the 'two general structures principles' of corporate groups.[101] Antunes points out that the efficiency and synergy advantages of poly-corporate structures over their single-corporations result from their more elaborate and legally supported blend of hierarchical

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[96] CD Wallace, *Legal Control of the Multinational Enterprise* (Martinus Nijhoff, The Haghe 1982) 20.

[97] ibid.

[98] Antunes, *Liability of Corporate Groups* 69.

[99] M Brook and HL Remmers, *The Strategy of Multinational Enterprise* (Pitman, London 1978) 57.

[100] See eg RP Austin, 'Problems for Directors within Corporate Groups' in M Gillooly (ed), *The Law Relating to Corporate Groups* (Federation Press, Sydney 1993) 133-59, 140-45.

[101] Antunes, *Liability of Corporate Groups* 163.

control and contextual autonomy.[102] The degree of parent control varies from *group to group,* and it is virtually impossible to generalise due to a variety of factors according to which the balance between autonomy/control can vary, and due to infinite group configurations.[103]

1.6.4.3. Group Operation, Taxation and Financial Reporting.

According to internationally recognised principles, a parent company must deal fairly with a partly owned subsidiary both in transactions between the parent and the subsidiary and in self-interested conduct by the parent not involving a transaction between the parent and the subsidiary.[104] This obligation conventionally crystallizes into the "arms' length principle. Different countries describe the arm's length principle with different language such as: (a) Revenues and expenses that are 'reasonable in the circumstances' (Canada), (b) Terms and conditions which deviate from those which unrelated third parties would have agreed upon (West Germany), (c) "...will adjust transaction to that which would have applied if the transaction had been between independent parties dealing at arm's length" (United Kingdom). However, this language demonstrates the presence of a similar approach.[105] The arm's length principle, as embodied in the model tax treaties, permits national tax authorities to adjust the accounts of enterprises under common control if they consider that 'conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises', in order to reallocate profit which would have accrued but for those conditions.[106]

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[102] ibid.

[103] H Stieglitz, *Top Management Organizations in Divisionalized Companies* (National Industrial Conference Board, New York 1965) 4.

[104] AM Eisenberg, 'Corporate Groups' in M Gillooly (ed), *The Law Relating to Corporate Groups* (Federation Press, Sydney 1993) 1-29, 19.

[105] RW Lawlor (ed), *Cross-Border Transactions between Related Companies* (Kluwer, Deventer 1985) 4.

[106] S Picciotto, 'Transfer Pricing and Corporate Regulation' in M Cahery (ed), *Corporate Control and Accountability* (Clarendon Press, Oxford 1992) 398.

It is recognised that the taxation of related companies within a single corporate group should take into account its overall unity. Within a single tax system, affiliated corporations could be required to file a consolidated tax return and prepare consolidated accounts.[107] The necessity for group accounts arises from the fact that the annual accounts of a single company that is a member of a group are less meaningful than the accounts of an independent company.[108] The importance of proper disclosure for corporate groups can be perceived from the OECD Principles of Corporate Governance and Disclosure Guidelines.[109] Statutory requirements in respect of the consolidation of group accounts are now almost universal, though the legislation was introduced much earlier in common-law than in civil-law jurisdictions.[110]

1.6.4.4. Statutes of General Application.

Judicial and administrative developments in the construction and application of statutes of general application to corporate groups make no specific reference to corporate groups or enterprise principles.[111] Blumberg commented on the statutes of general application:

> In the case of corporate groups, as distinct from corporations controlled by individuals, the question is under what circumstances the statutory obligations of a subsidiary (or parent) corporation may also apply to its parent (or subsidiary and affiliate corporations)? In other words when does a statute of general application receive an enterprise or "group" construction?[112]

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[107] ibid 394.

[108] W Muller, 'Group Accounts under the Proposed Seventh EEC Directive: A Practitioner's View: The English Experience' in J Hort (ed), *Groups of Companies in European Law* (Walter de Gruyter, Berlin 1982) 176.

[109] See Muchlinski, *Multinational Enterprises and the Law* 337-40.

[110] Hadden, 'Regulating Corporate Groups: An International Perspective' 362.

[111] PI Blumberg, 'The American Law of Corporate Groups' in SP Joseph McCahery, Colin Scott (ed), ibid (1992) 305-43, 309.

[112] PI Blumberg, *Problems of Parent and Subsidiary Corporations under Statutory Law Specifically Applying Enterprise Principles* (The Law of Corporate Groups Series, Little, Brown and Company, Boston 1992) 5.

In deciding whether a statutory provision is applicable in case of a particular corporate group, courts may use either statutory construction or "piercing the veil" jurisprudence.[113]

1.6.4.5. Statutes of Specific Application to Corporate Groups.

Legislative and administrative developments in the enactment of statutes and regulations adopt enterprise principles and apply them to corporate groups, sometimes for pervasive industry-wide regulation, but most frequently for selected purposes in statutes otherwise resting on entity law.[114] The Racketeer Influenced and Corrupt Organization Act (RICO), [115]the Foreign Corrupt Practices Act (FCPA)[116] and the Sherman Antitrust Act[117] are examples of such statutes.[118] Such statutes refer to a general class in the manner of other types of statutes, yet they also specifically refer to those who "control" or are "controlled by" or are "under common control" of a member of the class, and they may specifically refer to a parent, subsidiary or affiliated corporation.[119] In such statutes, uncertainty no longer exists.[120]

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[113] See PI Blumberg, *Blumberg on Corporate Groups* (Second edn, Panel Publishers 2005) 96.6-96.8.

[114] Blumberg, 'The American Law of Corporate Groups' 309.

[115] 18 USC §§ 1961-1968 (1976).

[116] 15 USC §§ 78dd-l and -2 (1988).

[117] 15 USC §§ 1, 2 (1988).

[118] See also Muchlinski, *Multinational Enterprises and the Law* 385-428, 73-575.

[119] Blumberg, *Blumberg on Corporate Groups* 96-4.

[120] ibid.

1.6.4.6. Bankruptcy and Protection of the Creditors.

Depending on the jurisdiction, the courts may exercise an approach based on universalism or territorialism in respect of bankruptcy of corporate groups.[121] "Territorialism" is based on traditional rules of private international law and advocates the rule of territorial jurisdiction.[122] "Universalism" refers to a system in which a single bankruptcy court controls the administration of the debtor's assets and makes the distributions to creditors worldwide.[123] Therefore, in some common law jurisdictions, the courts are able to consolidate the assets of the corporate group that faces bankruptcy and impose the relevant liability for the debts of the subsidiaries on the parent company.[124]

1.6.4.7. Liability of Corporate Groups. Piercing the Veil Jurisprudence.

The Entity Law Approach is the fundamental principle of liability in corporate groups. One member of a corporate group, namely the parent corporation, cannot be made liable for the debts or the acts of another group member, for the reason that they are distinct legal entities. Only in exceptional cases could a corporate entity of the corporation involved be disregarded. In Anglo-American jurisprudence, the direct liability of a parent company can arise both in contract and tort.[125] In tort, the parent corporation can be liable if it is shown that, by its acts or omissions, it was a joint tortfeasor with its subsidiary.[126]

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[121] See in general PB Stephan, 'The Futility of Unification and Harmonization in International Commercial Law' (1999) 39 VA J INT'L L 743-98; Pottow, 'Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions To "Local Interests"'.

[122] See on the concept eg LM LoPucki, 'Cooperation in Itnernational Bankruptcy: A Post-Universalist Approach' (1998-1999) 84 Cornell L Rev 696-762.

[123] See eg JL Westbrook, 'Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum' (1991) 65 Am Bankr LJ 457-90, 458; DT Trautman, 'Four Models for International Bankruptcy' (1993) 41 Am J Comp L 573-625, 579.

[124] See eg PI Blumberg, 'The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities' (1996) 28 Conn L Rev 295-346, 295-346.

[125] Muchlinski, *Multinational Enterprises and the Law* 309.

[126] ibid 301.

The U.S. doctrine of piercing the corporate veil offers a means of justifying group liability in circumstances where the subsidiary has insufficient assets to meet the claims against it, and where the case for compensation of the claimants is hard to resist on policy grounds.[127] The doctrine is characterized by bringing intra-group liability issues under a rule-exception approach.[128] In traditional piercing the veil jurisprudence, the existence of some fraudulent, inequitable or other fundamentally unfair conduct detrimental to creditors has been viewed as essential for application of the doctrine. Modern cases are departing from this requirement in an impressive number of decisions, expanding the capacity of the legal system to disregard the confining limitations of entity law in order to achieve the objectives of the law in this area.[129] The primacy of the 'piercing the corporate veil' jurisprudence in the treatment of intra-group liability in the U.S. legal system, did not prevent the emergence of competing doctrines. These doctrines also serve as an alternative basis for the imposition of liability on parent corporations, without any disregard for the corporate entity of the subsidiaries involved (commonly known as the 'functional equivalents' of piercing).[130]

The above review shows that regardless to the significant differences in both the theoretical understanding of the corporate group concept and the regulatory framework, there are several "loose" conceptual similarities, depending on jurisdiction, which enable a corporate group to be distinguished from other corporate foundations.

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[127] ibid 313-14.

[128] See eg JM Dobson, '"Lifiting the Veil" In Four Countries: The Law of Argentina, England, France and the United States' (1986) 35 Int'l & Comp LQ 839-63; KA Strasser, 'Piercing the Veil in Corporate Groups' (2005) 37 Conn L Rev 637-66.

[129] See PI Blumberg, 'The Corporate Entity in an Era of Multinational Corporation' (1990) 15 (2) DelJCorpL 283-374, 283-374.

[130] WM Fletcher, *Cyclopedia of the Law of Private Corporations* (Thompson West, Chicago 1981) para. 41; RC Clark, *Corporate Law* (A A Balkema, Rotterdam 1986) 35.

1.7. The Notion of the Rule of Law in the Dissertation: International and Domestic Aspects.

One of the most frequently cited terms in this dissertation is the notion of the rule of law. Any discussion of the rule of law in the successor states of the USSR, including Russia, presupposes an understanding of what is meant by "rule of law" in this context.[131]

1.7.1. Defining the Rule of Law.

Several preliminary remarks have to be made before discussing the problem of definition. First, the concept of the rule of law plays an important role in any developed judicial system. For example, American lawyers point out that respect for the rule of law is central to the U.S. political and rhetorical traditions, even to its sense of national identity.[132] Secondly, the rule of law is a relative concept and is best treated as an ideal. No country has ever fully realized the rule of law.[133] Thirdly, there is broad consensus in political science that the rule of law is as integral to an effectively functioning modern democratic system as electoral politics and a robust civil society.[134]

Broadly described, but by no means defined, the rule of law is the tenet that both citizens and government are subject to a set of accepted laws that are fairly and equally applied to all members of society. The rule of law is characterized and ensured by the separation of powers in government, by holding free elections, and by having an independent judiciary.

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[131] FJ Feldbrugge, 'The Rule of Law in the European CIS States' (2000) 26 Rev Cent & E Eur L 213-30, 214.

[132] See F Michelman, 'Law's Republic' (1987-1988) 97 Yale LJ 1493-537, 1499-503.

[133] K Hendley, 'Assessing the Rule of Law in Russia' (2006) 14 Cardozo J Int'l & Comp L 349.

[134] J Kahn, 'The Search for the Rule of Law in Russia' (2006) 37 Geo J Int'l L 353-97, 358.

The rule of law concept has been a fundamental notion in Western legal theory since the time of the French Revolution.[135] However the rule of law is "a notoriously contested concept" and its precise meaning is subject to debate.[136]

The British version of the rule of law, with an "unwritten constitution" and parliamentary sovereignty, is different from the U.S. form that has a strong tradition of judicial review. Both of these differ significantly from the German and French models.[137]

Although there may be disagreement over the importance or desirability of the rule of law as a virtue, there is a well-understood core understanding of its meaning. Zywicki points out that the fact that the rule of law has spawned so many detractors indicates that its meaning is well-understood among both enthusiasts and detractors.[138]

Nearly all scholars agree that the rule of law means the supremacy of law over government.[139] Reitz says that the core concept of the rule of law is that the exercise of all power, public or private, must be subject to limitation by law. To the extent that law limits the power of private parties, the rule of law is consonant with "law and order."[140] Carothers points out that the rule of law can be defined as a system in which the laws are public knowledge, are clear in meaning, and apply equally to everyone.[141] The rule of law, according to George Gins, is based on two systems, public and private law, the first granting the state limited rights, and the second protecting the rights of citizens.[142] Albert Dicey, the leading British constitutional theorist, states that no one, including the state,

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[135] J Quigley, 'The Soviet Union as a State under the Rule of Law: An Overview' (1990) 23 Cornell Int'l LJ 205-26, 205.

[136] See M Krygier, 'Marxism and the Rule of Law: Reflections after the Collapse of Communism' (1990) 15 Law & Soc Inquiry 633-64, 640.

[137] See JC Reitz, 'Export of the Rule of Law' (2003) 13 Transnat'l L & Contemp Probs 429-86, 435.

[138] TJ Zywicki, 'The Rule of Law, Freedom, and Prosperity' (2003) 10 Sup Ct Econ Rev 1-26, 3.

[139] See AV Dicey, *Introduction to the Study of the Law of the Constitution* (Adamant Media Corporation, London 2005) 187.

[140] Reitz, 'Export of the Rule of Law' 435.

[141] T Carothers, 'The Rule of Law Revival' (1998) 77 Foreign Aff 95-106, 96.

[142] G Gins, *Soviet Law and Soviet Society: Ethical Foundations of the Soviet Structure; Mechanism of the Planned Economy; Duties and Rights of Peasants and Workers; ... And the Soviet Pattern for a United World* (M. Nijhoff, The Haghe 1954) 10-11.

should stand above the law and that the rule of the people must be based on the rule of law.[143]

Based on the general principal concepts of the rule of law, academics suggest different definitions of this term, dividing it into several values.[144]

Zywicki points out that the core and traditional definition of the rule of law contains three basic values or concepts: (1) constitutionalism; (2) rule-based decision making; and (3) a commitment to neutral principles, such as federalism, separation of powers, and textualism.[145] Constitutionalism, according to Zywicki, comprises procedural and substantive limitations on the exercise of governmental authority.[146]

Hayek identified several characteristics of constitutionalism.[147] First, the rule of law requires that government action be "bound by rules fixed and announced beforehand."[148] Second, rules must be known and certain, so that individuals can conform their behavior to those laws.[149] Third, the rule of law requires equality in the sense that the law applies equally to all persons and does not prejudice some categories of people at the expense of others.[150]

The second essential characteristic of the rule of law, according to Zywicki, is the requirement of rule-based decision-making. [151] To quote a key U.S. Supreme Court judge, A. Scalia, this is the idea of "the rule of law as a law of rules."[152]

Zywicki's third characteristic is the "neutral principle" for judicial and constitutional decision-making.[153] Wechsler defined this principle as "one that rests on reasons with

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[143] DD Atchinson, 'Notes on Constitutionalism for a 21st-Century Russian President' (1998) 6 Cardozo J Int'l & Comp L 239-98, 304.

[144] See RHJ Fallon, '"The Rule of Law" As a Concept in Constitutional Discourse' (1997) 97 Colum L Rev 1-56, 4.

[145] Zywicki, 'The Rule of Law, Freedom, and Prosperity' 4.

[146] ibid.

[147] ibid 5.

[148] FA Hayek, *The Road to Serfdom* (U Chicago, Chicago 1944) 71.

[149] FA Hayek, *The Constitution of Liberty* (U Chicago, Chicago 1960) 208.

[150] ibid 209.

[151] Zywicki, 'The Rule of Law, Freedom, and Prosperity' 11.

[152] See A Scalia, 'The Rule of Law as a Law of Rules' (1989) 56 U Chi L Rev 1175 - 88.

respect to all the issues in the case, reasons that in their generality and their neutrality transcend any immediate result that is involved."[154]

Hendley also suggests breaking the concept down into three parts: (1) procedural regularity; (2) accessibility; and (3) efficacy. Procedural regularity in its institutional manifestation is judicial independence.[155] The second element of any rule of law definition is a legal system that is accessible. The hallmark of accessibility is transparency, in terms of an ability to find the law and an ability to observe and participate in the formulation of that law.[156] In respect of efficacy, Hendley points out that, "even a well-drafted law can lie dormant if it is overly ambitious. Thus, any assessment of the rule of law should be sensitive to the presence of laws that are literally impossible to obey."[157]

Kahn in his article on the rule of law in Russia also enumerates the three constituent parts of the concept. According to him, the first aspect of the rule of law is supremacy of law over government. This means that there can be no offence -- criminal, civil, political or administrative -- without law. [158] As Dicey expressed it, "no man is punishable or can be lawfully made to suffer in body or goods except for a distinct breach of law established in the ordinary legal manner before the ordinary courts of the land."[159] A second principle represents a universalization of the first principle: all law applies equally to all citizens. Political elites in the executive and the legislative branches do not enjoy the perogative to choose when the law applies, or to whom, a feature common to authoritarian regimes.[160] According to Kahn these two principles imply a third principle: the capacity for enforcement of this supremacy of law over government. Thus, the third principle of the rule of law requires the existence of an independent and politically neutral judiciary that is accessible to aggrieved individuals.[161]

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[153] Zywicki, 'The Rule of Law, Freedom, and Prosperity' 14.

[154] H Wechsler, 'Toward Neutral Principles of Constitutional Law' (1959) 73 Harv L Rev 1-35, 19.

[155] Hendley, 'Assessing the Rule of Law in Russia' 350.

[156] ibid.

[157] ibid 351.

[158] Kahn, 'The Search for the Rule of Law in Russia' 365.

[159] Dicey, *Introduction to the Study of the Law of the Constitution* 186.

[160] Kahn, 'The Search for the Rule of Law in Russia' 365.

[161] ibid 365-66.

Various scholars have tried to take basic concepts to identify elements essential to the rule of law.[162] Taking into consideration the limitations of the study the most known sets of elements are compared in Appendix 1.

Scholars have also identified limitations, concerning the definition of the rule of law concept. First, several of its conventional elements are vague, such as the requirement that the law should be "reasonably stable".[163] Second, no agreed standard exists for measuring the significance of departures from the rule of law's different elements. Nor is there agreement concerning what kinds of departures are the primary objects of concern.[164] Third, the extent to which a legal system approaches the rule of law ideal is itself a matter of degree.[165] It is unlikely that any legal system realizes all of the desiderata perfectly. Moreover, the defining elements of the rule of law can sometimes conflict.[166] Fourth, it seems impossible to specify the elements of the rule of law without reference to "the law." Among the most crucial questions is what this reference means, especially insofar as the rule of law implies that officials, including judges, must be ruled by law.[167]

The enumerations cited above suggest several important aspects of the rule of law upon which experts would agree: the independence of the judiciary, a limitation of the legislative (decree-making) power of the executive, a balance of power between the legislature and the executive, judicial review of administrative acts, etc. Other elements mentioned seem to have a less obvious relationship to the rule of law.[168] The essential elements of the concept will be used for the analysis of current situation with the rule of law in Russia.

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[162] JA Brauch, 'The Margin of Appreciation and the Jurisprudence of the European Court of Human Rights: Threat to the Rule of Law' (2004-2005) 11 Colum J Eur L 113-50, 123.

[163] Fallon, '"The Rule of Law" As a Concept in Constitutional Discourse' 9.

[164] ibid.

[165] J Raz, 'The Rule of Law and Its "Virtue"' in J Raz (ed), *The Authority of Law: Essays on Law and Morality* (Oxford University Press, New York 1979) 210-32, 228.

[166] G de Q Walker, *The Rule of Law: Foundation of Constitutional Democracy* (Melbourne University, Melbourne 1988) 42-44.

[167] FA Hayek, *The Political Ideal of the Rule of Law* (National Bank of Egypt, Cairo 1955) 33.

[168] See Feldbrugge, 'The Rule of Law in the European CIS States' 214.

1.7.2. Legal Certainty.

When analyzing the rule of law in contemporary Russian case law and politics, emphasis should be placed on legal certainty as an important principle of the rule of law.[169] The 'certainty of the law' focuses on the predictability of the application of formal law by the judge, the government and the administration, who are in turn bound by the law. The acts of parliament are presupposed to be rational, general and transparent. Their existence is supposed to guarantee personal freedom and certainty within a society.[170] There are several principles (sub-principles), through which legal certainty manifests itself as a legal principle: (1) the prohibition of retroactive legal effects, (2) the protection of legitimate expectations, (3) the protection of vested rights, (4) the accounting of time-limits, and (5) the requirement of comprehensible language.[171]

Legal certainty is conventionally understood as a guiding principle of the European legal system.[172] The ECHR integrates the principle of the certainty of law in the articles of the European Convention of Human Rights, especially in Article 7 and Clause 1 of the First Protocol (the right of property) and in the qualitative definition of the 'law', which is necessary to restrict human rights in accordance with the Treaty.[173] This principle has found numerous reflections in European case law.[174] For example, in one of the cases the ECHR pointed out the principle of legal certainty: "...requires that all law [must] be sufficiently precise to allow the person - if need be, with appropriate advice – to force to a degree that is reasonable in the circumstances, the consequences which a given action may entail."[175]

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[169] Z Bankowski, I White and U Hahn, *Informatics and the Foundations of Legal Reasoning* (Springer, Berlin 1995) 94.

[170] P Popelier, 'Legal Certainty and Principles of Proper Law Making' (2000) 2 Eur JL Reform 321-42, 326.

[171] Brauch, 'The Margin of Appreciation and the Jurisprudence of the European Court of Human Rights: Threat to the Rule of Law' 141.

[172] See JR Maxeiner, 'Legal Certainty: A European Alternative to American Legal Indeterminacy' (2006-2007) 41 Val U L Rev 517-90, 534.

[173] Popelier, 'Legal Certainty and Principles of Proper Law Making' 328.

[174] See J Raitio, *The Principle of Legal Certainty in EC Law* (Springer, Berlin 2003) 125-389.

[175] *Korchuganova v Russia* (App no 75039/01) (2006) ECHR <http://www.echr.coe.int>accessed 7 April 2007.

Legal certainty in the American sense can also be understood as "the prediction of the outcome of a lawsuit based on deduction from the content of a legal rule".[176]

1.7.3. The Rule of Law in Russia: the Recent History and Public Perception.

The Russian Federation is proclaimed to be "a democratic federative "rule of law" state in its fundamental law – the Constitution.[177] However, the genesis of the rule of law concept in Russia, which found its reflection in the concepts of "law-based state",[178] "dictatorship of law" and others, has its own distinct specifics. The key historical problem is that the rule of law in Russia has always been weak and remains so. Moreover, it does not show any signs that it is changing for the better.[179] Hendley, for example, pointed out: "By almost any definition, the "rule of law" [in Russia] has been mostly absent."[180] In a qualitative study of Russian legal culture, Kurkchiyan argues that "the negative myth of the rule of law is dominant" and that it is "self-perpetuating."[181]

One of most important conceptual aspects of the rule of law in Russia is proper definition and enforcement of property rights, broad access to those rights, and predictable rules for resolving property rights disputes.[182] The absence of the rule of law meant that, reportedly, even ownership rights were of dubious value.[183]

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[176] KN Llewellyn, P Gewirtz and M Ansaldi, 'The Case Law System in America' (1988) 88 Colum L Rev 989-1020, 1008.

[177] NT Vedernikov, 'Problems of Constitutional Jurisprudence and the Formulation of a Rule of Law State in Russia' (1993-1994) 38 St Louis U LJ 907-14, 907.

[178] See eg NJ Jamieson and A Trapeznik, 'A Legislative (Logico-Linguistic) Analysis of the Common Law Components of the Russian Constitution' (2006-2007) 16 Transnat'l L & Contemp Probs 431-90, 435-36.

[179] See Hendley, 'Assessing the Rule of Law in Russia' 351.

[180] ibid.

[181] M Kurkchiyan, 'The Illegitimacy of Law in Post-Soviet Societies' in DJ Galligan and M Kurkchiyan (eds), *Law and Informal Practices: The Post-Communist Experience* (Oxford University Press, Oxford 2003) 25-46, 30.

[182] K Hoff and JE Stiglitz, 'After the Big Bang? Obstacles to the Emergence of the Rule of Law in Post-Communist Societies' (2004) 94 (3) Am Econ Rev 753-63, 754.

[183] ibid 5.

A central reason for weakness of the rule of law is the weakness of the political demand for the rule of law and general understanding of the law as a tool in the hands of a state. [184] The general perception of the weakness of the rule of law in Russia finds its reflection in a Russia proverb, which reveals an understanding of the law as a tool: "zakon kak dyshlo -- kuda povernul, tuda i vyshlo: The law is like the shaft of a wagon; it goes wherever you turn it."[185] One respected American scholar urges that:

> ... [t]o build a state that abides by the rule of law, individual Russian judges, lawyers, and citizens must adopt a fundamentally new relationship with the law and make it a tool of defence that emanates from society rather than an instrument of control in the hands of the state.[186]

Nevertheless, nationwide surveys conducted in 1996, 1998, and 2000 to measure mass attitudes towards the rule of law revealed generally strong, albeit abstract, support for rule of law principles, at levels roughly comparable to those expressed by citizens in Western European countries.[187] But asked to apply those ideals to their own circumstances, a 2004 nationwide survey found that "[a]n overwhelming majority of Russians do not think that they live under a rule of law state."[188]

The story of the rule of law in Russia can be traced back to the time of the Peter the Great, but the limitations of the study only permit brief look at the most recent developments, which took place after the collapse of the former Soviet Union.

In the USSR the concept of the rule of law was viewed as reflecting the false legality found in Western states.[189] A 1956 Soviet legal dictionary defined *pravovoe gosudarstvo,* usually translated as "the law-based state",[190] as "...an unscientific concept depicting the

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[184] ibid 2-3.

[185] Or "One law for the rich, and another for the poor" See <http://en.wikiquote.org/wiki/Russian_proverbs>.

[186] M McFaul, *Russia's Unfinished Revolution: Political Change from Gorbachev to Putin* (Cornell University Press, New York 2002) 328.

[187] See JL Gibson, 'Russian Attitudes toward the Rule of Law: An Analysis of Survey Data' in DJ Galligan and M Kurkchiyan (eds), *Law and Informal Practices the Post-Communist Experience* (Oxford University Press, New York 2003) 77-93, 77-78, 88.

[188] R Rose, N Munro and W Mishler, 'Resigned Acceptance of an Incomplete Democracy: Russia's Political Equilibrium' (2004) 20 (3) Post-Soviet Aff 195-218, 200.

[189] Quigley, 'The Soviet Union as a State under the Rule of Law: An Overview' 206.

[190] DD Barry, 'Introduction' *Introduction in toward The "Rule of Law" In Russia? Political and Legal Reform in the Transition Period* (M.E. Sharpe, Armonk 1992) xiii.

bourgeois state as one in which there is supposedly no place for arbitrariness on the part of the executive authority and where, supposedly, the law and legality reign."[191]

Gorbachev was the first Soviet leader to make a systematic effort to change the role of the law.[192] He expressed the need to return to a *pravovoe gosudarstvo*.[193] In his speech at Stanford, Gorbachev said: "In its ideal development the state must act only according to the law and according to justice, and any act of the state authority must have a basis in law. That is how I see the essence of the rule of law."[194]

In this context, the then Director of the Institute of State and Law, and one of Gorbachev's frequent advisers, Vladimir Kudriavtsev, wrote in December 1986: "Of the two possible principles, 'You may do only what is permitted,' and 'You may do everything which is not forbidden,' priority should be given to the latter inasmuch as it unleashes the initiative and activism of people."[195]

As Archie Brown observed, Gorbachev "drew attention to the significance of moving to a state based upon the rule of law, pointing out that this meant that every person and all institutions must be subordinate to the law, including the Politburo."[196]

The Yeltsin era was a mélange of extraordinarily rapid statutory reform of Russia's civil, political, economic, and legal institutions and a painfully slow reform of attitudes and norms of behavior in each of those spheres.[197] Atchison points out that the term "legal nihilism" can be used to describe Yeltsin's approach to the rule of law as the President ignored the law to suit his personal political interests.[198] Figure 1 represents the

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[191] Quigley, 'The Soviet Union as a State under the Rule of Law: An Overview' 206, quoting PI Kudryavtsev (ed), *Yuridicheskii Slovar' [Legal Dictionary]* (Gosyurizdat, Moscow 1956) 196.

[192] Hendley, 'Assessing the Rule of Law in Russia' 352.

[193] In German the term *rechtsstaat,* meaning "legal state" or "law-based state," describes this principle; the Russian phrase *pravovoe gosudarstvo* is a literal translation. The English-speaking world uses the more cumbersome phrase "state under the rule of law." Quigley, 'The Soviet Union as a State under the Rule of Law: An Overview' 206.

[194] M Gorbachev, 'The Rule of Law' (1991-1992) 28 Stan J Int'l L 477-84, 481.

[195] V Kudryavtsev, 'Pravovaya Sistema: Puti Perestroiki [The Legal System: Ways of Reconstruction]' *Pravda [The Truth]* (Moscow 5 December 1986) 3.

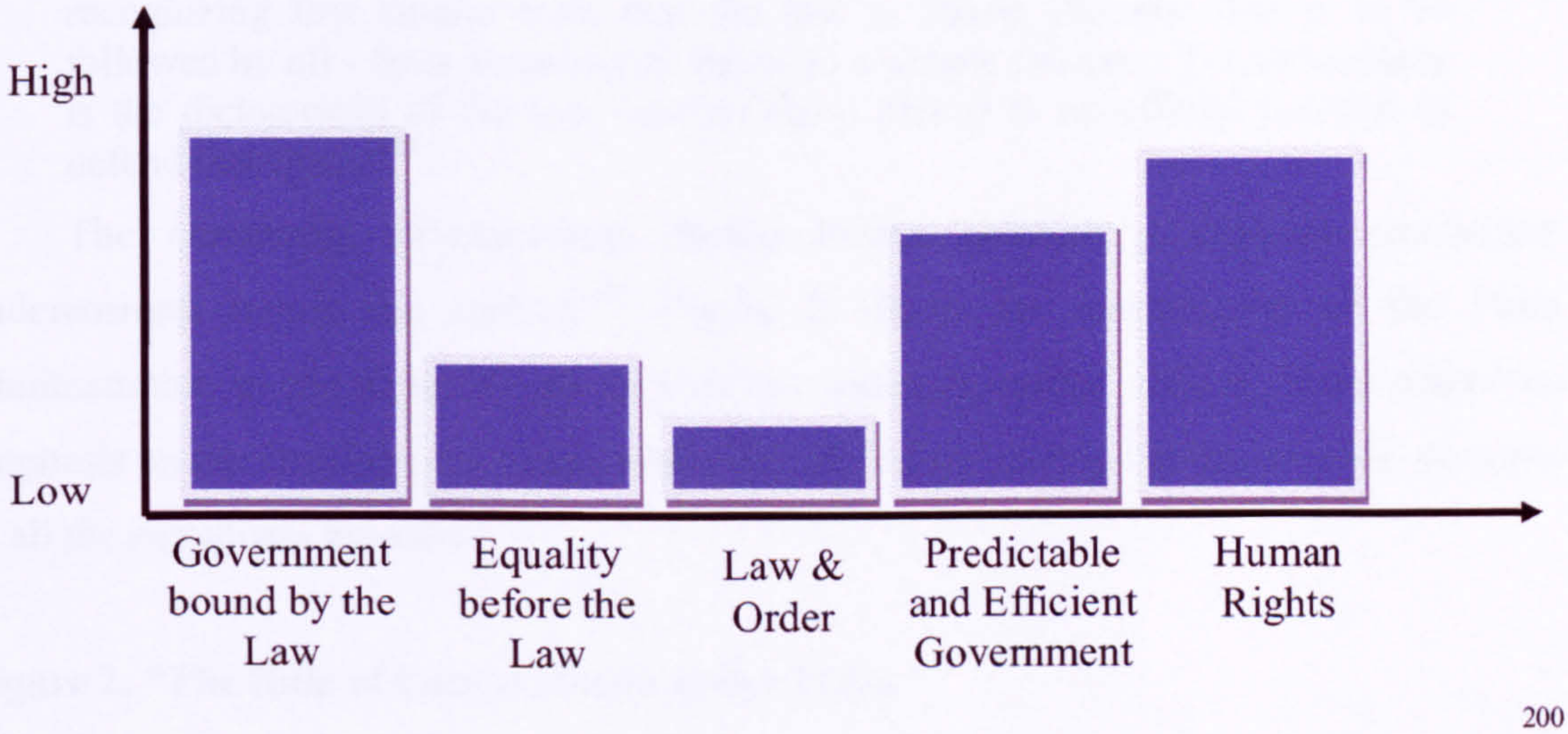
[196] A Brown, *The Gorbachev Factor* (Oxford University Press, New York 1996) 176.

[197] Kahn, 'The Search for the Rule of Law in Russia' 393-94.

[198] Atchinson, 'Notes on Constitutionalism for a 21st-Century Russian President' 304.

development of the Rule of Law in Russia during the Yeltsin administration. This laid the path for the problems ultimately faced by Putin.[199]

Figure 1. "The Rule of Law in Russia under Yeltsin."



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As his predecessors had done before him, the Prime Minister, then President, Vladimir Putin, announced his intention to end the disorder of the Yeltsin era and fight organised crime and corruption through a 'dictatorship of law'.[201] The presumption was that Russians, raised in the communist Soviet Union, would be willing to give up their civil rights in exchange for economic growth and stability in their daily lives.[202]

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[199] Kahn, 'The Search for the Rule of Law in Russia' 393-94.

[200] R Kleinfeld, 'Completing Defentioons of the Rule of Law' in T Carothers (ed), *Promoting the Rule of Law Abroad* (Carnegie Endowment for International Peace, Whasington 2006) 31-74, 62.

[201] AV Orlova, 'Organized Crime and the Rule of Law in the Russian Federation' (2006) 2 (1) EHRR 23-37, 28.

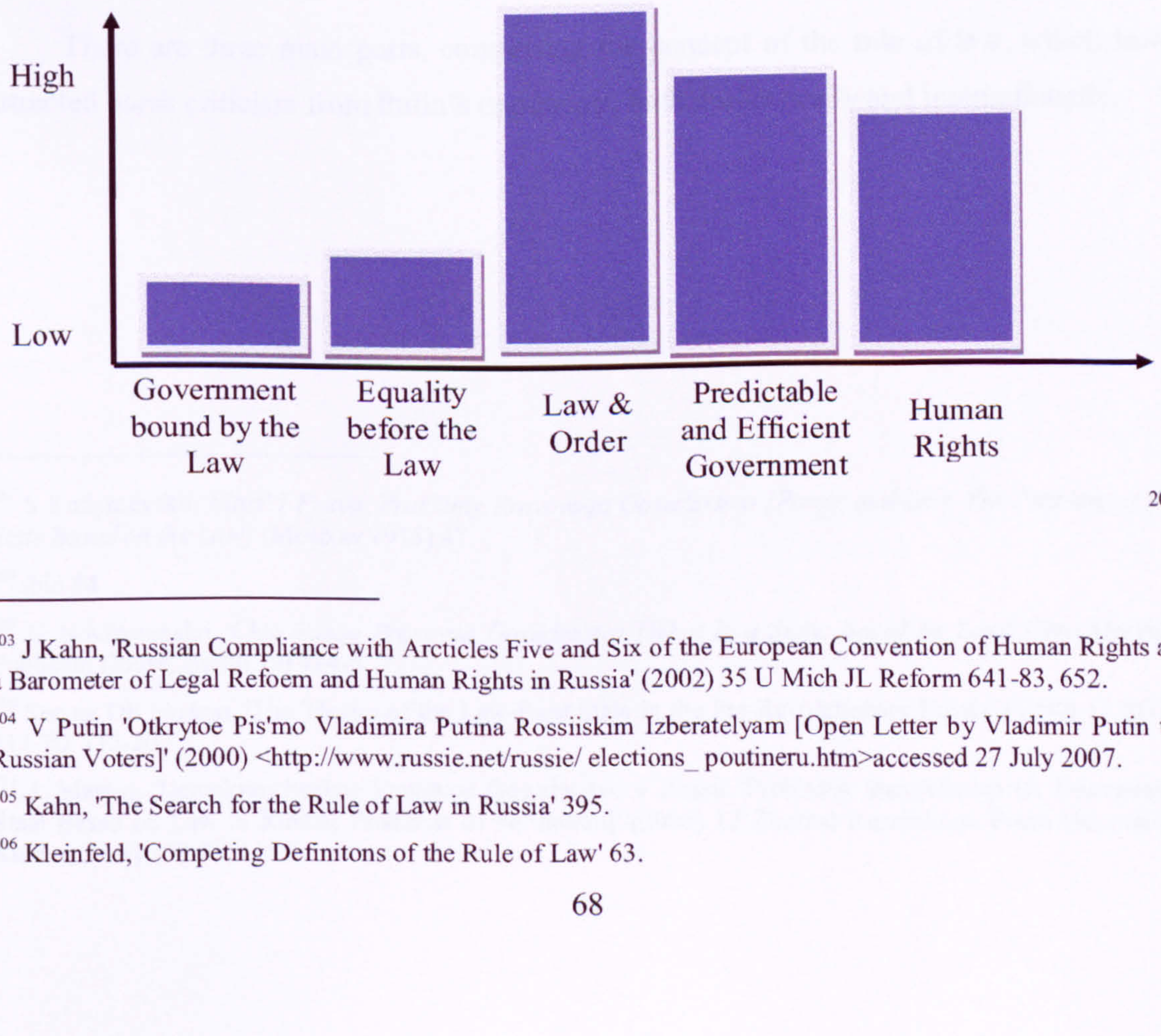
[202] ES Burger, 'The Price of Russia's "Dictatorship of Law"' (2006) 12 October Christ Sci Monit <http://www.csmonitor.com/2006/1012/p09s01-coop.html>accessed 15 November 2007.

Putin's speeches and writings on democracy and law were both encouraging and chilling.[203] His use of democratic concepts often left unclear in what manner he thought them best applied:

> In a non-law-governed, i.e. weak, state the individual is defenceless and not free. The stronger the state, the freer the individual. In a democracy, your and my rights are limited only by the same rights enjoyed by other people. It is on recognizing this simple truth that the law is based, the law that is to be followed by all - from an authority figure to a simple citizen… But democracy is the dictatorship of the law - not of those placed in an official position to defend that law....[204]

The continuing developments during Putin's presidency exposed reactionary undercurrents below the surface.[205] Figure 2 shows the contribution of the Putin administration to the Rule of Law in Russia, Although, unlike Yeltsin, Putin placed an emphasis on the development of law and order, he did not manage to improve the situation in all the significant aspects.

Figure 2. "The Rule of Law in Russia under Putin."



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[203] J Kahn, 'Russian Compliance with Arcticles Five and Six of the European Convention of Human Rights as a Barometer of Legal Refoem and Human Rights in Russia' (2002) 35 U Mich JL Reform 641-83, 652.

[204] V Putin 'Otkrytoe Pis'mo Vladimira Putina Rossiiskim Izberatelyam [Open Letter by Vladimir Putin to Russian Voters]' (2000) <http://www.russie.net/russie/ elections_ poutineru.htm>accessed 27 July 2007.

[205] Kahn, 'The Search for the Rule of Law in Russia' 395.

[206] Kleinfeld, 'Competing Definitons of the Rule of Law' 63.

The Russian version of "law-based state" concept, which includes the notion of "dictatorship of law", has much in common with the international perceptions of the rule of law. This term can be found in the Pre-Revolutionary writings of prominent Russian lawyers as an equivalent of the German term "*Rechtsstaat*".[207] Kotlarevsky said that the goal of the state based on law is to ensure public order and help to implement all possible human desires.[208] Another pre-Soviet Russian academic added: "The state in such countries [U.S., European countries] is called "based on the law" as the main laws of these countries recognize the supremacy of the people in establishing a form of governance in the state and general supremacy of the law.[209]

The modern perception of the "law-based state" concept does not differ in substance from its Pre–Revolutionary perception.[210] One prominent Russian theoretician, Leo Mamut, remarks: "The Russian democratic law-based state has two basic elements... One is common to all contemporary civilized states principles of formation and the functioning of the state... The most important of them are: equality ... fair elections...separation of powers...."[211]

There are three main parts, comprising the concept of the rule of law, which have attracted harsh criticism from Putin's opponents, both domestically and internationally.

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[207] S Kotlyarevskii, *Vlast' I Pravo. Problemy Pravovogo Gosudarstva [Power and Law. The Problem of the State Based on the Law]* (Moscow 1915) 47.

[208] ibid 54.

[209] G Novotorzhskii, *Chto Takoe Pravovoe Gosudarstvo [What Is a State, Based on Law]* (Otto Dervich Publishin House, Berlin 1914) 4-5.

[210] See eg OF Skakun, 'The Theory of the Law-Base State in the Pre-Revolutionary Russia' (1990) 12 SGIP 113-20, 113-20.

[211] L Mamut, 'Demokraticheskoe Pravovoe Gosudarstvo v Rossii: Problemy Stanovleniya [A Democratic State Based on Law in Russia: Problems of Formation]' (2006) 12 Zhurnal Rossiiskogo Prava [Journal of Russian Law] 108-16, 115.

1.7.3.1. Government, the Law and the Balance of Power.

Putin's initiatives were focused on strengthening "vertical power" and expanding the rights of the executive (presidential) branch.[212] These initiatives included the cancellation of governors' elections, significant modification of the election legislation and the actual formation of the Presidential Administration as the ultimate decision-making centre.[213]

So, nowadays Russia is in reality a "corporate state", managed exclusively by and in the interest of Putin's allies, a close group, which represents the Law as such.[214]

One of the key problems with the application and enforcement of Russian Law remains the lack of legal certainty,[215] which includes the problem of retrospective application. It pertains especially to the transitional period (1991-2003), when the majority of privatisation deals were conducted.[216] Quite a number of criminal cases that are deemed to be politically motivated stem from this uncertainty, which also surrounds tax legislation and case law. [217]

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[212] See PH Solomon, 'Vladimir Putin's Quest for a Strong State' (2005) 22.2 Int'l J on World Peace 3-8; L Aron, 'What Does Putin Want?' (2006) 29 November AEI 6 <http://www.aei.org/publication25204>accessed 10 March 2007.

[213] See eg G Kasparov, 'Don Putin' (2007) 26 July Wall St J <http://online.wsj.com/article /SB118541208507078414.html?mod=rss_opinion_main>accessed 26 July 2007; Treisman, 'Putin's Silovarchs'.

[214] See A Illarionov, *The Siloviki Regime in Russia* (CATO Institute & Institute of Economic Analysis Papers 2007) <www.iea.ru/article/siloviki_model/10_11_2007.ppt>accessed 15 November 2007; Kasparov, 'Don Putin'.

[215] See eg PH Rubin, 'Growing a Legal System in the Post-Communist Economies' (1994) 27 Cornell Int'l L J 1-48, 27-33; O Mikhailova, 'Doing Business in Russia' (2001) 29 Int'l Bus Law 211-15, 211.

[216] See eg Allen, 'Restitution and Transitional Justice in the European Court of Human Rights'.

[217] See G Kisunko, 'Economic Crime in Russia' (2001) <http://www.worldbank.org/ html/prddr/trans/j&a96/art7.htm>accessed 30 November 2007; Y Latynina, 'Billion-Dollar Principles' (2007) 1 August The Moscow Times.com <http://www.themoscowtimes.com/stories/2007/08/01/007.html> accessed 1 August 2007.

1.7.3.2. Human Rights and Equality before the Law.

The current situation with human rights in Russia remains a key area of strident criticism from the international community.[218] The main concerns are the continuous harassment of NGOs[219] and the freedom of the press, as all core media companies are under control of the state or the state-controlled giants.[220] On this issue the U.S. Department of State commented:

> The law provides for freedom of speech and of the press; however, government pressure on the media persisted, resulting in numerous infringements of these rights... The government used its controlling ownership interest in all national television and radio stations, as well as the majority of influential regional ones, to restrict access to information about issues deemed sensitive.[221]

The Country Report on Human Rights Practices 2006, issued by the U.S. Department of State[222] enumerates several other significant human rights problems, such as: alleged government involvement in politically motivated abductions, disappearances, and unlawful killing in Chechnya and elsewhere in the North Caucasus; hazing in the armed forces resulting in several deaths; and harassment. There have also been some cases of the abduction of individuals who have appealed to the European Court of Human Rights (ECHR). Allegedly the abductions were aimed to convince the appellant to drop their cases which told of; torture, violence, and other brutal or humiliating treatment; harsh and frequently life-threatening prison conditions; corruption in law enforcement; arbitrary arrest and detention, etc. Despite all this, Putin continues to present himself as a believer in democracy and human rights – and it appears that most of the international community

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[218] See eg Amnesty International, *Amnesty International Report 2007, Russian Federation* (2007) 6 <http://thereport.amnesty.org/eng/Regions/Europe-and-Central-Asia/Russian-Federation>accessed 20 December 2007.

[219] See MP Maxwell, 'NGOs in Russia: Is the Recent Russian NGO Legislation the End of Civil Society in Russia' (2006-2007) 15 Tul J Int'l & Comp L 235-64.

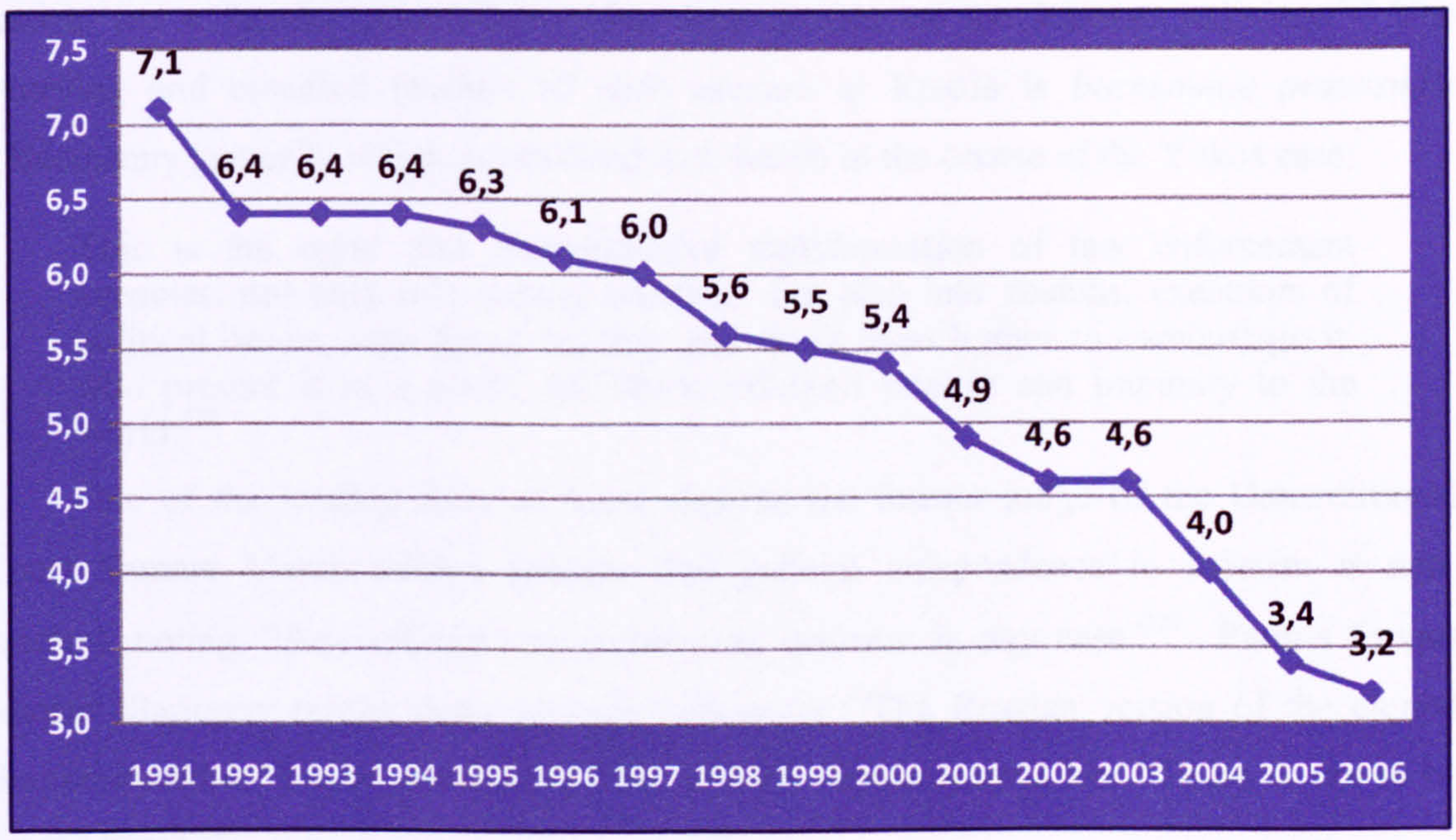
[220] See eg BF Lowenkron, 'Human Rights, Civil Society, and Democratic Governance in Russia: Current Situation and Prospects for the Future' (2006) <http://www.state.gov/g/drl/rls/rm/2006/68669.htm>accessed 15 March 2006.

[221] U.S. Department of State, 'Country Reports on Human Rights Practices' (2006) <www.thepersecution.org /ussd/us2006.html>accessed 10 March 2006.

[222] ibid.

believe him.[223] Figure 3 below demonstrates a steady decline in the Civil Liberties and Political Rights Index in Russia since the collapse of the USSR in 1991 to the beginning of the Yukos case in 2003. Following the Yukos case, the index plummets.

Figure 3. "Civil Liberties and Political Rights Index (CLPRI) in Russia, 1991-2006."



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1.7.3.3. Independent Judiciary.

The most crucial point in the development of the rule of law in Russia is the corruption of the independent judiciary and its transformation into an instrument of the political authorities, namely the Presidential Administration.[225]

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[223] Human Rights Watch, *Human Rights Watch World Report 2005: The Events of 2004* (Human Rights Watch, New York 2005) 406.

[224] Illarionov, *The Siloviki Regime in Russia* 89.

[225] See FreedomHouse, *Russia:Khodorkovsky Sentencing Illuminates Erosion of Rule of Law* (2005) 404-07 <http://www.freedomhouse.org/template.cfm?page=70&release=276>accessed 20 March 2007; Orlova, 'Organized Crime and the Rule of Law in the Russian Federation' 28-31.

However, it should be noted that a number of commentators stress Putin's positive achievements in this area. For example, Hendley, defending Putin, points out that: "Over the past two decades, Russia's legal system has undergone a profound set of institutional reforms. Judged on those terms, it has surely moved closer to the ideal of the "rule of law."[226] Kahn adds: "Putin has increased the salaries of judges and law enforcement personnel, and he has called for more funding for the courts."[227] Nevertheless, other sources show that these positive results, mainly concerning the organisational side of justice, are a façade, camouflaging the deep erosion of the Russian judiciary.[228] The worrying and essential product of such erosion in Russia is *basmannoe pravosudie* ("Basmanny justice"), which crystallized as a notion in the course of the Yukos case:

> This is the rapid and demonstrative transformation of law enforcement agencies: not only into simply obedient, but also into zealous, executors of political orders, who break the law and don't even bother to camouflage it, who present it as a merit, and show off their muscle and impunity to the world.[229]

One of the leading Russian legal experts, the former judge of the Constitutional Court Tamara Morshchakova stresses that judicial independence in Russian is non-existent, noting, "Any official can dictate any decision in any case"[230] Putin's former adviser Illarionov makes even stronger comments: "The Russian version of the eternal Hamlet question "To be or not to be?" in today's Russia sounds like "To be or not to be behind bars?"[231]

A report on the independence of the Russian judiciary, prepared by a number of experts, summarises the current situation in the judiciary by pointing out that a partial restoration of the Soviet system, under which the judicial power depends on the political

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[226] Hendley, 'Assessing the Rule of Law in Russia' 370.

[227] Kahn, 'The Search for the Rule of Law in Russia' 396.

[228] See eg SL Myers, 'Russia and the Rule of Law: Poisoning Case Underscores Europe's Doubts' (2007) 27 May International Herald Tribune <http://www.iht.com/articles/2007/05/27/news/russia.php#end_main> accessed 28 October 2007.

[229] M McAuley, A Ledeneva and H Barnes, *Dictatorship or Reform? The Rule of Law in Russia* (Foreign Policy Centre, London 2006) 24.

[230] PK Baev, 'Putin Upholds Non Exsistent Rule of Law in Russia' (2007) 4 (10) Eurasia Daily Monit <http://www.jamestown.org/edm/article.php?article_id=2371804>accessed 14 October 2007.

[231] Illarionov, *The Siloviki Regime in Russia* 3.

administration and the "prosecution conveyor belt", is taking place and President Putin's team and the Kremlin will most likely continue to suppress the judicial system.[232]

It should be noted that the successful formation of the neo-KGB (FSB) state and the erosion of democratic freedoms and rule of law in Russia wouldn't have been possible without the willful blindness and conciliatory position of Western leaders.[233] Figure 4 describes the ways in which Western leaders have encouraged the anti-democratic regime in Russia.

Figure 4. "The West's Approval of the Siloviki Model."

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Based on the conclusions of the reports by various international organisations, the existing rule of law rankings[235] consistantly give Russia low marks and demonstrate an inclination for its further downgrading.[236]

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[232] Russian Axis, *The Judicial System of the Russian Federation*. See Appendix 2.

[233] See eg A Gill, 'Betraying Human Rights in Russia' (2007) 11 June HRW.org <http://hrw.org/ english/ docs/2007/06/11/russia16149.htm>accessed 20 November 2007.

[234] Illarionov, *The Siloviki Regime in Russia* 127.

Summarising the issues of the rule of law both in Russia, in general, and in the Yukos case in particular, Lavelle remarked: 'The largest casualty of the Yukos case has been Putin's "Dictatorship of Law".[237] In fact it has become a missed opportunity to enforce that principle.'[238]

A brief review of the international perception of the rule of law, and the genesis of similar concepts in Russia shows that they have much in common. Thus in this study, the concept of the rule of law will be used as understood in its application to Russia as explained in this part of the dissertation. Discussion will cover core values as: government, law and the balance of power, human rights and equality before the law, and the independence of the judiciary.

1.8. The Yukos Story: the Historical Context.[239]

With its complex mixture of political, social, economic and legal factors, the Yukos case can be considered only within the socio-economic context of the last two decades of Russian history, from the command Soviet system to a free market economy.[240]

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[235] See eg Swivel, 'Rule of Law Percentile Rank' (2007) <http://www.swivel.com/data_columns/show/4218261>accessed 20 November 2007; The World Bank, 'Governance Matters 2007: Worldwide Governance Indicators 1996-2006' (2007) <http://info.worldbank.org/governance/wgi2007/mc_countries.asp>accessed 20 November 2007.

[236] See Appendix 3.

[237] Putin, 'Open Letter by Vladimir Putin to Russian Voters'.

[238] P Lavelle, 'Experts on the Yukos Affair and Impact' (2005) 27 May Weekly Analysis & Commentary <http://www.untimely-thoughts.com/index.html?art=1691&action=printer>accessed 29 May 2005.

[239] For the detailed review see Appendix 4.

[240] See eg VB Supyan, 'Privatization in Russia: Phases and Effects' in MD Hancock and J Logue (eds), *Transitions to Capitalism and Democracy in Russia and Central Europe: Achievements, Problems, Prospects* (CT: Praeger Publishers, Westport 2000) 11-28.

1.8.1. Perestroika, Financial-Industrial Groups, Privatisation and the Menatep Bank.

The general reform of the Soviet financial sector that occurred during Gorbachev's governance resulted in the emergence of a new financial institution known as the 'commercial bank', which played a critical role in the formation of the new Russian economy. Several of these institutions later became the centres of the large business conglomerates[241]: These conglomerates were the Financial-Industrial Groups which aggressively participated in the privatisation of the of the former Soviet Union economy.[242]

The business conglomerate known as the Menatep Group went through the same development. Its founder, Mikhail Khodorkovsky used cash from his small co-operative firm to found the Menatep Bank.[243] In August 1988, the co-operative, established by him with his friends, was reorganised into the Interbank Organisation for Scientific Technical Progress. Later, in 1990 the Commercial Innovative Bank was rechartered as Menatep, a joint stock company, and Khodorkovsky became chairman of the board of directors.[244] In 1997 Menatep was ranked 10th amongst the largest Russian banks.[245] In the mid 1990s the bank was at the heart of the Khodorkovsky's empire, but after the rise of Yukos, Menatep began playing a subordinate role, as its income could not be compared with Yukos's oil revenues. In 1998 Menatep, like many other Russian banks, was hit by Russia's biggest financial crisis.[246] As a result the bank was liquidated, but the Menatep Group and Yukos organised a complex buy-out scheme that helped them to accumulate the bulk of bank's

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[241] D Lane, 'The Evolution of Post-Communist Banking' in D Lane (ed), *Russian Banking: Evolution, Problems and Prospects* (Edward Elgar Publishing, Cheltenham 2002) 9-35, 14.

[242] SM Cox, 'The Politics of Russia's Financial-Industrial Groups' (2000) 1 (1) Doğuş University Journal 28-42, 30.

[243] H Fraser, 'Russia's Oligarchs: Their Risky Routes to Riches' (2004) 27 July BBC World Service business reporter <http://news.bbc.co.uk/2/hi/business/3927523.stm>accessed 26 July 2007.

[244] MI Goldman, *The Piratization of Russia: Russian Reform Goes Awry* (Routledge, New York 2003) 147.

[245] Iji, 'Corporate Control and Governance Practices in Russia' 13.

[246] See eg J Johnson, *A Fistful of Rubles: The Rise and Fall of Banking in Russia,* (Cornell University Press, New York 2000); A Steinherr, 'Russian Banking since the Crisis of 1998' (2004) September Sacred Heart University Research Papers <http://www.shu.lu/images/pages_content/02_Faculty/04_research/NewRussia-Steinherr.pdf>accessed 1 September 2007.

debts for a fraction of their real price.[247] This scheme helped Khodorkovsky to rescue his reputation, as the other liquidated banks had paid nothing to their creditors.[248]

Russian privatisation began in late 1991[249] as an experiment, only to emerge as the government's most popular reform.[250] The premise of privatisation was that companies would perform more efficiently if they were controlled by private owners rather than by governmental officials.[251] The results of the privatisation are closely linked to the approach to privatisation that was adopted by the Russian government,[252] which was both rapid and pervasive.[253] The gigantic Soviet economy was privatised within a three-year period.[254]

Russian privatisation was conducted in several distinct stages and gave birth to the notorious oligarchic system.[255] Three main models of privatisation were adopted in Russia in line with practices existing in transitional economies: Mass Privatisation (MP), Insider's Model, (MEBO – Management and Employees Buy Out), and Initial Majority Shareholdings (IMS).[256] The first stage was meant to symbolize populist capitalism, which

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[247] See Yukos, *Annual Report for 2000* (2001) 45-46.

[248] See AS Alexandrovich, 'Bankruptcy Law, an Economic Medicine: How Russia's New Bankruptcy Legislation Faciliated Recovery from the National Financial Crisis of August ' (1998) 34 Cornell Int'l LJ 95-119.

[249] See JR Wedel, 'Clans, Cliques, and Captured States: Rethinking 'Transition' in Central and Eastern Europe and the Former Soviet Union' (2001) WIDER Discussion Paper No 2001/58, 10-12 <http://www.wider.unu.edu/publications/working-papers/discussion-papers/2001/en_GB/dp2001-58> accessed 10 August 2007.

[250] M Boycko and others, 'Privatizing Russia' (1993) 2 Brookings Papers on Economic Activity 139-92, 178.

[251] MDV Coco, 'Towards Enterprisation: Shareholder Rights and Economic Reform in Russia' (1998-1999) 39 Va J Int'l L 169-80, 181.

[252] International Labour Organisation, 'Privatization: Lessons from Russia and China' (2000) Enterprise and Management Development Working Paper № EMD/24/E <http://www.ilo./public/ english/employment /ent/papers/emd24.htm>accessed 24 January 2006.

[253] MB Fox, 'Corporate Governance Lessons from Russian Enterprise Fiascoes' (2000) 75 NYU L Rev 1720-80, 1721.

[254] D Doeh, 'Oil, Law and Politics in Russia' (2005) 9 IELTR 205-09, 206.

[255] See eg Hoffman, *The Oligarchs: Wealth and Power in the New Russia*; Guriev and Rachinsky, 'The Role of Oligarchs in Russian Capitalism'.

[256] RK Mishra, 'Privatisation and Economic Development Strategy in Russia' (2000) Argentine Center of International Studies Working Papers - Programa CEI & Países Bálticos № 14 3 <www.caei.com.ar>accessed 21 March 2007.

was compliant with Yeltsin's statement that Russia needed millions of owners, but not a handful of billionaires.[257]

Among many other foreign innovations imported to Russia and used in the privatisation process, the Russian Government resorted to the use of holding companies.[258] The holding company structure was suitable for a situation when the state planned to reserve a majority ownership in a large number of enterprises in the same or related industries. [259] Instead of achieving this objective by retaining a majority interest in each of the numerous industrial producers, the state would obtain the desired 51 per cent interest in a holding company that controlled production companies.[260]

Yeltsin's Decree established vertically integrated oil companies (VIOCs) using the principles of holdings with certain exemptions.[261] Each oil holding company (VIOC) was made up of oil production subsidiaries and refining subsidiaries.[262] The first three vertically integrated oil companies were Yukos, Lukoil and Surgut.[263]

On July 22, 1994, Yeltsin issued a decree on the second stage of privatisation, leading to the notorious loans-for-shares auctions.[264] Privatisation of the major holdings, created in accordance with the Decree, took place from 1995-1999 via investment tenders and the loans-for-shares programme[265] as part of the 'cash stage' of privatisation.[266] The

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[257] V Coulloudon, 'Privatization in Russia: Catalyst for the Elite' (1998) 22 Fletcher F World Aff 43-56, 47.

[258] N Poussenkova, *From Rigs to Richers: Oilmen Vs Financiers in the Russian Oil Sector* (James A Baker Institute for Public Policy of Rice University Research Project Papers 2004) 2 <www.rice.edu/energy/publications/docs/PEC_Poussenkova_10_25_04.pdf>accessed 15 March 2007.

[259] See eg D Lane and I Seifulmulukov, 'Structure of Ownership' in D Lane (ed), *Political Economy of Russian Oil* (Rowman & Littlefield, Lanham 1999) 15-46, 16-19; Iji, 'Corporate Control and Governance Practices in Russia' 8-12.

[260] WG Frenkel, 'Analysis of the Russian Regulations on Holding Companies: State Monopoly Duaring Market Reform and Privatisation' (1993) 4 (6) ICCLR 226-30, 228.

[261] See D Gololobov and S Bakhmina, 'Tri Etapa Razvitiya Kholdingovykh Kompanii v Neftyanoi Otrasli [The Three Stages in the Development of Oil Industry Holding Companies]' (2001) 10 Zakonodatel'stvo i Ekonomika [Law and Business] 22-28.

[262] See P Rutland, 'Lost Opprotunities: Energy and Politics in Russia' (1997) 8 (5) NBR Analysis 1-30, 9.

[263] Iji, 'Corporate Control and Governance Practices in Russia' 9.

[264] See D Allen, 'Banks an the Loan-for Shares Auctions' in D Lane (ed), *Russian Banking: Evolution, Problems and Prospects* (Edward Elgar Publishing, Cheltenham 2002) 137-59.

[265] Coulloudon, 'Privatization in Russia: Catalyst for the Elite' 49.

[266] See Lane and Seifulmulukov, 'Structure of Ownership' 30-36.

loans-for-shares scheme (LFS) was a pseudo-privatisation programme, whereby selected commercial banks served as trustees and auctioneers for rights to manage the stock in major Russian companies in exchange for loans.[267] The banks chosen to organise the auctions were controlled by the "oligarchs" who had already obtained the blessing from the Russian government to buy these companies, camouflaging the real sale by pledging the stock for loans.[268]

The result of the second stage of privatisation (1992- 1997) was the formation of gigantic private financial-industrial-media groups.[269] For a short period, Russia seemed to have moved toward a system of corporate control, concentrated in huge financial and production conglomerates, organised around chief oligarchs.[270] These groups quickly became centres for the control of the Russian economy and politics.[271]

The auctions of 1995 are the most controversial episode in recent Russian political-economic history.[272] The "jewels" of the former Soviet Union industry were sold in a corrupt fashion to a handful of well-connected men, forming the new Russian elite.[273] Subsequently, attitudes to oligarchs and their role in Russia have always been controversial and mostly negative,[274] but their real contribution to the Russian business and politics is unlikely to get its final assessment for several decades.[275]

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[267] IW Lieberman, 'The Rush for State Shares in the Klondyke of Wild East Capitalism: Loans-for-Shares Transactions in Russia' (1995-1996) 29 Geo Wash J Int'l L & Econ 737-68, 738.

[268] Salter, 'Yukos' 4.

[269] Cox, 'The Politics of Russia's Financial-Industrial Groups' 33; E Paszyc and I Wiæniewska, 'Big Business in the Russian Economy and Politics under Putin's Rule' (2002) 5 Prace OSW / CES Studies 5-45, 46 <http://pdc.ceu.hu/archive/00002224/01/big_business.pdf>accessed 23 July 2007.

[270] Fox, 'Corporate Governance Lessons from Russian Enterprise Fiascoes' 1774.

[271] Cox, 'The Politics of Russia's Financial-Industrial Groups' 29.

[272] Fraser, 'Russia's Oligarchs: Their Risky Routes to Riches'.

[273] B Black, R Kraakman and A Tarassova, 'Russian Privitization and Corporate Governance: What Went Wrong' (1999-2000) 52 Stan L Rev 1731-82, 1736.

[274] See eg Shamseeva, 'Yukos's Affairs and the Yukos Case'; Y Gorodnichenko and Y Grygorenko, 'Are Oligarchs Productive? Theory and Evidence' (2006) Working Paper Series<http://ssrn.com/ abstract= 613692>accessed 18 July 2007.

[275] See eg W Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem' in A Pravda (ed), *Leading Russia: Putin in Perspective: Essays in Honour of Archie Brown* (Oxford University Press, Oxford 2006) 179-202; S Pearlstein, 'Oil, Oligarchs and Opulence' (2007) 6 July Washingtonpost.com <http://www.washingtonpost.com/wp-dyn/content/article/2007/07/05/AR2007070501928.html?hpid=sec-world>accessed 7 July 2007.

From 1996-97 several entrepreneurs who, according to Berezovsky, controlled fifty percent of the Russian economy[276] and were actively involved in political events, established themselves as a "Group of Seven" and began to play the role of "shadow cabinet".[277] In order to prevent the possible return of the Communists, the Group of Seven decided to finance Yeltsin's re-election campaign.[278] Thus the oligarchs, in return for future tax exemptions, greater investment opportunities, protection of their assets and government posts, offered Yeltsin's team control over oligarchy media and funds.[279] Therefore, the transition period that took place in Russia from 1995-1999 can be characterized as a period when perilously accumulated financial capital obtained control over the bulk of Russian industry, and maintained its control by using all available political means.

When the state-wide privatisation campaign began, Khodorkovsky and his team saw a unique opportunity to expand beyond banking. Menatep was regarded as the only Russian bank that expressed its industrial orientation from the very beginning, and it formed a large, well-structured, diversified, industrial group.[280] Ultimately the bank and its affiliates acquired stock in more than a hundred industrial enterprises.[281]

In 1995 the bank incorporated ZAO Rosprom to manage its industrial portfolio,[282] which included six basic categories of companies: chemicals, construction, textiles, consumer goods, mining, and oil.[283] Later, Yukos and Apatit were reorganised in independent holdings and Rosprom was liquidated.[284]

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[276] Treisman, 'Putin's Silovarchs' 1.

[277] Schroder, 'El'tsin and the Oligarchs' 967.

[278] V Coulloudon, 'Elite Groups in Russia' (1998) 6 (3) Demokratizatsiya 535-49, 539; Schroder, 'El'tsin and the Oligarchs' 967.

[279] C Freeland, 'The Men Who Really Rule Russia' (1998) 127 (4400) New Statesman 17-18.

[280] Iji, 'Corporate Control and Governance Practices in Russia' 13.

[281] See Y Latynina, 'Mikhail Khodorkovskii: Khimiya I Zhizn [Mikhail Khodorkovsky: Chemistry and Life]' (1999) 1 August Sovershenno Sekretno [Top Secret] <http://sovsekretno.ru/ magazines/article/376>accessed 20 July 2007.

[282] F Ippolito, *The Banking Sector Rescue in Russia* (2002) 24 <http://www.countryanalyticwork.net/ CAW/Cawdoclib.nsf/0/CA5AB56573DCA2CF85256D24004775AB/$file/bon1202.pdf>accessed 27 March 2007.

[283] Goldman, *The Piratization of Russia: Russian Reform Goes Awry* 147.

[284] See Korotov and others, 'Mikhail Khodorkovsky and Yukos. Man with a Ruble' 7; A Startseva, 'The Man Behind Menatep's Machine' (2003) <http://www.rusnet.nl/news/2003/07/04/report04.shtml>accessed 14 December 2006.

The jewel in the Khodorkovsky crown - Yukos[285] was formed on April 15, 1993.[286] Before the formation of the holding, the Yukos oil production daughter companies, such as Yuganskneftegaz and Samaraneftegaz, were corporatized into joint stock companies and went through the privatisation process.[287] Using the example of the main Yukos' production unit, the figure 5 shows the typical distribution of shares of a Russian public company established in the course of privatisation.

Figure 5. "Scheme of the Yganskneftegas Privatisation."

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In the mid 1990s the Russian government decided to sell its stake in Yukos to private investors,[289] along with other Russian oil production companies experiencing significant production and structural problems.[290]

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[285] Yuganskneftegas + KuibyshevnefteOrgSintez = YUKOS. See Center for Managment Research, 'Yukos: The Fall of a Russian Oil Giant' (2004) 2004 ICFAL <http://www.icmr.icfai.org/ casestudies/catalogue/ Economics/ECON007.htm>accessed 18 July 2007.

[286] Yukos, 'The History of Yukos' (2006) <www.yukos.com/About_us/History.asp>accessed 10 April 2007.

[287] Iji, 'Corporate Control and Governance Practices in Russia' 10-11.

[288] ibid.

[289] Center for Managment Research, 'Yukos: The Fall of a Russian Oil Giant' 2.

Menatep, having obtained Governmental approval to buy Yukos, organised a group of commercial banks, Russian companies, and individuals to bid for seventy-eight percent of Yukos shares.[291] As a result of the preplanned auction, Group Menatep, dominated by Khodorkovsky and his five friends, gained control of Yukos for $300 million.[292]

After winning the LFS auction, Menatep began aggressively acquiring Yukos shares from different minor investors. By the beginning of 1997 approximately 85 percent of Yukos's shares were owned by the Menatep group. [293]

When Menatep took over Yukos in 1996, the company was suffering from the same problems that were affecting the rest of the post Soviet oil sector.[294] Oil production by its main production company Yuganskneftegas had dropped from 1.4 million barrels a day (1987) to 0.5 million barrels a day (1995).[295] After establishing managerial control over Yukos, Khodorkovsky had to solve the threefold problem of how to optimise the taxes, provide a reasonable level of investment to maintain the company as an ongoing concern, and how to stop the practice of theft.[296] This task required several years of hard managerial work and lobbying. Expanding into new regions under Khodorkovsky's management, Yukos acquired a controlling interest in VNK (Eastern Oil Company) privatised in an investment tender in 1997 for $800 million. [297]

The money-spinning strategies used by the Khodorkovsky-controlled management of the Yukos-VNK holding in the late 1990s, resembled ones used by other Russian production companies. Experts alleged that Khodorkovsky had skimmed over 30 cents per

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[290] ibid.

[291] Lieberman, 'He Rush for State Shares in the Klondyke of Wild East Capitalism' 751.

[292] MD Goldhaber, 'Russian Roulette' (2004) August Amer Law.

[293]Lane and Seifulmulukov, 'Structure of Ownership' 30.

[294] Aron, 'The Yukos Affair' 2.

[295] Poussenkova, *From Rigs to Richers: Oilmen Vs Financiers in the Russian Oil Sector* 22.

[296] See Hoffman, *The Oligarchs: Wealth and Power in the New Russia* 445-46; Chudnovsky, *Privatizing Russia: Case Study of Yukos Oil Company* 15-17.

[297] O Fedorov, *Preventing Abusive Self-Dealing: 3 Case Studies on Abusive Self-Dealing* (OECD/World Bank Corporate Governance Roundtable for Russia "Shareholder Rights and Equitable Tratment" 2000) 76.

dollar of revenue while cutting down his workers' wages, defaulting on tax payments, destroying the value of minority shares in Yukos and not reinvesting in Yukos' oil fields.[298]

The problems experienced by Yukos in the mid 1990s were aggravated by the 1998 crisis.[299] The collapse of the Russian banking system and the 90-day moratorium decreed by Russia for paying off its debt had a tremendously negative impact on the Russian oil industry.[300]

Responding to the crisis, Khodorkovsky approved and implemented several drastic cost-cutting measures, which began to pay off quickly.[301] Yukos spun off many services and centralized the management of the remaining services, splitting "upstream" and "downstream" operations into separate business lines.[302] The company also made significant employee layoffs.[303]

A significant problem experienced by many Russian privatised companies was dual-level privatisation.[304] The duality was due to the creation of vertically-integrated oil holding companies, that included existing enterprises as subsidiaries, followed by the privatisation of the subsidiaries and then of the holdings.[305] The shareholders in the subsidiaries were concerned about the dividends that they would receive from the companies where they held the stock, not the profit of the holding company that was controlled by an oligarchy group. [306] This situation gave rise to numerous corporate

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[298] Black, Kraakman and Tarassova, 'Russian Privitization and Corporate Governance: What Went Wrong' 1737.

[299] Center for Managment Research, 'Yukos: The Fall of a Russian Oil Giant' 2.

[300] C Locatelli, 'The Russian Oil Industry Restructuration: Towards the Emergence of Western Type Enterprises' (1999) 27 (8) Energy Policy 435-49, 20.

[301] Korotov and others, 'Mikhail Khodorkovsky and Yukos. Man with a Ruble' 8.

[302] ibid 10.

[303] See Yukos, 'The History of Yukos'.

[304] Iji, 'Corporate Control and Governance Practices in Russia' 8.

[305] See L Dienes, 'Corporate Russia: Privatization and Prospects in the Oil and Gas Sectors ' (1996) The Donald W Treadgold Papers № 5 <http://depts.washington.edu/reecas/dwt/titles.htm>accessed 15 April 2007.

[306] D Gololobov, *Aktsionernoe Obscestvo Protiv Aktsionera [Company v. Shareholder: Greenmail Resistance Strategies]* (2nd edn, Yustitsinform, Moscow 2004) 253-95.

conflicts in the industry and in the oil holdings.[307] Although standards of corporate governance remained generally very low, some companies made attempts to change the situation for the better.[308]

From 1998-1999 Yukos, aiming to solve the problem of "duality" inside the holding and improve corporate governance regime, started a campaign of consolidation (buy-out) of its production subsidiaries shares.[309] The programme provided different buy-out options for cash and shares of the holding company.[310] During the implementation of the consolidation programme, Yukos had to go through a heavyweight fight with the international greenmailer Kenneth Dart, who tried to oppose consolidation, aiming to sell shares of the Yukos subsidiaries belonging to him at a exhorbitant price. Although victory in the battle with Dart helped Yukos to deal with the issue of "duality" it also contributed to Khodorkovsky's reputation as a corporate "bad-boy".[311] Nevertheless, the successful performance of the shares consolidation programme finally made Yukos a holding company that owned one hundred per cent of the stock of all its main subsidiaries.[312]

Having earned the reputation of a 'corporate gangster" because of its battles with minority shareholders, Yukos began making efforts to clean up its image in 2000.[313] The new approach to management involved three key reforms: western-style disclosure, independence of the board, and a corporate governance charter.[314]

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[307] See eg S Kolchin, 'Russia's Oil and Gas Companies at War with Their Minority Shareholders' (2002) 8 (3) Prism.

[308] Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem'.

[309] See Fedorov, *Preventing Abusive Self-Dealing: 3 Case Studies on Abusive Self-Dealing* 73-76.

[310] See Yukos, 'The History of Yukos'.

[311] See eg Fedorov, *Preventing Abusive Self-Dealing: 3 Case Studies on Abusive Self-Dealing*,73-76; D Yousef-Martinek, R Minder Knight and R Rabimov, 'Yukos Oil: A Corporate Governance Success Story' (2003) Fall The Chazen Web Journal of International Business 1-11, 3.

[312] Yukos, 'The History of Yukos'.

[313] See eg K Koriukin, 'Who Is Kenneth Dart?' (1999) 8 June St Peter Times <http://www.caymannetnews.com/Archive/Archive%20Articles/November%202001/Issue%20123/Who%20is%20.html>accessed 7 July 2007.

[314] Yousef-Martinek, Minder Knight and Rabimov, 'Yukos Oil: A Corporate Governance Success Story' 4.

Over three years, the company established an international, independent Board of Directors with mostly non-executive directors.[315] Yukos also developed a corporate governance code,[316] published financial statements in accordance with U.S. GAAP, which were audited by outside auditors,[317] and in Russia Yukos became a leader in the corporate governance sphere.[318]

In 1998 Berezovsky signed a settlement agreement with Khodorkovsky, aiming to create Yuksi, Russia's biggest oil company.[319] This new alliance would have given Berezovsky and Khodorkovsky enough funds and power to buy Rosneft (the strategic state-owned oil company). However, the Kremlin announced that Rosneft would no longer represent the state in production sharing agreements with foreign oil companies and the deal collapsed.[320]

By 2001, Yukos had become the giant of the Russian oil industry and was among the top private oil producers in the world, turning out 1.1 million barrels per day.[321] The company raised dividends on common stock from $300 million in 2000 and $500 million in 2001 to $2.0 billion in the first nine months of 2003.[322] In December 2001 Yukos ADR Level 1 began to be traded on NEWEX. [323] The company planned to issue ADR Levels 2 and 3.[324]

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[315] See A Wood, 'Independent Directors and Practical Corporate Governance' (2002) Spring Independent Director 1-2, 2.

[316] Yukos, 'Corporate Governance Charter' (2003) <http://www.yukos.com/New_IR/ Corporate_governance_ charter.asp>accessed 20 July 2007.

[317] See eg Yukos, *U.S. GAAP Consolidated Financial Statements, December 31, 2001* (2002); Yukos, *U.S. GAAP Interim Condensed Consolidated Financial Statements* (2003).

[318] See Goriaev and Sonin, 'Prosecutors and Financial Markets' 5; Goriaev and Sonin, 'Is Political Risk Company - Specific? The Market Side of the Yukos Affair' 6.

[319] See S Kolchin, 'Rosneft Privatisation Set to Complete the Carve-up of the Russian Oil Industry' (1998) 4 (6) Prism.

[320] Coulloudon, 'Elite Groups in Russia' 541.

[321] Salter, 'Yukos' 5.

[322] Korotov and others, 'Mikhail Khodorkovsky and Yukos. Man with a Ruble' 11; Poussenkova, *From Rigs to Richers: Oilmen Vs Financiers in the Russian Oil Sector* 29.

[323] SRU Limited and Expert Information Group, *Corporate Governance in Russia, Investor Perceptions in the West and Business Reality on the Ground* (SRU Limited Expert Information Group, 2002-2003) 60.

[324] See on Russian ADR Salter, 'Yukos' 11.

As previously mentioned, under the leadership of Mikhail Khodorkovsky, Yukos had become Russia's largest oil corporation implementing global best practices such as good corporate governance and transparency, improving efficiency and performance, and creating value for its shareholders.[325]

One more step towards transparency was taken in 2002 when Menatep Group revealed the ownership structure for a 61.01% stake in Yukos.[326]

In 2001 Yukos began its expansion abroad.[327] Unlike other Russian companies from the energy sector, Yukos intended to focus outside the Commonwealth of Independent States. Yukos' major foreign investments included purchasing 49% of Slovak Transpetrol shares, 53% of shares in the Mazeikiu Nafta refinery in Lithuania in 2002 and others.[328] Figure 6 describes the relationships of ownership and control inside and outside the Yukos corporate group, including its ultimate shareholders.

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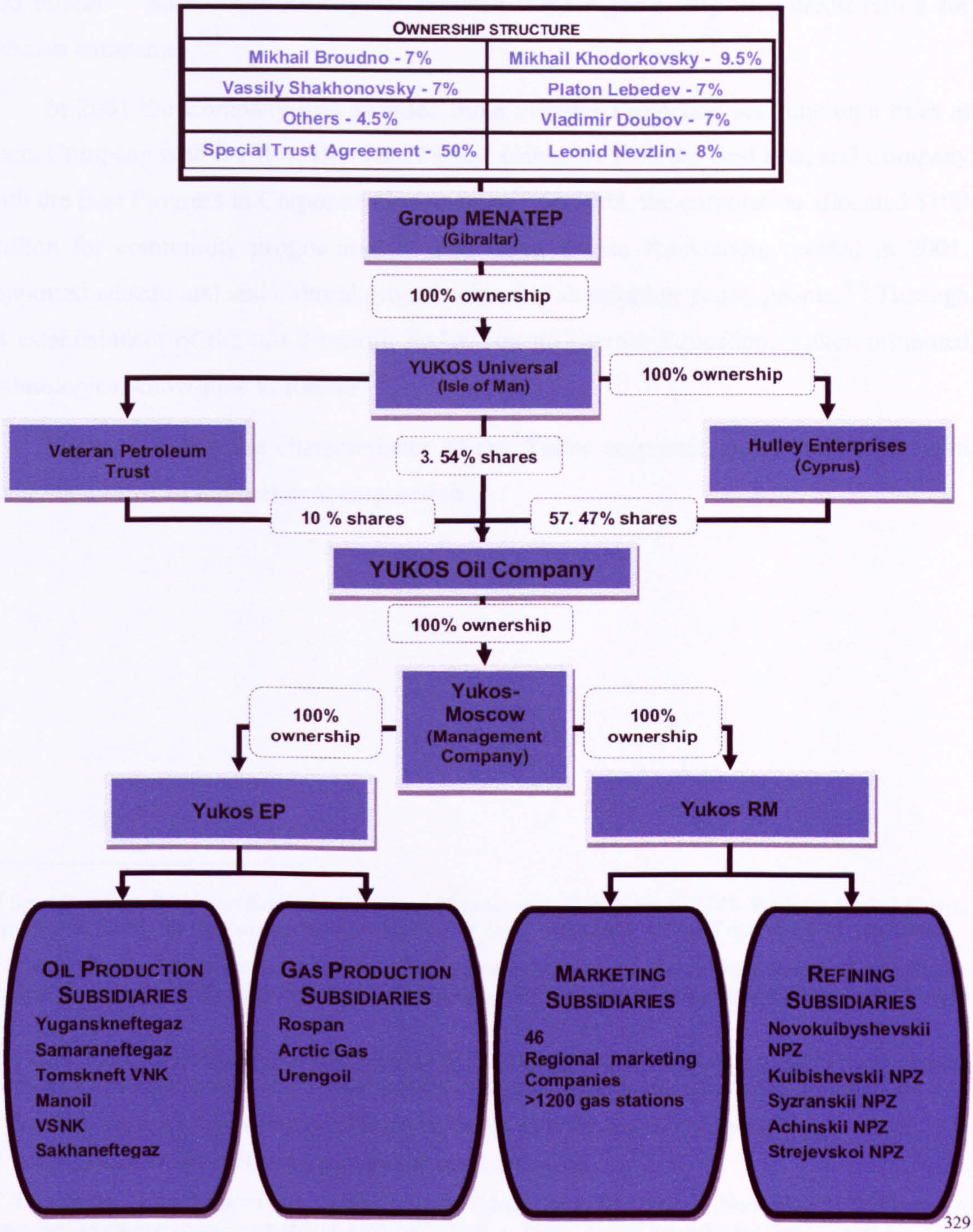
[325] ICFAL, 'Yukos: The Fall of a Russian Oil Giant'.

[326] See C Belton, 'No Individual Menatep Owners Left' (2004) 13 February The Moscow Times.com <http://www.moscowtimes.ru/stories/2004/02/13/042.html>accessed 30 March 2007.

[327] See Yukos, 'The History of Yukos'; Gololobov and Tanega, 'Yukos Risk' 630-37.

[328] Kononczuk, *The "Yukos Affair", Its Motives and Implications* 36.

Figure 6. "The Structure of Ownership and Control of the Yukos Oil Company (2002)."



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[329] See Gololobov and Tanega, 'Yukos Risk' 584.

From summer 1999 to spring 2003 (the tenth anniversary of Yukos), its market capitalization grew from $320 million to $21 billion, and in March 2004 reached a peak of $36 billion.[330] S&P[331] and Moody's[332] awarded it the highest long-term credit rating for Russian companies.[333]

In 2001 the Company was awarded three Investor Protection Association's titles at once: Company with the Best Dividend Policy, Company with the Best Site, and Company with the Best Progress in Corporate Governance.[334] In 2003, the corporation allocated $100 million for community programmes.[335] The Open Russia Foundation, created in 2001, supported educational and cultural projects aimed at developing young people.[336] Through its establishment of the not-for-profit Federation of Internet Education, Yukos promoted technological know-how in Russia.[337]

Figure 7 shows the characteristics of the Yukos corporate group correlating with main features of an international corporation.

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[330] See Misamore, 'Goldman Sachs Global Energy Conference'; B Misamore, 'UBS Warburg Global Energy Conference' (2003) 30 <yukos.com/new_ir/pdf/UBSW_conf_May_2003_web.pdf>accessed 25 May 2006.

[331] Yukos, 'Standard & Poor's Assigns Yukos Oil Company Highest Long-Term Credit Rating of Any Private Russian Company' (2002) <http://www.yukos.com/vpo/news.asp?year=2002&month=12>accessed 10 April 2007.

[332] Yukos, 'Moody's Assigns Yukos Oil Company Highest Long-Term Credit Rating of Any Private Russian Company' (2003) <http://www.yukos.com/vpo/news.asp?year=2003&month=1>accessed 10 April 2007.

[333] Poussenkova, *From Rigs to Richers: Oilmen Vs Financiers in the Russian Oil Sector* 30.

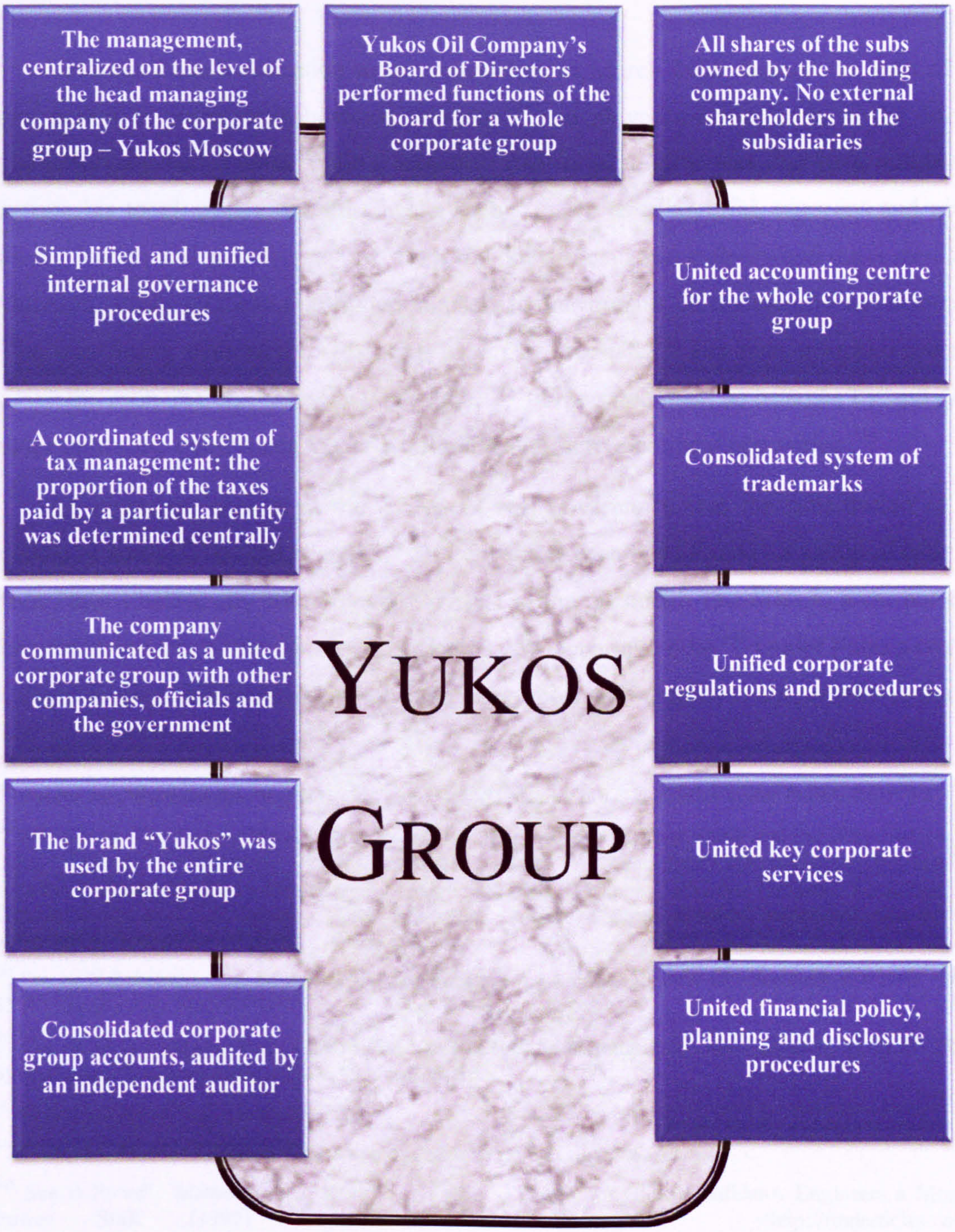
[334] Yukos, 'Yukos Wins Four Good Corporate Governance Awards'.

[335] TL O'Brien, 'How Russian Oil Tycoon Courted Friends in U.S.' (2003) 5 November N Y Times 1A <http://select.nytimes.com>accessed 21 June 2007; Yukos, *Yukos: Social Report 2002-2003* (2004) 4.

[336] See Yukos, 'Open Russia Foundation Launched in U.S.' (2003) <http://www.yukos.com/exclusive/exclusive.asp?id=6107>accessed 4 March 2005.

[337] See eg J Gambrell, 'Philanthropy in Russia: New Money under Pressure' (2004) 3 (1) Carnegie Reporter <http://www.carnegie.org/reporter/09/philanthropy/index.html>accessed 15 March 2006.

Figure 7. "The Characteristics of the Company as a Business (Corporate) Group in 2002-2003."



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[338] See Appendix 4 Para 10.

1.8.2. Russia after Yeltsin: Putin's "Strong State" Strategy and the "Equidistancing" of Oligarchs.

Vladimir Putin's accession to the presidency in March 2000 flagged the start of the next period in government-business relations[339] and played a critical role in the fate of Khodorkovsky and Yukos. Putin's meteoric rise in popularity was due to a number of factors: his tough policy toward Chechnya; his image as a youthful, vigorous and plain-talking leader; and massive support from the Yeltsin clan and state-owned mass media.[340] Although, Putin publicly committed himself to the pursuit of democratic development, [341]he was firmly dedicated to restoring power of the state.[342] His twin priorities were to revive the economy and strengthen the state.[343] In the same time, he brought TV and radio under tight state-control and virtually eliminated effective political opposition.[344]

An important change in the sphere of real governance was the substitution of the Yeltsin "Family"[345] by the so called "St. Petersburg Clan" or *Siloviki* - a group of officials from Putin's native city who enjoyed the trust of the president. The *Siloviki* were not only the new governors of the country, but also its new economic elite.[346] Under Putin's control Russian foreign and internal policy had grown more self-confident and assertive, fuelled

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[339] Paszyc and Wiæniewska, 'Big Business in the Russian Economy and Politics under Putin's Rule' 52.

[340] MB Olcott, *The Energy Dimension in Russian Global Srategy: Vladimir Putin and the Geopolitics of Oil* (Rice University Research Project Papers 2004) 4 <http://www.rice.edu/energy/publications/docs/PEC_Olcott_10_2004.pdf>accessed 14 May 2007; SD Goldman, *Russian Political, Economic, and Security Issues and U.S. Interests* (CRS Report for Congress-Russian Political, Economic, and Security Issues and U.S. Interests RL33407, 2006) CRS3.

[341] See eg N Robinson, 'The Economy and the Prospects for Anti-Democratic Development in Russia' (2000) 52 (8) Europe-Asia Stud 1391-416.

[342] See eg TF Remington, 'Putin's Third Way: Russia and the "Strong State" Ideal' (2000) 9 (1/2) EECR 65-69; Solomon, 'Vladimir Putin's Quest for a Strong State'.

[343] Crompton, 'How Risky Is Russia?' 25.

[344] Goldman, *Russian Political, Economic, and Security Issues and U.S. Interests* i.

[345] See B Powell, 'Masters of the Kremlin : Yeltsin's 'Family' of Close Confidants Engineers a Moscow Power Shift' (1999) August Newsweek International <http://findarticles.com/p/articles/mi_hb3335/is_199908/ai_n8047899>accessed 12 August 2007; --, 'Yeltsin, "The Family" And the Bureaucratic Mafia' (2000) 26 Class Struggle Magazine <http://www.the-spark.net/csart264.html>accessed 18 June 2007.

[346] J Morales, 'Who Rules Russia Today?: An Analysis of Vladimir Putin and His Political Project (II)' (2003) UNISCI Discussion Papers № 4 6 <http://www.ucm.es/eprints/6370/>accessed 12 April 2007.

by its perceived status as an "energy superpower".[347] As a result the Russian energy sector has come to represent Russian state interests globally and Russia's energy companies are expanding internationally with the assistance of the government.[348]

Under Putin the roles of the FIGs as political and economic actors changed. When Putin rose to power, the media commented on the following strategy: the President would not disturb the billionaires who enriched themselves during the privatisation era (oligarchs)—if they stayed out of politics. [349] Following the widely publicized meeting on 28th July 2000 with 21 representatives of big business, the tycoons claimed they had agreed a pact with the President: they would be immune from prosecution over privatisation deals as long as they refrained from being involved in politics.[350]

However, several oligarchs, including Gusinsky and Berezovsky, refused to conform to Putin's rules.[351] Subsequently, politically motivated civil and criminal suits were used to deprive them of key assets and both went into exile in order to avoid criminal charges in Russia.[352] The Russian government and media portrayed efforts against the oligarchs as the restoration of law and order.[353]

In these political conditions Khodorkovsky's initiative to merge Yukos' with Sibneft, which would have established Khodorkovsky's leadership in the Russian oil sector, looked extremely risky.[354] Yukos would have acquired 92% in Sibneft in return for $3 billion in cash and 26% of Yukos stock[355] and Khodorkovsky would have become the CEO of

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[347] L Aron, 'Russia's Oil Woes' (2007) January 08 AMERICANCOM 3 <http://www.american.com/archive/2007/january-february-magazine-contents/russia20...>accessed 7 March 2007.

[348] F Hill, 'Energy Empire: Oil, Gas and Russia's Revival' (2004) The Foreign Policy Centre Papers 27 <www.fpc.org.uk/publications>accessed 2 March 2007.

[349] Goldhaber, 'Russian Roulette'.

[350] See Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem' 10.

[351] Goldhaber, 'Russian Roulette'.

[352] Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem' 4-5.

[353] See D Patterson, 'Russian Oligarchs, Taming' (1999) 30 November IDEA <http://www.idebate.org/debatabase/topic_details.php?topicID=292>accessed 18 July 2007.

[354] Poussenkova, *From Rigs to Richers: Oilmen Vs Financiers in the Russian Oil Sector* 36.

[355] See Yukos, 'Yukos Clarifies Terms of Share Buy-Back and Sibneft Share Exchange' (2003) <http://www.yukos.com/vpo/news.asp?year=2003&month=7>accessed 23 July 2007.

YukosSibneft.[356] The Yukos-Sibneft deal would have created the world's fourth biggest oil company worth approximately $35bn.[357] It was widely rumored that a 25-50 per cent share of the new concern might have been taken by ExxonMobil. [358] The merger announced in April 2003 was understood as a political manoeuvre, rather than a business deal; it would first have to be approved by the Kremlin, and it would have created a tremendously politically influential business group.[359] Formally, the Russian authorities approved the deal and the merger was almost completed in October 2003.

1.8.3. The Beginning of the Attack on Yukos.

The events, later named "the Yukos Affair", actually marked the start of a new stage in the process of concentrating power in Russia.[360] The Yukos campaign was largely intended to remind the oligarchs that they remained vulnerable—and was also intended to scare off foreign investors, whose acquisition of large stakes in 'oligarchic' companies would make those companies harder to subject to political pressure or bureaucratic rent-seeking.[361]

Flagging the beginning of the attack on Khodorkovsky and Yukos, his friend Platon Lebedev, was arrested in July 2003.[362] Lebedev was the second most important person in Yukos, the head of the Group Menatep, one of Yukos' major shareholders.[363] Khodorkovsky's desperate attempts to free Lebedev failed completely.

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[356] Korotov and others, 'Mikhail Khodorkovsky and Yukos. Man with a Ruble' 1.

[357] V Panyushkin, *Mikhail Khodorkovskii: Uznik Tishiny [Mikhail Khodorkovsky: Prisoner of Thishina]* (Sekret Firmy, Moscow 2006) 164-65.

[358] Y Galukhina and M Rubchenko, 'Yukos/Sibneft. A Gift for the President.' (2003) 10 December Gateway to Russia <http://www.gateway2russia.com/st/art_180088.php>accessed 8 May 2007; T Orszag-Land, 'Putin Pursues Russia's Oil Oligarchs' (2004) August Contemp Rev 65-71, 66.

[359] See D Butrin and P Sapozhnikov, 'The Oil and Gas Industry 2000-2004' (2004) 17 May Kommersant Online <http://www.kommersant.com/tree.asp?rubric=3&node=33&doc_id=474677>accessed 28 July 2007.

[360] Morales, 'Who Rules Russia Today?: An Analysis of Vladimir Putin and His Political Project (II)' 6.

[361] Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem' 9.

[362] Kononczuk, *The "Yukos Affair", Its Motives and Implications* 34.

[363] See ibid 37.

The crisis around the company eventually led to the cancellation of the Yukos-Sibneft merger,[364] which was seen as a political decision dictated by the Kremlin to Abramovich.[365]

On 25 October 2003 Mikhail Khodorkovsky, the Chief Executive of Yukos, was arrested on board his plane in Siberia.[366] Khodorkovsky's arrest was seen as politically motivated, aimed at eliminating a political enemy.[367] It was rumored that Khodorkovsky had violated the 'unwritten rules,' announced in June 2000 at the meeting between Putin and the oligarchs, who were told not to intervene in politics.[368] Formally, Khodorkovsky's arrest was linked to the 1996 privatisation of the Apatit fertilizer company by the Menatep[369] and several other post privatisation episodes.[370]

The tax attack on Yukos began several months after Khodorkovsky's detention.[371] At the end of 2003 the Ministry of Tax and Levies conducted an extraordinary audit of the Yukos accounts.[372] Just before the New Year vacation the Company was hit with a claim

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[364] P Vahtra, 'Russian Oil Sector Today and Tomorrow: The Implications of the Case OAO Yukos' (2004) <http://www.tukkk.fi/pei/>accessed 10 February 2007.

[365] J Strauss, 'Oil Marriage Is over, Confirms Besieged Yukos' (2003) 18 December Telegraph.co.uk <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2003/12/18/cnoil18.xml>accessed 20 July 2007.

[366] Crompton, 'How Risky Is Russia?' 24; T Nicholls, 'The Boss Behind Bars; It Is a Year since Mikhail Khodorkovsky, the Billionaire Head of Russian Oil Giant Yukos Was Arrested at Gunpoint at a Siberian Airport' *Evening Stand* (London 22 October 2004) 48.

[367] D Satter, 'Yukos State' (2003) 6 November Nationalreviewonline <http://www.nationalreview.com/comment/satter200311060916.asp>accessed 10 July 2007; Goldman, *Russian Political, Economic, and Security Issues and U.S. Interests* CRS5.

[368] See eg E Helque, 'The Oligarchs and the President: A Farce in Three Acts' (2004) (March -April) Russ Life 22-31; W Tompson, *Putin and the 'Oligarchs': A Two-Sided Commitment Problem* (Prosepects for Russian Federartion Project Briefing Note № REP BN 04/03 2004).

[369] On the Apatit case see sections 2.6. and 2.7.

[370] See eg A Rodionov, *Nalogovye Skhemy, Za Kotorye Posadili Khodorkovskogo [Tax Schemes That Lead Khodorkovsky to Prison]* (Vershina, Moscow 2005); Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges'.

[371] See A Kuchins, 'Putin's Pandora's Box' (2002) 8 November Carnegie Moscow Center Publications <http://www.carnegie.ru/en/pubs/media/68666.htm>accessed 20 May 2007; T Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' (2005) 17 February U.S. Senate Committee on Foreign Relations 3-4 <http://foreign.senate.gov/testimony/2005/OsborneTestimony050217.pdf>accessed 20 June 2005.

[372] See Gololobov, 'The Yukos Money Laundering Case' 6.

of U.S. $3.4 bn.[373] In May - August 2004 the courts found Yukos guilty of tax avoidance/evasion in 2000,[374] obliging the company to pay the bill.[375] In September the Ministry of Taxation announced an additional claim against Yukos of Rb 120 bn for 2001.[376] The same procedure was repeated for 2002 and 2003. Including massive penalties, fines and interest, these assessments totaled approximately $27.5 bn.[377]

All the proposals concerning the debt restructuring sent by the Company's management to the Government and the Administration were promptly ignored or rejected on formal grounds.[378]

The trial of Mikhail Khodorkovsky and Platon Lebedev is considered by some to be the most important "legal" case in Russian history since the break-up of the Soviet Union.[379] Regardless of the lawyers' best efforts, Khodorkovsky and Lebedev were found guilty of six of the seven charges of tax evasion, fraud and embezzlement and were sentenced to nine years.[380] The appeal reduced Khodorkovsky and Lebedev's sentences to eight years and they were sent to Siberia.[381]

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[373] See Ministry for Taxes and Levies, 'Resolution # 14-3-05/1609-1 to Hold the Taxpayer Fiscally Liable for a Tax Offence' (2004) <http://www.yukos.com/taxes/YUKOStaxResolution_full.pdf>accessed 1 March 2007; PL Clateman, 'Yukos Part VI: Tax Claims Revisited' (2005) 16 May Johnson's Russia List <http://www.cdi.org/russia/johnson/Yukos-tax-revisited.pdf>accessed 7 March 2007.

[374] On the term see section 4.5.2.

[375] The Moscow Times, 'Court Upholds $3.4bln Yukos Tax Claim' (2004) 21 June The Moscow Times.com 1 <http://www.moscowtimes.ru/stories/2004/06/21/003.html>accessed 20 March 2007.

[376] See C Hope, 'Russia Piles Tax Demand onto Yukos' (2004) 6 July Telegraph.co.uk <http://www.telegraph.co.uk/ money/main.jhtml?xml=/money/2004/07/07/cnyukos07.xml>accessed 20 July 2007.

[377] SM Theede, 'Written Testimony before the Senate Foreign Relations Committee' (2005) <http://www.senate.gov/~foreign/testimony/2005/TheedeTestimony050217.pdf>accessed 5 March 2007.

[378] See ibid; SM Theede, 'Speech Delivered at the CIS Oil&Gas Conference' (2005) <http://www.yukos.com/exclusive/exclusive.asp?id=7562>accessed 9 April 2007.

[379] Y Kvurt, 'Selective Prosecution in Russia - Myth or Reality' (2007) 15 Cardozo J Int'l & Comp L 127-67, 127.

[380] BBC News, 'Yukos Ex-Chief Jailed for 9 Years' (2005) 31 May BBC News <http://news.bbc.co.uk/1/hi/business/4595289.stm>accessed 30 March 2007; Human Rights House, 'The Yukos Case Is Finished' (2005) <http://www.humanrightshouse.org/dllvis5_print.asp?id=3320&noimages=1>accessed 5 March 2007.

[381] See eg Kommersant.com, 'Khodorkovsky Appeals the Sentence' (2005) 10 June Kommersant Online <http://www.kommersant.com/p584390/Khodorkovsky_Appeals_the_Sentence/>accessed 3 April 2007.

Approximately a year later prosecutors, pursuing a strategy of ruining the Company and the image of its shareholders, brought fresh charges against Mikhail Khodorkovsky that are likely to ensure that the former Yukos oil magnate will not leave his Siberian prison camp in the foreseeable future.[382]

On November 19th the Russian Federal Property Fund announced its intention to auction off the shares held by Yukos in its largest subsidiary, Yuganskneftegaz, to pay off the parent's debts.[383] Yuganskneftegaz was at the core of Yukos operations, accounting for around 60% of the company's oil production in 2003.[384] The auction was preceded by incredible pressure applied by the prosecutors on the company's key managers with the goal of squeezing them out of the country.[385] Most of the management, wishing to avoid detention, flew to the U.S. and the UK.

A few days before the Yuganskneftegaz auction, the management of Yukos filed a voluntary chapter 11 petition in an effort to prevent the sale of Yuganskneftegaz.[386] Although initially the TRO was granted, ultimately the case was dismissed by the U.S. Bankruptcy Court which found Russia to be the appropriate forum for resolution of the parties' dispute.[387] Aiming to comply with the TRO, prohibiting the sale to a number of the parties named in it, the Government organised the sale of Yuganskneftegaz to a shell

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[382] Presscenter, 'Statement on the New Chargers' (2007) 1 <http://www.mbktrial.com/about/new_charges.cfm>accessed 15 March 2007 (the full name of the publisher is "Presscenter for Defence Attorneys of Mikhail Khodorkovsky and Platon Lebedev"; The Wall Street Journal, 'Russian Justice'.

[383] BrokerCreditService, *Yukos. Go Ahead, Make My Day* (2004) 6; Y Alexandrov, 'The End of Yukos or Beginning of a New Age' (2006) March 7 New Times 19 <http://www.newtimes.ru/eng/detail.asp?art_id=1232>accessed 25 May 2006.

[384] Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' 5.

[385] See The Sunday Times, 'Yukos Chiefs Flee to London for Safety' (2004) 28 November Times online <http://business.timesonline.co.uk/tol/business/industry_sectors/natural_resources/article396306.ece> accessed 21 June 2007; B Condie, 'Moscow Levels Charges at Yukos Boss in London' *Evening Stand* (London 18 July 2005) 1.

[386] See on the case P Sapozhnikov and others, 'Yukos Surrenders to the Allies' (2004) 16 December Kommersant Online <http://www.kommersant.com/page.asp?id=533815>accessed 21 July 2007; GC Moss, 'Between Private and Public International Law: Exorbitant Jurisdiction as Illustrated by the Yukos Case' (2007) 32 Rev Cent & E Eur L 1-17.

[387] See G Moss, 'Dismissal of Yukos Chapter 11 Proceedings' (2005) 18 (5) Insolv Int 77-78.

company Bikalfinancegroup.[388] After the auction it became absolutely clear that the days of the company were numbered.

In spring 2006 a consortium of the Western banks declared that Yukos had defaulted on several loans and obtained a decision from the International Arbitration confirming the company's debt, and filed a bankruptcy application with the Arbitration Court of Moscow.[389] An interim receiver was appointed, who after examining the solvency of the company, recommended the creditors and the court to liquidate it.[390] Yukos was declared bankrupt and the liquidation of its assets to pay creditors was ordered.[391] All the company's assets were sold on a series of pre-organised auctions, mostly to Rosneft and Gasprom.[392]

The 'Yukos affair' has been a catalyst for a fundamental transformation of the Russian oil sector and the energy sector as a whole.[393] Putin made it clear that the state expected big business to share the burden of tackling Russia's social problems and that the resource-extraction industries in particular, would be required to bear a heavier tax burden.[394] Those oligarchs who have remained out of politics and participated in politics only in so far as they refrained from opposition to the Kremlin, have remained

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[388] See Gololobov and Tanega, 'Yukos Risk' 602-08.

[389] See BBC News, 'Bankruptcy Court Opens Yukos Case' (2006) 28 March BBC News <http://news.bbc.co.uk/1/hi/business/4854530.stm>accessed 29 June 2007; C Belton, 'Yukos Bankruptcy Case to Kick Off' (2006) 28 March The Moscow Times.com <http://www.moscowtimes.ru/stories/2006/03/28/041.html>accessed 20 August 2007.

[390] See P Finn, 'Ex-Yukos Executive Calls Russian Probe 'Retaliation'" (2006) 23 August Washington Post Foreign Service <http://www.washingtonpost.com/wp-dyn/content/article/2006/08/22/AR2006082201186.html>accessed 15 September 2006; V Korchagina, 'Court Declares Yukos Bankrupt' (2006) 2 August The Moscow Times.com <http://www.themoscowtimes.com/stories/2006/ 08/02/001.html>accessed 10 May 2007.

[391] AE Kramer, 'Judges Declare Yukos Bankrupt in 'Last Act' of Oligarchs ' (2006) 1 August International Herald Tribune <http://www.iht.com/articles/2006/08/01/business/yukos.php>accessed 23 July 2007.

[392] See eg C Belton, 'Rosneft Buys Moscow Head Office of Yukos' (2007) 3 July FT.com <http://www.ft.com/cms/s/e0af906c-28fd-11dc-af78-000b5df10621.html>accessed 4 July 2007; C Belton, 'Rosneft Denies Purchasing Yukos Offshoot' (2007) 16 August FT.com <http://www.ft.com/cms/s/f18fb546-4b90-11dc-861a-0000779fd2ac.html>accessed 16 August 2007.

[393] Kononczuk, *The "Yukos Affair", Its Motives and Implications* 33.

[394] Tompson, 'Putin and the 'Oligarchs': A Two-Sided Commitment Problem' 13.

unscathed.[395] The new "slovarch" regime functions in two main directions: the control of all the profitable business and direct confiscation from those who are not loyal.[396]

The economic outcome of the Kremlin's attack against Khodorkovsky and Yukos is the merger of the company into a large new oligarchic group of banks and companies controlled by Putin and his loyalists.[397]

Russian society, on the whole, approved of the attack on Yukos.[398] As many as 73 percent of Russians believe that the privatisation process of the 1990s was illegitimate.[399]

The Western community tends to understand the Yukos case as being motivated by politics, not by the rule of law.[400] The European Court of Human Rights and Amnesty International have shown interest in the Yukos case.[401]

The Yukos case is a vivid illustration of how state institutions can be used to carry out attacks on influential business groups.[402] There are several lessons that can be drawn from the case. First, the rule of law in Russia remains weak.[403] Secondly, the Kremlin's taming of the media in 2000–02 has largely been successful. [404] Thirdly, there are no other institutions,

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[395] Lavelle, 'Experts on the Yukos Affair and Impact'.

[396] See eg T Netreba, 'The Shape of Putin's Russia' (2002) September - October Russ Life 22-28; The Economist, 'The Making of a Neo-KGB State'.

[397] S Menshikov, 'The Anatomy of Russian Capitalism' (2005) 48 (2) Challenge 67-89, 75.

[398] See eg Shamseeva, 'Yukos's Affairs and the Yukos Case'.

[399] Shevtsova, 'Implications of the Yukos Scandal for Russian Domestic Politics'.

[400] C Jobatey and A Vacano, 'The Yukos Case and Its Consequences - Interview with Sabine Leutheusser-Schnarrenberger' (2004) <www.supportmbk.com/pdfs/zdf_sls_7-8-04_engl.pdf>accessed 1 March 2007.

[401] Human Rights House, 'The Yukos Case Is Finished'; RIA Novosti, 'Strasbourg Court to Examine Key Yukos Shareholder Case Soon' (2007) 6 June RIA Novosti <http://en.rian.ru/russia/20070605/66704414.html>accessed 7 June 2007.

[402] See The Royal Institute of International Affairs, *The Predatory Russian State* (Chatham House Russia and Eurasia Programme Briefing Note 2004) 1; N Sharansky, 'Bowing to Russia' *Wash Post* (Washington 27 October 2005) 5.

[403] See eg J Kahn, *Federalism, Democratization, and the Rule of Law in Russia* (Oxford University Press, New York 2002); Russian Axis, *The Judicial System of the Russian Federation* 11-13; Hendley, 'Assessing the Rule of Law in Russia'.

[404] See U.S. Department of State, '2005 Country Report on Human Rights Practices in Russia' (2006) <http://www.state.gov/g/drl/rls/hrrpt/2005/61671.htm>accessed 8 March 2006; U.S. Department of State, *Supporting Human Rights and Democracy: The U.S. Record 2006* (2006).

state or private, prepared to challenge the federal executive.[405] Fourthly, property rights in Russia remain insecure, and the Yeltsin-era privatisation settlement remains open to further, possibly substantial, revision.[406]

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[405] See M Khodorkovsky, 'Liberalism in Crisis: What Is to Be Done?' (2004) 1 April The Moscow Times.com <http://www.khodorkovskytrial.com/pdfs/liberalism.pdf>accessed 12 August 2006.

[406] See eg Hedlund, 'Property without Rights: Dimensions of Russian Privatisation'; FOM (Public Opinion Foundation), 'Yukos and the Re-Division of Large Property.'" (2003) <<www.fom.ru>>accessed 1 May 2006; M Khodorkovsky, 'Personal Property and Freedom' *Vedomosti* (Moscow 28 December 2004) 1.

Chapter 2.

The Yukos Case: General Overview.

2.1. Introduction.

In 2003 the General Prosecutors Office of the Russian Federation, acting with the Kremlin's political blessing,[407] launched a series of planned criminal investigations aimed at crushing Russia's wealthiest businessman Mikhail Khodorkovsky and his allies.[408] Yukos Oil Company was also attacked as the core source of Khodorkovsky's wealth and power.[409] As the names of Khodorkovsky and Yukos were closely associated,[410] the whole affair was called "The Yukos Case".[411]

For some analysts the case is seen as an attempt to attack all the so-called "oligarchs" and is publicly understood to be a success for Putin's promotion of the "Rule of Law" in Russia.[412] Others understand the case as a restoration of Stalinist methods of political governance and the rigid abuse of human rights and basic democratic freedoms.[413]

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[407] –, 'Kremlin Vs. Yukos: Oil Company Caught in Kremlin Sights' (2003) September-October Russ Life.

[408] Defence Attorneys of Mikhail Khodorkovsky, 'Political Persecution of Mikhail Khodorkovsky: Comments on MBK's Arrest' (2006) <http://www.supportmbk.com/support/comments_legal.cfm>accessed 1 March 2007.

[409] See Salter, 'Yukos'.

[410] See MK de Vries and others, 'The Two - Headed Eagle - Mikhail Khodorkovsky and Yukos' (2005) 5 March Managmenttoday.com <http://www.managementtoday.co.uk/search/article/548120/the-two-headed-eagle-mikhail-khodorkovsky-yukos/>accessed 30 October 2007.

[411] See eg Shamseeva, 'Yukos's Affairs and the Yukos Case'; Jobatey and Vacano, 'The Yukos Case and Its Consequences - Interview with Sabine Leutheusser-Schnarrenberger'.

[412] Guriev and Rachinsky, 'The Role of Oligarchs in Russian Capitalism' 146-47.

[413] See CJ Chivers, 'Return of the Show Trial; Stalin and the Czars Haunt Khodorkovsky in the Dock' (2004) 7 November NYTimes <http://www.nytimes.com/2004/11/07/weekinreview/07chiv.html?_r=1&oref=slogin>accessed 15 May 2005; BF Lowenkron, 'Human Rights, Civil Society, and Democratic Governance in Russia: Current Situation and Prospects for the Future' (2006) <http://www.state.gov/g/drl/rls/rm2/2006/68669.htm>accessed 15 February 2006.

The Yukos case is the first known Russian corporate disaster.[414] The political,[415] legal and economic[416] implications of the case are manifold and their comprehensive assessment will probably take several decades.[417] Some academics compare the Yukos case with the collapse of other international corporate giants, putting the notorious Enron case at the helm.[418] Yet the Yukos case contains more ambiguities, legal "black spots" and raises more questions than any other case in recent corporate and white-collar crime history. It flags a completely new era of corporate fraud and money laundering scandals.[419]

This chapter pursues the main aim of describing the Yukos case concisely, showing the links between the "secondary level" cases comprising the "Big Yukos Case" and their overlap.

It is important to note that whilst the Yukos case is recognized as a "legal beast" of tremendous complexity, it is still developing[420] and branching out.[421] Therefore, the case is to be reviewed as an ongoing progress, including the analysis of possible future events. The main events in the Yukos criminal case have been highlighted in the previous chapter that describes the timeline of events in the Yukos affair as a whole.

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[414] FOM (Public Opinion Foundation), 'Yukos and the Re-Division of Large Property.'; Shamseeva, 'Yukos's Affairs and the Yukos Case'.

[415] See eg Kononczuk, *The "Yukos Affair", Its Motives and Implications*.

[416] See Goriaev and Sonin, 'Prosecutors and Financial Markets'.

[417] See Jobatey and Vacano, 'The Yukos Case and Its Consequences - Interview with Sabine Leutheusser-Schnarrenberger'; Schor, 'The Yukos Affair: Rectifying the Past or Polluting the Future?'.

[418] Guriev, 'Enron, Yukos and the Gatekeepers'.

[419] See Lavelle, 'Experts on the Yukos Affair and Impact'.

[420] See eg Presscenter, 'Lebedev Submits Third Appeal to Strasbourg' (2007) <http://www.khodorkovsky.info /lebedev_in_colony/135784.html>accessed 7 November 2007.

[421] See eg A Ostrovsky, 'Volgotanker Sights a Yukos Event Horizon' (2005) 4 March FT.com <http://www.ft.com/cms/s/0/b5425f0c-8c53-11d9-a895-00000e2511c8.html>accessed 10 November 2007.

2.2. Literature Review.

The sources on the problem of Yukos/Khodorkovsky case and its political motivation are numerous as the case has lasted for more than four years and is still in progress.[422] However, the criminal side of the Yukos story has been analysed only in a limited number of sources, amongst which the most comprehensive ones are electronic. This can be explained by the unprecedented and politically controversial nature of the case.

It should be noted that the information environment surrounding the Yukos case is extremely politicised.[423] The Kremlin never stops playing its own public relations games, trying to persuade the international community that Khodorkovsky and his allies are just high profile, experienced criminals.[424] Therefore, the Yukos-related information landscape can be divided into three main groups of sources.

Non-sponsored academic and professional sources

From the sources regarded as neutral, only one book is published: "The schemes for which Khodorkovsky is behind bars", by A. Rodionov. However, this book is only an overview of the summary of charges of the "First Khodorkovsky case" with some comments and special emphasis on the tax evasion issues, and cannot claim to be a comprehensive source on the case as a whole.[425] The principles of the Khodorkovsky case in the context of the current Russian business and legal environment were further researched by Rodionov and his co-author in the book "Tax Evaders of Putin's Epoch: Who are they?"[426]

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[422] See eg Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

[423] See eg Orszag-Land, 'Putin Pursues Russia's Oil Oligarchs'; Tompson, *Putin and the 'Oligarchs': A Two-Sided Commitment Problem*.

[424] See eg V Perekrest, 'What Is Mikhail Khodorkovsky Behind Bars for (Part 1)' (2006) 18 May Prigovor. RU <http://prigovor.com/info/37302.html>accessed 14 December 2006 and his subsequent publications.

[425] See Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison*.

[426] See J Vitkina and A Rodionov, *Nalogovye Prestupniki Epokhi Putina: Kto Oni? [Tax Evaders of Putin's Epoch: Who Are They?]* (Vershina, Moscow 2007).

Amongst western commentators on the Yukos/Khodorkovsky case, only one commenting comprehensively on the legal aspects of the case has been identified so far. In 2004 the American lawyer Peter Clateman, who has practiced in Russia for several years, posted some papers to Johnson's list.[427] These papers concern the early developments of the Yukos/Khodorkovsky case, and, unfortunately, have not been updated. They represent a rare attempt to comment on a Russian criminal case from an international perspective.[428] The recently published Fortescue book, "Russian's Oil and Barons and Metal Magnates" mostly analyses the socio-economic reasons for the Yukos affair rather than the criminal case itself.[429]

Sources, presumably sponsored by Khodorkovsky defence and Group Menatep

The sources that defend Yukos and Khodorkovsky are primarily international or foreign newspapers and magazines.[430] The main publications are summarised on two international web sites www.khodorkovsky.info and www.mikhailkhodorkovskysociety.blogspot.com. www.khodorkovsky.info has its "mirror" site in Russian www.khodorkovsky.ru, which is known as the main site about the attack on Yukos/Khodorkovsky. After the commencement of the Yukos bankruptcy procedure, the main Yukos site, www.yukos.com, stopped being properly maintained and the relevant information concerning Yukos began to be posted by the Khodorkovsky press-centre on www.khodorkovsky.ru. The main players on the Yukos/ Khodorkovsky side have their own web sites such as www.platonlebedev.ru (the official site of Platon Lebedev); http://www.robertamsterdam.com (the official site of Khodorkovsky's international lawyer Robert Amsterdam).[431] There are several other web resources, which

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[427] See <http://www.cdi.org/russia/johnson/default.cfm>.

[428] See eg P Clateman, 'Summary and Analysis of the "Statement on the Form of the Indictment Presented to Platon Lebedev"' (2004) April 1 Johnson's Russia List <http://www.cdi.org/russia/johnson/7462-9.cfm>accessed 10 February 2007; P Clateman, 'Further Legal Observations on the Yukos Affair' (2004) 3 September Johnson's Russia List <http://www.cdi.org/russia/johnson/Yukos-tax.pdf>accessed 6 March 2007; and his other publications, assesible on Johnson's list.

[429] S Fortescue, *Russian's Oil Barons and Metal Magnates* (Palgrave Macmillan, New York 2006).

[430] The comprehensive list of the main publications is located on <http://www.khodorkovsky.info/media>.

[431] Amsterdam & Peroff (www.amsterdamandperoff.com).

continually publish supportive information on the case,[432] belonging to the main Russian human rights institutions or NGOs (for example, the Sovset Groupe - www.sovest.org). However, these sites merely reproduce the information posted on Lebedev and Khodorkovsky's main web sites.

There are also several recently published books on the case including "Mikhail Khodorkovsky: The prisoner of Tishina",[433] which, unfortunately is just a highly politicised semi-fictional story about Khodorkovsky's preliminary detention and trial.

Sources, sponsored by the Russian authorities and state-owned companies

There are three main groups of the sources on the case, which represent opposition views on the case and deliver pro-governmental information to the public and other mass media. Firstly there is the "general" official public mass media, controlled by the government, official political parties or state-controlled companies.[434] A well known project was the publication of a series of articles: "What is Mikhail Khodorkovsky behind bars for?" by Vladimir Perekrest in one of the most popular "Former-Soviet" Russian newspapers "Izvestia". These articles attempt to explain that Khodorkovsky and his allies have been prosecuted for an attempt to commit a "soft oligarchy coup" and for attempting to monopolize political power in the country.[435] The second source is comprised of web resources, created exclusively for the "information war" within the Yukos/Khodorkovsky case. The typical representative of this group is the web site www.prigovor.com with its Russian language "mirror" www.prigovor.ru, which gathers and publishes all the "opponent" data on the case.[436]

The third group of anti-Yukos mass media comprises of one important official web-site belonging to the General Prosecutors Office of the Russian Federation. It has published quite a number of press releases and the main summaries of Khodorkovsky and Lebedev's

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[432] See eg <http://letthemgonow.org>.

[433] See Panyushkin, *Mikhail Khodorkovsky: Prisoner of Thishina*.

[434] RBC.ru, 'Press Freedom List: Russia Ranked 121st out of 139' (2003) <http://www.eng.yabloko.ru/Publ/2003/I-NET/030910_rbc_ru.html>accessed 2 March 2007.

[435] Perekrest, 'Khodorkovsky (Part 1)' and his subsequent publications in Izvestija.

[436] On this site see <http://nevzlin.livejournal.com/133993.html>.

charges. So the domestic mass media is completely under state control and exclusively on the side of the prosecution.[437]

The difference in the approaches to the same events makes the proper cross-checking and triangulation of the relevant data extremely important.

2.3. Methodological Issues.

2.3.1. The Limitations of the Study Related to Russian Criminal Law and Procedure.

This research will be focused on the issues related to Russian criminal law and procedure as the Yukos criminal investigations and court hearings have mostly taken place in Russia. However, the former management of the Company and its core shareholders, who represented part of the opposition to Vladimir Putin, have made desperate efforts to give the case international publicity, presenting it as a benchmark case which illustrate the evils of Putin's regime.[438] As mentioned previously, the case, in its various aspects, has been reviewed by the U.S.[439] and U.K.[440] courts and several other jurisdictions[441] and extensive comments have been issued by a number of international political institutions.[442] Therefore, the Yukos-related criminal cases ought to be seen through the prism of international legal developments. An example is the Dutch case, concerning the forceful

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[437] See U.S. Department of State, *Supporting Human Rights and Democracy: The U.S. Record 2006.*

[438] See eg Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' 18-20.

[439] See eg *Re Yukos Oil Company* 2005 WL 517959 (Bankr SD Tex 2005).

[440] See eg *Russian Federation v Temerko* (Bow Street Magistrates' Court 23 December 2005).

[441] MosNews, 'Russia Asks Extradition of Former Yukos Executive Held in Italy' (2006) 16 May Mosnews.com <http://www.mosnews.com/news/2006/05/16/golubovich.shtml>accessed 27 March 2007; Kommersant.com, 'Khodorkovsky Accomplice Freed in Cyprus' (2007) 25 January Kommersant Online <http://www.kommersant.com/p736650/r_500/Vladislav_Kartashov_YUKOS_Cyprus/>accessed 25 March 2007.

[442] See Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"'; Amsterdam and Peroff, 'White Paper'.

sale of the Yukos Dutch subsidiary Yukos International B.V., where the court criticised the procedural issues of the tax cases against Yukos.[443]

There are three main types of action undertaken by Khodorkovsky and the Yukos defendants: 1) Political action aimed at getting international institutions and the U.S. and EU governments to recognize the case as being political;[444] 2) Applications filed with the international courts, including ECHR, and hearings in different jurisdictions, focused on the recognition of the political and selective nature of the Yukos case;[445] 3) Cases filed with the purpose of blackening the international reputation of the Russian political regime and creating certain obstacles to the business activities of the state owned companies that directly or indirectly participated in the seizure and confiscation of Yukos' assets, including in the first instance the YNG auction.[446]

The named groups of legal actions, taken abroad, should be seen as the main contributors to the "legal data" of the Yukos case besides the Russian criminal developments. Those cases should also be understood as creating the political and legal environment for further international and foreign disputes and for ECHR decisions.[447]

The series of tax avoidance and evasions cases, known as the "Yukos tax case" should be distinguished from other non-criminal cases. Although these cases are civil in their legal substance, they are closely linked to the criminal cases and their findings are actively used in them. The tax cases are connected to the money laundering side of the Yukos story and should be considered in their interrelation.[448]

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[443] See M Elder, 'Court Rebuffs Yukos Receiver' (2007) 1 November The Moscow Times.com <http://www.themoscowtimes.com/stories/2007/11/01/002.html>accessed 1 November 2007; Reuters, 'Dutch Court Voids Yukos Bankruptcy in Netherlands' (2007) 31 October Reuters UK <http://uk.reuters.com/article/oilRpt/idUKL31319559200710317sp=true>accessed 1 November 2007.

[444] MosNews, 'Wanted Yukos Shareholders Meet Bush in White House' (2005) 4 February Mosnews.com 5 <http://www.mosnews.com/news/2005/02/04/brudno.shtml>accessed 7 April 2007; MosNews, 'Yukos Shareholder Tells U.S. Audience of Putin's Authoritarianism' (2005) 15 December Mosnews.com <http://www.mosnews.com/feature/2005/07/14/newhelsinki.shtml>accessed 18 September 2007.

[445] The best example is the extradition cases in the UK. See *Russian Federation v Maruev et al* (Bow Street Magistrates' Court 18 March 2005); *Russian Federation v Temerko*.

[446] See *Yukos et al v FSA et al* [2006] EWHC 2044 (admin).

[447] See eg K Zigfeld, 'Is Mikhail Khodorkovsky a Political Prisoner?' (2007) 28 October Free Dominion <http://www.freedominion.ca/phpBB2/viewtopic.php?t=89688&sid=9f84c99c938aabf5075af9b27656885d> accessed 28 October 2007.

[448] The case is reviewed in Chapter 4.

When researching the Yukos-related criminal case several important remarks and reservations regarding the limitations on the scope of the study must be made.

One significant limitation on this research, mostly with regard to this chapter, is general accessibility of the data on the Yukos-related criminal cases. Due to the non-disclosure requirements imposed on the criminal defence lawyers by Russian law, only publicly available data may be used for this study. Use of such significantly abridged data may result in the exclusion of certain information (names, dates, figures, etc.) pertaining to the criminal cases.[449]

The next significant limitation on scope concerns alleged violent crimes. Although they comprise a highly publicised side to the Yukos story, they have to be excluded from the scope of this study as they are unrelated to the corporate and money laundering cases. Any research on such cases is likely to fail due to the strict non-disclosure commitments put on the defence by the prosecution. Therefore, any research on this area would have to overcome insurmountable obstacles resulting from very limited access to the relevant data.[450]

In order to avoid unnecessary repetition and detailed elaboration, criminal cases based on the same grounds (for example, different cases on tax evasion, pertaining to the same company, but to different years – i.e. "secondary cases") will be reviewed as one case.[451]

One of the significant problems concerning methodology is the problem of definitions, accurate "translation" and correct use of Russian legal vocabulary and legal data in the context of the study.[452] The limitations of this study do not allow for comment on the Russian legislation and practice at any time when Russian law or cases are cited. Thus, in order to avoid any possible mistranslations and misinterpretations the relevant

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[449] See eg The International Protection Centre, 'Harassment of Defence Lawyers of M.B. Khodorkovsky and P.L. Lebedev' (2006) <http://www.ip-centre.ru/modules.php?name=News&file=article&sid=204>accessed 27 May 2007.

[450] See D Igoshina and I Petrakova, 'Prosecutors Persevere with Yukos Murder Case' (2003) 28 September Gazeta <http://www.gazeta.ru/print/2003/09/19/Prosecutorsp.shtml>accessed 14 September 2006.

[451] See S Koverga, 'Tax Evasion Cases Slowed by Indecisive Courts' (2006) 19 October WPS Russian Media Monitoring Agency <http://global.factiva.com/aa/default.aspx?napc=S&fcpil=en&_XFORMSTATE=AAN>accessed 25 October 2006.

[452] See footnote 61.

terms will be used in meaning given to them by the western courts and international institutions, or the international lawyers in their comments and white papers. The necessary comments and clarifications will be provided where Russian law and practice significantly differ from the international or Anglo-American treaties, or where terminology, used in statutes or case law, being linguistically similar, has a different meaning in different judicial systems.

2.3.2. The Definitions of "the Case" and "the Group" in this Research.

2.3.2.1. The Case.

This chapter raises the problem of definitions, which is important for the whole research. It is important to note that the term "The Yukos case" is political in nature and used mostly by politicians and journalists, but not lawyers, to describe the attack on all Yukos and Khodorkovsky-affiliated companies and individuals. Such use of this term creates some problems and ambiguities for practitioners and academics.

In the current situation, when the "Main Yukos Case" or its constituent cases are still developing, being investigated, or are subject to certain judicial procedures in different common and civil law jurisdictions, the problem of definitions is aggravated. Cross-submission of the legal documentation makes the issue even more complicated.[453] Therefore, the primary terminological problem concerning the dissertation is how to define the term "case" in a way that is both comprehensible for Russian and international practitioners and academics.

The word "case" in the Yukos story is commonly used with three substantially different meanings:

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[453] For example, PACER list of filings for the case *Re Yukos Oil Company* 2005 WL 517959 (Bankr SD Tex 2005) contains 244 entry (<https://ecf.txcb.uscourts.gov>).

The "Yukos case" (the "Yukos Affair") or the "Yukos-Khodorkovsky case" in its entirety, can be defined as a state attack on the company, its shareholders, managers, employees, and other directly or indirectly affiliated individuals or companies. Sometimes, in order to be associated with the Yukos case it was sufficient just to declare a particular relationship to Yukos, Khodorkovsky or his allies.[454]

It can be used to describe the "group of cases", launched against the same individuals or on the grounds of the same circumstances.[455] An example of such an approach is the so-called "VNK" case, launched on Khodorkovsky, Lebedev, Nevzlin and others in respect of the alleged embezzlement and laundering of the shares belonging to VNK.

The term 'case' is also used in accordance with the meaning given to it by the Criminal-Procedural Code of the Russian Federation – i.e. a formally separate criminal investigation procedure with particular identification details (a particular number, a responsible investigator, etc.).[456]

In the first two instances, the term "case" is used in its public and political meaning, which does not bear any particular legal significance, except for describing a nebulous group of cases, related to Yukos or Khodorkovsky. However, an analysis of the groups of interrelated cases will be used in this chapter in order to simplify the structure of the study.

When researching the criminal side of the Yukos story, it should be noted that one of the key reasons for the close interrelation between the Yukos tax case, as a corporate tax avoidance and evasion case, and the Khodorkovsky cases (the first and second) is the absence of criminal liability and criminal prosecution for legal entities in the Russian Federation.[457] Although this problem is under constant academic discussion,[458] Russian

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[454] MosNews, 'Lithuanian Court Refuses to Extradite Former Yukos Banker' (2006) 2 March Mosnews.com <http://www.mosnews.com/news/2006/10/23/babenko.shtml>accessed 20 September 2007. --, 'DJ Lithuanian Court Confirms Russian Banker's Asylum Status' (2006) 16 October Comtex News Network 1-1.

[455] See eg Compromat.RU, 'Vyvod Aktivov VNK [VNK Assets Stripping]' (2003) <www.compromat.ru/main/hodorkovskiy/shahn3.htm>accessed 10 March 2007.

[456] L Orland, 'A Russian Legal Revolution: The 2002 Criminal Procedure Code' (2002-2003) 18 Conn J Int'l L 133 - 388, 162-65, 76-79, 232-37.

[457] See CC RF art 19. On the Russina Criminal Code see Appendix 5 and Appendix 6.

law stipulates that legal entities of any type can only be subject to civil and administrative sanctions.[459] The principal characteristics of Russian administrative law, and its system of sanctions, make the question of how it differs from criminal law completely theoretical.[460] Administrative sanctions can be imposed on legal entities for violations of environmental law, labour law, custom law, anti-trust law and other branches of law, in the form of pecuniary penalties or different restrictions.[461] Tax sanctions for legal entities are classified as administrative, although managers responsible for large-scale tax evasions are criminally liable, as are managers responsible for serious violations of labour law, environmental law, etc.[462] Such duality means that in the business sphere, especially in taxation, sanctions for tax evasion can be imposed on a legal entity in the form of fines and criminal sanctions in different forms. These may include the detention of the responsible managers of a company. Therefore the tax authorities may conduct a tax audit and an administrative investigation against a company, and on the basis of their findings, the prosecution may launch a criminal investigation against the managers.[463]

In the Yukos/Khodorkovsky case, the prosecutors have used the methodology of bringing charges against the core shareholder and the chief executive officer of the corporation, instead of bringing charges of money laundering, fraud and tax evasion against the legal entity. This is despite the alleged crimes being "corporate" in nature. Within a different judicial system these alleged crimes could be attributed to the whole corporation as their primary beneficiary.[464]

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[458] See Y Kravets, 'Ob Ugolovnoi Otvetstvennosti Yuridicheskikh Lits v Sfere Predprinimatel'skoi Deyatel'nosti [On the Criminal Liability of Legal Entities]' (2004) 6 Zhurnal Rossiiskogo Prava [Journal of Russian Law] 70-77, 70.

[459] See eg ibid.

[460] See on the problems of administrative liability of legal entities in Russia D Cherkaev, 'Administrativnaya Otvetstvennost' Yuridicheskih Lits [The Administrative Liability of Legal Entities]' (2001) 11 Zakonodatel'stvo [Legislation] 51-59; L Ivanov, 'Administrativnaya Otvetstvennost' Yuridicheskikh Lits [The Administrative Liability of Legal Entities]' (2001) 3 Rossiiskaya Yustitsiya [Russian Justice] 21-23.

[461] Kravets, 'On the Criminal Liability of Legal Entities' 71.

[462] See eg A Borisov and I Makhrov, 'Administrativnaya Otvetstvennost' Za Narushenie Zakonodatel'stva O Nalogakh [Administrative Sanctions for Violations of Tax Laws]' (2003) 10 Pravo i Ekonomika [Law and Business] 53 – 59.

[463] See eg Vitkina and Rodionov, *Tax Evaders of Putin's Epoch* 235-40.

[464] See Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 11-12, 16-18.

To avoid any possible misunderstanding all the cases should be referenced in a manner that permits their correct and accurate identification. Hence, the following system of definitions will be used exclusively for the purpose of this dissertation.

The "Yukos case" will mean all the Yukos-related cases jointly as a group, concerning all the individuals and entities who are subject to criminal prosecution or adverse consequences under civil law, resulting, directly or indirectly from the conflict between Khodorkovsky and the State.[465] The terms "the Yukos/Khodorkovsky case" and "the Yukos case", will be used interchangeably, except for the cases related to Khodorkovsky exclusively.

A case with a particular name (for example, "VNK case") may include several legally or logically interrelated investigations, launched against particular individuals on similar grounds.[466]

A case with additional identification characteristics (for example, the case against Mr Smith, concerning the deals with VNK shares) will mean a particular investigatory case.[467]

2.3.2.2. The Group.

The term "organised criminal group" is also one of the core terms in the Yukos case. There are a number of problems in giving this term an accurate definition. The most important issue is its correspondence with the international and western understanding of organised criminal groups and the difference between the legal and political use of the term.

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[465] See eg Shamseeva, 'Yukos's Affairs and the Yukos Case'; Jobatey and Vacano, 'The Yukos Case and Its Consequences - Interview with Sabine Leutheusser-Schnarrenberger'; Volkov, 'Standard Oil and Yukos Cases'.

[466] See Koverga, 'Tax Evasion Cases Slowed by Indecisive Courts'.

[467] See -- 'Informatsiya O Dele Khodorkovskogo № 18/41-03 [Information on the Khodorkovsky Case № 18/41-03]' (2003) 21 July Kompromat.RU <http://www.compromat.ru/main/hodorkovskiy/spravka.htm>accessed 12 March 2007

In legal documentation, including the relevant Bills of Indictment, the term "Organised Group" or "Organised Criminal Group" are used in their direct legal meaning given in the Russian Criminal Code.[468] The commentary to the Code defines an organised group as "comprise[d] of two or more individuals who have joined efforts in order to commit one or several crimes. This variety of complicity is characterized by professionalism and stability."[469] Complicity refers to the agreement by the members of the organised group to engage in one or more criminal acts prior to their actually taking steps to implement any criminal objective.[470] The stability component requires the existence of "permanent ties between the member of the organised group and [choice] of particular methods of activity involved in the preparation and perpetration of their crimes. The stability of an organised group, therefore, requires prior agreement and a degree of organisation."[471]

The concept of an "organised group" bears some similarities to the concept of "organised crime" as defined in organised crimes statutes in the U.S.[472] An "organised group" under Russian law is closer to a group of conspirators under U.S. law. It does not require the use of a legal entity or of a quasi-corporate entity. Forming and acting as an "organised group" does not form a separate crime (although it stiffens the punishment applicable to specific crimes). The Russian Criminal Code does contain a separate concept of "organised crime"; Article 210 of the Criminal Code establishes a separate crime for what mirrors the definition of "organised crime" under U.S. federal and local statutes.[473] However, neither Khodorkovsky nor Lebedev are charged with this offence.[474]

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[468] Presscenter, 'The Bill of Indictment' (2003) <http://www.khodorkovsky.info/trial/case/133827.html> accessed 1 March 2007.

[469] CC RF art 35.

[470] Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 3-4.

[471] ibid.

[472] It also corresponds to the definition of "organised criminal group" given in the Article 2 of Palermo Convention. See United Nations Convention Against Transnational Organized Crime GA Res 55/25 (2000) UN GAOR 55th Sess Supp No 49 UN Doc A/RES/55/25 art 2.

[473] CC RF art 210.

[474] Clateman, 'Summary and Analysis of the "Statement on the Form of the Indictment Presented to Platon Lebedev"'.

Applying the concept of the "organised group" to the offences, allegedly committed by Khodorkovsky and his allies, the prosecutors aimed to achieve certain procedural and political goals:[475]

- holding Khodorkovsky, Lebedev and other defendants (existing and prospective) criminally liable for the alleged acts of other conspirators in the "organised criminal group";[476]
- extending the statute of limitations periods for the charged offences;[477]
- materially increasing penalties and tightening security measures such as pre-trial detention.[478]

According to existing Russian practice, any individual, employed or contracted by a company used by an organised criminal group for its criminal goals, may be charged with participation in organised crime.[479] He/she may also be documented as a member of several "organised criminal groups" allegedly involved in the criminal commitments of different criminal groups.[480] One popular investigative techinque is that sometimes not all the members of the relevant criminal group are named in the investigative documentation, and the legal formula: "the unknown (unidentified) members of the group" is used.[481] Such

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[475] See in general Defence Attorneys of Mikhail Khodorkovsky, 'Specific General Comments Regarding Charging Khodorkovsky with Having Committed Joint Crimes.' (2005) <http://www.khodorkovsky.info/docs/134205__AppealGroup.pdf>accessed 26 October 2007.

[476] See eg A Arutyunov, 'Organisovannye Gruppy I Prestupnye Soobscestva: Voprosy Kvalifikatsii [Organised Groups and Criminal Associations: Issues of Qualification]' (2002) 9 Zakonodatel'stvo i Ekonomika [Law and Business] 38-40, 38-39.

[477] See eg ibid.

[478] See Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 2.

[479] See C Belton, 'Officials Outline Case against Raided Bank' (2005) 12 December The Moscow Times.com <http://iib.ru/eng/news/fin/2005/12/fn1012.html>accessed 20 September 2007; M Lepina, 'Top Menedzherov Neftyanogo Obvinili v Sozdanii Ustoichivoi Gruppy [Bank Neftyanoi Top-Managers Are Charged with Organised Crime]' (2007) 3 October Kommersant Online <http://www.kommersant.ru/doc.aspx?docsid=810851>accessed 10 October 2007.

[480] Khodorkovsky-Lebedev-Krainov in the first Khodorkovsky case for the episode of the privatisation of Apatit and the Khodorkovsky, Lebedev, Nevzlin and others for the episode of VNK in the Second Khodorkovsky-Yukos case.

[481] See eg General Prosecutors Office, 'Obvinitel'noe Zaklyuchenie Po Obvineniyu Lebedeva Platona Leonidovicha v Sovershenii Prestupleniya [Bill of Indictment for Lebedev]' (2004) <http://www.khodorkovsky.ru/docs/1174__Obvinitel_noe_zaklyuchenie_Lebedevadoc>accessed 13 March 2007, 22, 28, 35.

formulae enable investigators to bring charges against any individual allegedly related to a particular group.[482]

The term "organised group" or "organised criminal group" may be used in this study with a reference to a case (e.g. "an organised group" in the Yukos embezzlement and money laundering case) or to the individuals involved (e.g. Khodorkovsky-Lebedev-Krainov group).[483] Any other reference to a group of people involved in a crime will need an explanation of the characteristics of a group and its membership.

2.4. The Structure of the Yukos Case.

The Khodorkovsky-Yukos case involves cases that mostly belong to one of the three main groups:

Group 1 "Khodorkovsky – related criminal cases"

This group comprises of criminal cases directly related to Khodorkovsky, based on the charges brought against him. Almost all these cases also pertain to his friend Platon Lebedev.[484]

These cases can be separated into two main groups: so called "The First Khodorkovsky Case" and "The Second Khodorkovsky Case", which began in December 2006 and, quite evidently, will continue to develop for several years to come.[485]

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[482] See NovayaGazeta, 'Defence Attacks' (2005) 7 April NovayaGazeta.Ru <http://2005.novayagazeta.ru/nomer/2005/25n/n25n-s14.shtml>accessed 23 September 2007.

[483] See eg *Opredelenie Po Delu M.B. Khodorkovskogo, P.L. Lebedeva I A.V. Krainova Otnositelno Prekrasheniya Proizvodstva Po Episodu "Apatit" [Russian Federation v Mb Khodorkovsky, Pl Lebedev and Av Kraynov (Court Decision in the Part of Accusation of Fraudulent Acquisition of the Shares of Open Stock Company «Apatit)]* (The Meshchansky District Court of the city of Moscow 16 May 2005) <http://wwwkhodorkovskyinfo/docs/133825__Court_Decisionpdf> accessesd 26 May 2006 (hereinafter - *Russian Federation v Khokorkovsky et al (Court Decision)*).

[484] BBC News, 'Yukos Ex-Chief Jailed for 9 Years'. V. Krainov (a former manager of Menatep Bank) was also a member of the organised group in the "First Khodorkovky Case" (several episodes), but in order to avoid a real sentence he actively cooperated with the GPO. See also O Luchterhandt, 'Legal Nihilism in Action' (2006) 4 April Eurozine <http://www.eurozine.com/articles/2006-04-04-luchterhandt-en.html> accessed 30 March 2007.

[485] See Appendix 7. See also CPC RF chapters IX-XV.

Group 2 "Other Yukos – related criminal cases"

These are criminal cases related to other individuals with different degrees of affiliation to Yukos, Yukos-related companies or the Menatep Group.[486] It should be noted that the scope of such cases can only be defined in general terms as some of them are of little or arguable relevance to the Yukos Affair.[487]

Group 3 "Yukos corporate civil and tax cases"

This group comprises civil and administrative cases related to Yukos Oil Company, its subsidiaries or other directly or indirectly affiliated legal entities, based on the charges brought against the individuals or serving as the grounds for bringing such charges.

Figure 8 summarises the civil, administrative and criminal cases comprising the Yukos case and shows their subordination. Other figures in this chapter represent findings of the courts in the relevant cases, focusing on the relationships of the participants which gave grounds for bringing criminal charges. The tables in this chapter describe, in an abridged form, the charges brought in the relevant episodes with references to particular articles of CC, summarising the court verdicts and the decisions of the cassation.

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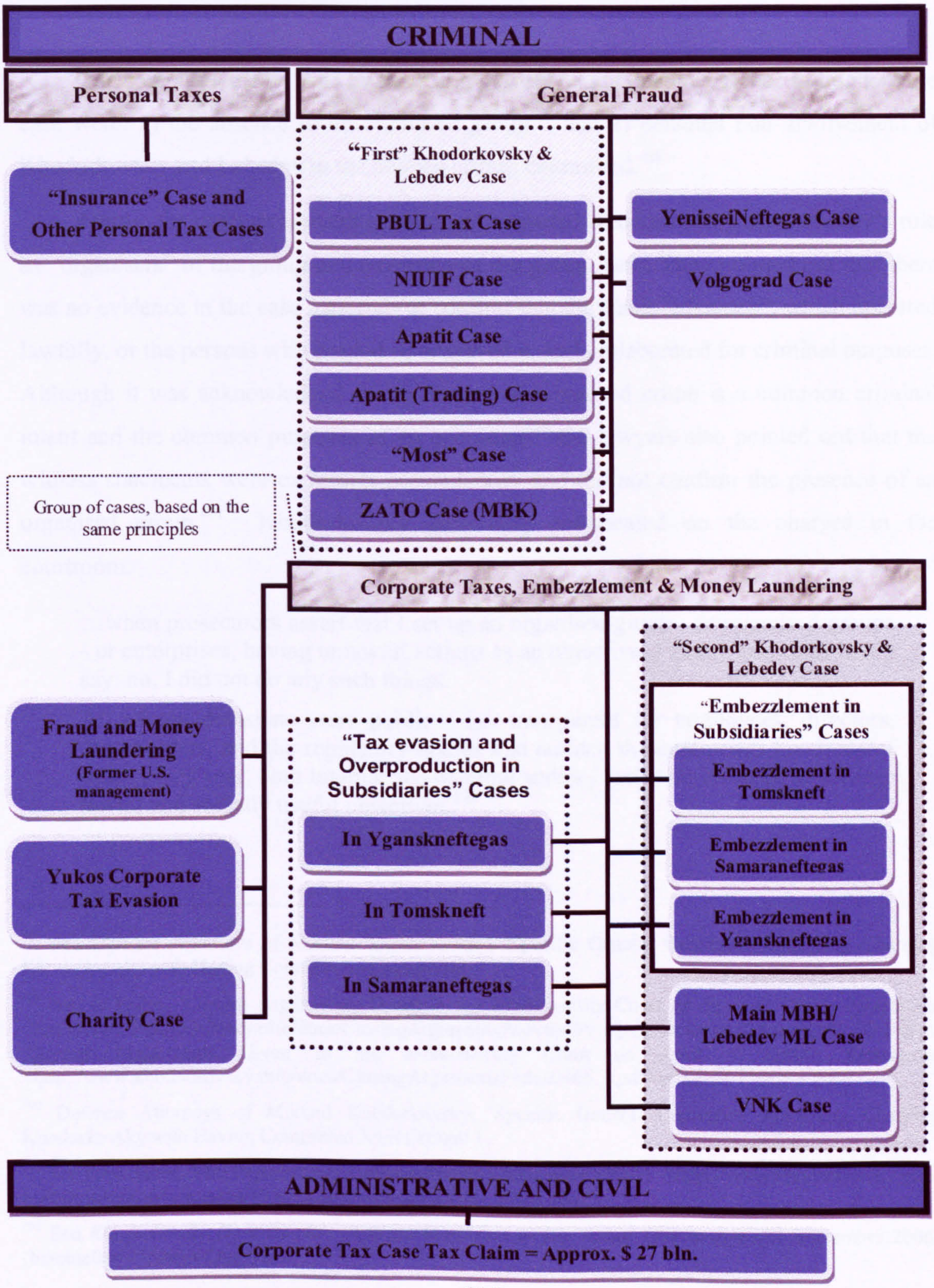
[486] See eg MosNews, 'Russian Court Jails Former Yukos Manager for 14 Years'; R Ukolov, 'The Case of Yukos: Trial Three' *Nezavisimaya Gazeta* (Moscow 8 July 2005) 3.

[487] See eg Commodities Service DowJones, 'DJ Lithuanian Court Confirms Russian Banker's Asylum Status' (2006) <http://global.factiva.com/aa/default.aspx?napc=S&fcpil=en&_XFORMSTATE=AAN...>accessed 16 March 2007; Kommersant.com, 'Lithuania Denies Asylum to Russian Banker' (2006) 23 May Kommersant Online <http://www.kommersant.com/p675494/Lithuania_Denies_Asylum_to_Russian_Banker/>accessed 20 March 2007.

Figure 8. "The Principal Structure of the Yukos Case."



2.5. The Arguements of the Defence Regarding the "Organised Criminal Group".

The core arguements used by the Khodorkovsky and Lebedev defence throughout the case were: 1) the absence of an organised group[488] and 2) personal non-involvement of Khodorkovsky and Lebedev in the alleged crimes committed.[489]

Firstly, the defence lawyers unanimously rejected Khodorkovsky and Lebedev's role as "organisers" of the group and existence of the group itself. They pointed out that there was no evidence in the case materials to confirm that the Bank "Menatep", which operated lawfully, or the persons who headed it, or served it, had collaborated for criminal purposes. Although it was acknowledged that a feature of organised crime is a common criminal intent and the common purposes of an operation[490] the lawyers also pointed out that the witness statements were extremely contradictory and did not confirm the presence of an organised group.[491] Khodorkovsky personally commented on the charges in the courtroom:

> ...when prosecutors assert that I set up an organised group - or organised groups - or enterprises, having unlawful actions as an objective, I firmly and confidently say: no, I did not do any such things.
>
> All of my decisions were public - i.e. transparent for employees, directors, shareholders, and the regulatory bodies that audited the enterprises hundreds of times every year, both internal and external audits - and were intended to achieve lawful and socially useful objectives.[492]

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[488] See Defence Attorneys of Mikhail Khodorkovsky, 'Specific General Comments Regarding Charging Khodorkovsky with Having Committed Joint Crimes'.

[489] See G Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' (2005) Presscenter <http://www.khodorkovsky.info/docs/ClosingArgumentsPadva0406_e.pdf>accessed 6 April 2007; G Padva, 'Closing Arguements Given in the Meshchansky Court on April 5' (2005) Presscenter <http://www.khodorkovsky.info/docs/ClosingArgumentsPadva0405_e.pdf>accessed 15 April 2007.

[490] Defence Attorneys of Mikhail Khodorkovsky, 'Specific General Comments Regarding Charging Khodorkovsky with Having Committed Joint Crimes' 1.

[491] See Presscenter, 'The Prosecution's Defence-Friendly Witnesses' (2005) <http://www.khodorkovsky.info/trial/prosecution/witnesses/133098.html>accessed 19 October 2007.

[492] See *Khodorkovsky (2) v Russia* (App no 11082/06) ECHR Annex One to App (21 September 2006) (hereinafter - "Annex One") 1-2.

Secondly, the advocates pointed out that the prosecutors and the court had not specified when, among what persons, or how the roles in the Organised Criminal Group had been distributed, when such a declaration had been necessary according to the Law. Instead, the decision of the court contained general phrases that the distribution of the roles had allegedly taken place.[493]

Thirdly, the lawyers stressed that *de facto*, the case materials established the existence of various associations close to the concept of a financial and industrial group, such as the "YUKOS" group of companies, which comprised OAO "NK "YUKOS" and its subsidiaries, "Group Menatep Limited" (GML) Holding, and, finally, the "Menatep" group of companies. A financial and industrial group under the Federal Law "On Financial and Industrial Groups" was a set of legal entities acting as a parent company and subsidiaries, which consolidated their tangible and intangible assets, fully or partially.[494] However, the prosecutors and the court effectively replaced the concept of "management of a commercial entity" with that of "management of an organised group created to commit a crime". Therefore, in a number of cases, the prosecutors and the court adduced evidence of Khodorkovsky's involvement in management of commercial entities as evidence of management of an organised group.[495]

Lawyers summarised their arguements on the organised group in the following manner:

> Thus, both in the charges and in the verdict there are irreconcilable contradictions regarding the creation and operation of the group. The membership of "the organised group" and the roles of Khodorkovsky and Lebedev are described in the same inconsistent manner.[496]

The arguements related to the "organised group concept" were critically important for bringing the guilty verdict necessary for Khodorkovsky's enemies. Therefore, all the arguements of the defence inevitably failed. The key reason for this failure was the actual leading role, played by Khodorkovsky in the management of Menatep Group and Yukos,

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[493] Defence Attorneys of Mikhail Khodorkovsky, 'Specific General Comments Regarding Charging Khodorkovsky with Having Committed Joint Crimes' 8.

[494] ibid 5-6.

[495] ibid 6.

[496] i.e. the prosecutors have fused concept of the governance of corporations with the management of criminal groups. See ibid 10-11.

which was quite evident for the prosecutors and the court, regardless of the defence's attempts to challenge it.[497]

As the above arguements of the defence were used with some slight differences in respect of each particular episode of the case, the relevant clarifications will be given where necessary.

2.6. APATIT "Privatisation" Case.

This case is understood to be a core part of "The First Khodorkovsky case", as it unfolded around the problem of fair privatisation in Russia.[498] The accused in this case were Khodorkovsky, Lebedev and Krainov.[499]

Khodorkovsky and Lebedev were accused of leading an organised group in the fraudulent acquisition of a 20% stake in the fertiliser producer Apatit at an investment tender in the summer of 1994.[500] The case began in 1994 when Bank Menatep and its controlled (affiliated) companies won a tender for Apatit, Russian largest fertilizer company.[501] The government auction to privatise 20% of Apatit was won by Volna, a firm controlled by the Menatep group.[502] According to the tender, Volna paid $225,000 for the stock and had to invest $283 million within a year in the development of the company and the city where the company was located (the "Investment Plan").[503] Volna failed to fulfill

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[497] See eg Figure 21.

[498] See Economist.com, 'Crime and Punishment' (2005) 25 May Economist.com 1 <http://proquest.umi.com/pqdweb?did=843880441&sid=1&Fmt=3&clientId=44714&RQT=309&VName=PQD>accessed 16 March 2007; J Scott-Joynt, 'Khodorkovsky: An Oligarch Undone' (2005) 31 May BBC <http://news.bbc.co.uk/2/hi/business/4482203.stm>accessed 28 September 2007.

[499] See *Russian Federation v Khokorkovsky et al (Court Decision).*

[500] Annex One 2.

[501] See the details of the Apatit story L Komisar, 'Yukos Kingpin on Trial. Billionaite Mikhail Khodorkovsky Faces the Music in Moscow. Are the Charges Politically Motivated?' (2005) <http://www.gnn.tv/print/1376/Yukos_Kingpin_on_Trial>accessed 2 March 2007. For more information on Apatit see <http://eng.phosagro.biz>.

[502] Four entities bid in the Auction – Volna, Malakhit, Flora and Intermedinvest Latta, 'Khodorkovsky, Menatep, and Yukos'.

[503] ibid.

several material requirements of Investment Plan for a number of reasons, the main one being the conditions of the Investment Plan were substantially outdated and its fulfillment would lead to negative consequences for the company and the investor.[504] However, the authorities succeeded in terminating the sale and purchase agreement in the Arbitration Court, so the share of Apatit had to be returned to the State. By the time the court decision became enforceable, the notorious shares were resold to the other companies and could not be transferred back to the State.[505] All that led to a lengthy and fruitless dispute between the State, represented by the Fund and Menatep Group.

In 2002 the Menatep and Yukos officials reached a compromise agreement with the Federal Property Fund, under which a settlement was paid to the Fund to the amount of $15 million as consideration for non-returned shares.[506] Just before the attack on Yukos the Prosecutor General conducted a special review of the Apatit privatisation procedure and the results of the tender, and reported no violations to the President.[507] However, it did not prevent this episode from being dragged into the Yukos case.

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[504] *Russian Federation v Khokorkovsky et al (Court Decision).*

[505] ibid.

[506] Goldhaber, 'Russian Roulette'.

[507] Latta, 'Khodorkovsky, Menatep, and Yukos'.

Table 1. "Summary of the "Apatit" Case."[508]

INDICTMENT[509]	VERDICT[510]	SENTENCE [511]	CASSATIONAL DECISION [512]
Apatit-fraud July 1994 **Art. 159 para 3 a, b of CC RF (1996)** [Acquisition of other people's property by way of deceit by an organised group in large quantities on repeated occasions.]	Pursuant to Art. 10 of the CC,[513] the Defendants' actions were labeled under Art. 147 para. 3 CC RSFSR (fraud committed in large quantities by an organised group)[514] The statute of limitation period expired during the court trial, so the criminal case in the part of this episode was discontinued.[515]	-	-
Apatit -malicious non-execution of Court Judgement 1998-2002 **Art. 33 para. 3 and Art. 315 of CC RF (1996)** [Malicious non-execution of an injured Court Judgement.]	Art. 33 para. 3 and Art. 315 of CC RF	**1.5 years** (All Defendants)[516]	Conviction reversed.

[508] See Annex One 2-3, *Khodorkovsky (2) v Russia* (App no 11082/06) ECHR Annex Two to App (21 September 2006) (hereinafter - "Annex Two") 3.

[509] Labelling according to indictment.

[510] Re-labelling in verdict.

[511] Sentence for the charge.

[512] Moscow City Court Cassational Decision.

[513] On Article 10 "The retroactive effect of Criminal Law" see Appendix 6.

[514] As this crime was committed in July 1994, then according to article 10 of the CC of RF, the court qualifies their actions under part 3 article 147 of the Criminal Code of RSFRS. See *Russian Federation v Khokorkovsky et al (Court Decision)*.

[515] ibid.

[516] See *Prigovor Po Delu M.B. Khodorkovskogo, P.L. Lebedeva I A.V. Krainova [Russian Federation v MB Khodorkovsky, PL Lebedev and AV Kraynov (Judgement)]* (The Meshchansky District Court of the city of Moscow 16 May 2005) <http://wwwkhodorkovskyru/docs/prigovor_16052005pdf>accessed 12 March 2006, 660-61.

In this case the prosecutors alleged three forms of fraudulent conduct. Firstly, the defendants conspired to create shell companies secretly controlled by Bank Menatep for the purpose of bidding. Secondly, the defendants knew that Volna, at the time it bid, had no intention of complying with the Investment Plan. Thirdly, the defendants organised the submission of false documents to the MRPF as part of the bidding process.[517]

As discussed before, the arguements of the defence were based on complete rejections of the existence of any ties between Khodorkovsky and Lebedev and the Apatit privatisation deal. According to the defence advocates there was no legal or factual basis for the Procuracy's leveling the criminal fraud charges regarding the Apatit episode. Under both the Russian Criminal Code and U.S. criminal law, a fraud conviction requires the establishment of a specific intent to defraud – *scienter*, malicious intent, or *mens rea* – at the time of the initial act. There was no, and could be no, evidence of any requisite malicious intent on the part of Khodorkovsky and Lebedev.[518]

The defence also pointed out that Bank Menatep owned no stock in any of the bidding companies, each of which was a separate and distinct corporate entity from the others, and had no business relationship with them beyond Volna, Flora and Malakhit being bank customers.[519] They also stressed that Menatep's relationship to the bidding entities had been disclosed. The Procurator's charges ignored this critical fact: Volna, Malakhit and Flora[520] each expressly disclosed their relationships with Bank Menatep in their submissions of applications for the privatisation tender: that each was a client of the bank; maintained a valid account with it; and that the bank guaranteed the financial performance of the Investment Plan.[521]

The defence argued that neither Khodorkovsky nor Lebedev was under an obligation to disclose any alleged common ownership, control or business relationships between or among the bidding entities. There was no express, affirmative obligation to make any such

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[517] *Russian Federation v Khokorkovsky et al (Court Decision)*; *Russian Federation v Khokorkovsky et al (Judgement)* 15-16.

[518] Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 5.

[519] ibid 6.

[520] The bidding entities. See ibid 5.

[521] ibid 6.

disclosure. Then, the applicable law did not prohibit affiliated entities from participating in the same auction.[522]

The defence also argued that the Meschansky Court should have terminated proceedings in relation to this charge as the statute of limitation period - i.e. the 10-year deadline from the date the crime was allegedly committed expired during the court trial.[523]

The case shows evident loopholes in the Russian privatisation legislation, especially concerning the obligations of purchasers to invest in newly acquired companies; and it highlights the questionable strategies employed by oligarchs to keep the control over the privatised assets.[524] Similar situations have taken place in two out of three privatisation scenarios. The case has gone some way to confirm that the whole case was politically motivated, as the deal was carefully examined by the prosecutors just before the attack was launched.[525] The case in this part was discontinued as the statute of limitation period had expired.[526]

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[522] ibid.

[523] Annex One 3.

[524] Eg L Aron, 'The Yukos Affair' (2003) Fall Russian Outlook 1-10, 2-5.

[525] It was confirmed in the letter of the Prosecutor General to the President. See Group Sovest, 'Khronika Sobytii [Chronicle]' (2006) <http://www.sovest.org/cron.html>accessed 20 August 2008.

[526] *Russian Federation v Khokorkovsky et al (Court Decision).*

2.7. The "APATIT Trading" Case.

The case is closely connected to the episode regarding the acquisition of the control of the Apatit shares and, according to the prosecutors, represents the second stage of the crime – benefiting from the illegal acquisition of the shares through the privatisation tender. The prosecutors alleged that Lebedev and Khodorkovsky organised and implemented the fraudulent transfer-pricing scheme, which allowed them to siphon off the profit from Apatit, accumulating it in the offshore entities, presumably controlled by Menatep.[527] The "Apatit trading case" charges formally included charges of misappropriation and of causing damage to property[528] in the process of implementing the transfer pricing scheme.

Table 2. "Summary of the "Apatit Trading" Case." [529]

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
APATIT **Misappropriation** (1995-2002) **Art. 160 para. 3 a, b of CC RF(1996)** [Misappropriation of other people's property in large quantities on repeated occasions.]	The matter of "repeated occasions" was excluded.[530]	**7 years** (Khodorkovsky and Lebedev)[531]	Requalified actions so that they came within Article 165 (3) (a) but the proceedings were dismissed because of the expiry of the limitation period.

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[527] *Russian Federation v Khokorkovsky et al (Judgement)* 14-19.

[528] As a result of the trading policy of the persons, controlling the company, adverse for Apatit.

[529] See Annex Two 2.

[530] This matter had been excluded from CC RF.

[531] See *Russian Federation v Khokorkovsky et al (Judgement)* 660-61.

APATIT **Causing damage to property** (1995-2002) Art. 165 para 3 a, b of CC RF (1996) [Causing on repeated occasions damage property to the property owners in large quantities by an organised group in the absence of elements of stealing.]	The matter of "repeated occasions" was excluded.	**3 years** (All Defendants)[532]	Reclassified from Article 165 (3) (a) (b) of the CC RF (1996) to fall within Article 165 (3) (a) of CC RF. Sentence upheld.

The prosecutors alleged that Khodorkovsky and Lebedev seized control of Apatit, its production and cash flows.[533] Acting under their management the company managers set up a transfer pricing scheme, selling Apatit products at low prices to their shell companies, which in turn sold them on the world market for much more.[534] The taxes and dividends were paid at a low figure,[535] and therefore, Khodorkovsky defrauded the company and shareholders of more than $200 million and the country of millions in taxes.[536] The prosecutors alleged that Lebedev and Khodorkovsky plundered a total amount of $ approximately 32 000 000.[537]

In this case, the defence again put forward the old arguement by saying that Khodorkovsky did not participate in the management of Apatit during this period.[538] They also stressed that only by using the questionable trading schemes was Apatit able to pay its debts and survive.[539] Under Menatep management, the loss-making company Apatit

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[532] See ibid.

[533] ibid 14.

[534] ibid 14-19.

[535] ibid 20.

[536] Komisar, 'Yukos Kingpin on Trial. Billionaite Mikhail Khodorkovsky Faces the Music in Moscow. Are the Charges Politically Motivated?'.

[537] *Russian Federation v Khokorkovsky et al (Judgement)* 18-19. See also Annex One 5.

[538] M Khodorkovsky, 'Final Statement to Meshchansky Court' (2005) 4 <http://www.khodorkovskytrial.com>accessed 11 April 2007.

[539] Y Schmidt, 'The Khodorkovsky Case: A Defence Attorney's Standpoint' (2004) <http://www.supportmbk.com/documents/schmidt_standpoint.cfm>accessed 15 December 2006.

became a profitable business.[540] The lawyers emphasized that no claims were filed by the authorities against the management and the trading policy. Moreover, the trading policy was approved by the Board of Directors and reported to the shareholders.[541] The advocates pointed out that the PwC opinion on the Apatit accounts contradicts the prosecutors' allegations.[542]

Clateman's comments on the "trading episode" of the case were not favorable for the defence:

> Although this charge is based on the same scheme described in the previous charge, it focuses on a different set of transactions, which took place during 1997-2000. Specific allegations made regarding these transactions and the flow of funds serve to demonstrate that K and L, through the organised group, converted funds representing the transfer price difference to their own use. This charge is straightforward embezzlement.[543]

The case is one in a series of contemporary "privatisation-related" cases, which like the Apatit acquisition, highlight the ambiguities and misinterpretations in the Russian privatisation and corporate legislation,[544] and simultaneously demonstrates the questionable methods of oligarchy groups,[545] who tried to use any loophole in the law to maximize their profit from the newly privatised assets. The case concerns the creation and the application of a plain "transfer pricing" scheme, ubiquitously used in 1990s' Russia, and should be regarded as the "predecessor" to the "Second Khodorkovsky Case". Taking into consideration the political significance of the case, which set up the precedent for challenging a whole class of "transfer pricing" schemes,[546] it is not surprising that Khodorkovsky and Lebedev were found guilty.

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[540] ibid; Khodorkovsky, 'Final Statement to Meshchansky Court' 4.

[541] Khodorkovsky, 'Final Statement to Meshchansky Court' 4.

[542] Schmidt, 'The Khodorkovsky Case: A Defence Attorney's Standpoint'; Khodorkovsky, 'Final Statement to Meshchansky Court' 4.

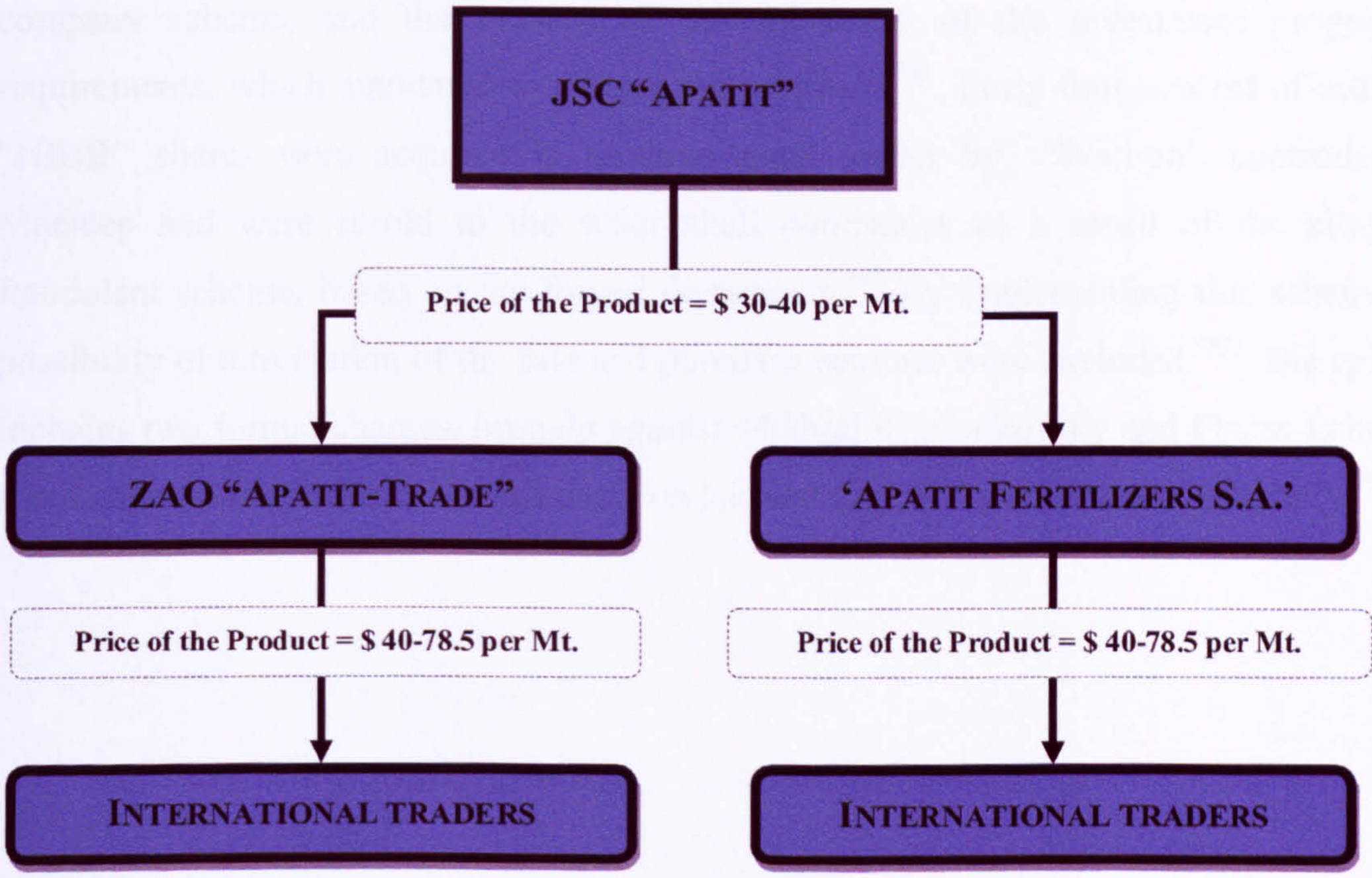
[543] Clateman, 'Summary and Analysis of the "Statement on the Form of the Indictment Presented to Platon Lebedev"'.

[544] Khodorkovsky, 'Final Statement to Meshchansky Court' 4.

[545] See RC Schneider, 'Property and Small-Scale Privitization in Russia' (1992-1993) 24 St Mary's LJ 507-38, 531-36; Shamseeva, 'Yukos's Affairs and the Yukos Case'.

[546] See eg V Ram, 'Yukos Memories Haunt Mechel' (2008) 25 July Forbes com <http://www.forbes.com/markets/2008/07/25/mechel-putin-zyuzin-markets-equity-cx_vr_0725markets 26.html>accessed 26 July 2008.

Figure 9. "The Scheme of the "APATIT Trading" Case."



2.8. The "NIUIF" Case.

The 'NIUIF'[547] case represents the same type of case as the "Apatit-privatisation" case, built on 90s oligarchy privatisation principles: acquisition by arranging a shell company scheme, and the evasion of the fulfilment of the investment programme requirements, which amounted to alleged illegal profit.[548] Forty-four percent of ordinary "NIUIF' shares were acquired in an investment tender by 'Wallton', controlled by Menatep and were resold to the other shell companies as a result of the allegedly fraudulent scheme, based on the forged documents.[549] By implementing this scheme the possibility of termination of the sale and purchase contract were excluded.[550] The episode includes two formal charges, brought against Mikhail Khodorkovsky and Platon Lebedev: fraud and non-execution of a court decision (similar to U.S. "abstraction of justice").[551]

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[547] AO 'NIUIF'- 'Professor Ya.V.Samoylov Research Institute of Fertilizers and Insecto-Fungicides' *Russian Federation v Khokorkovsky et al (Judgement)* 4.

[548] --, 'Advokat Dyavola: Kartinki S Vystavki - Delo NIUIF [The Devil's Advocate: the Pictures from the Exhibition- the Niuif Case]' (2004) <http://www.compromat.ru/main/ hodorkovskiy/ niuif.htm>accessed 22 July 2006. See also Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 4-18.

[549] --, 'The Devil's Advocate: the Pictures from the Exhibition - the NIUIF Case'.

[550] *Russian Federation v Khokorkovsky et al (Judgement)* 4-14; Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 5.

[551] See Annex One 11.

Table 3. "Summary of the "NIUIF" Case."[552]

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
NIUIF- Fraud **21.09.1995** **Art. 159 para. 3 a, b of CC RF (1996)**	A) The matter of "repeated occasions" was excluded. B) Pursuant to Art. 10 of the CC, the Defendants' actions were labeled under Art. 147 para. 3 CC RSFSR (fraud committed in large quantities by an organised group).	**7 years** (Khodorkovsky and Lebedev)[553]	Conviction upheld
NIUIF-malicious non-execution of Court Judgement **Art. 33 para. 3 and Art. 315 of CC RF(1996)**	Art. 33 para. 3 and Art. 315 of CC RF	**1.5 years** (Khodorkovsky and Lebedev)[554]	Conviction reversed

In the "NIUIF" case the prosecutors alleged that the organised group, directed by Khodorkovsky and Lebedev, developed and implemented a fraudulent scheme to plunder 44% of shares in 'NIUIF'.[555] Menatep Bank officials subordinate to Khodorkovsky and Lebedev abused their powers in order to draw up forged official documents that were requisite for the investment tender for sale of the 'NIUIF' shares. Lebedev also misused his powers as President of Bank Menatep in order to direct the conduct of the organised group, other persons working for the Bank, and associated companies under his control.[556] By

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[552] See Annex Two 1.

[553] See *Russian Federation v Khokorkovsky et al (Judgement)* 660-61.

[554] See ibid.

[555] ibid 4.

[556] ibid.

submitting the deliberately forged documents, the organised group misled the Russian Federal Property Fund (RFFI) officials as to the state of finances and good standing of the shell companies that had participated in the tender.[557]

The prosecutors also alleged that the organised group fraudulently persuaded the director of 'NIUIF' to approve a statement as to the performance of the investment commitments. They alleged that the director was coaxed into signing the papers that allowed for the transfer of the fraudulently invested funds back to 'Wallton'.[558] Because of the fraudulent actions, the organised group facilitated the transfer of the shares to the other shell companies, fraudulently evading the investment obligations.[559]

On 24 November 1997, the Moscow Arbitration Court annulled the purchase agreement for the 44 % block of shares in "NIUIF". The "NIUIF" shares were not returned to the state, but instead were sold by "Wallton" to the "dummy" companies. Thus the court decision was not executed.[560]

The arguements of the defence in this case can be divided into two main groups. The first set of arguements concerns the legality of the privatisation transaction and the material subsequent events concerning the investment obligations of the purchaser. The defence pointed out that the price of the privatisation transaction was fair and based on the political and economic realities of that time.[561] It was irrelevant whether the company that purchased the shares was a front company. The important factor was that Menatep Bank as the guarantor of the deal was a real structure, which could have been charged with the failure to comply with investment obligations.[562] They emphasised that the investment plan was outdated, but was fulfilled and the company suffered no damage.[563] It was stressed that

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[557] ibid 9.

[558] ibid 10.

[559] AOZT 'Wallton', as an investor, undertook to transfer the funds amounting to $ 25,000,000 or RUR 116,200,000,000 ibid 9.

[560] Annex One 11.

[561] Khodorkovsky, 'Final Statement to Meshchansky Court' 3.

[562] Schmidt, 'The Khodorkovsky Case: A Defence Attorney's Standpoint'; Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 12.

[563] --, 'Obseravtions from the Courtroom' (2004) <http://www.khodorkovsky.info>accessed 2 March 2007; Khodorkovsky, 'Final Statement to Meshchansky Court' 3; Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 18.

the failure to comply with the investment provision of the privatisation sale and purchase agreement was wrongly interpreted by the investigation as fraud, or gaining control of property by way of deception.[564]

Secondly, the defence lawyers employed their usual arguement that Khodorkovsky had not been personally involved and had not controlled the shell companies.[565] They also used the arguement of the passage of time: The commitment took place some 9 years ago and the statute of limitation period was likely to expire before the Judgement would come into force.[566]

In respect of non fulfillment of the court decision the defence argued that there was no court decision ordering the return of the block of shares in "NIUIF" to the state and so there was no possibility of evading any such decision.[567]

Clateman in his comments on the "NIUIF" episode paid attention on the lawyers "games" around the detention of the "purchase price". He pointed out:

> ...(The) arguement attempts to assert a rather peculiar definition of fraud and the Criminal Code and commentary make clear that fraud may be based on any attempt to evade full or partial compensation for property, whether or not such compensation is formally called the "price".[568]

Thus, he stressed that the "price" of the assets ("NIUIF") included the prospective investments that were never made.

In the NIUIF case as in the "Apatit trading" case,[569] ambiguities and monitions in the privatisation legislation, grossly supplemented by the oligarchy methods[570] of business

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[564] Schmidt, 'The Khodorkovsky Case: A Defence Attorney's Standpoint'.

[565] Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 9-14.

[566] Schmidt, 'The Khodorkovsky Case: A Defence Attorney's Standpoint'. According to Article 78 of CC RF for such crimes it is ten years since the date of the alleged commitment of the offence. For comments see VK Duyunov and others, *Kommentarii K Ugolovnomu Kodeksu Rossiiskoi Federatsii [Commentaries on the Criminal Code of the Russian Federation]* (Walters Kluwer, Moscow 2005) art 78.

[567] Annex One 11-12.

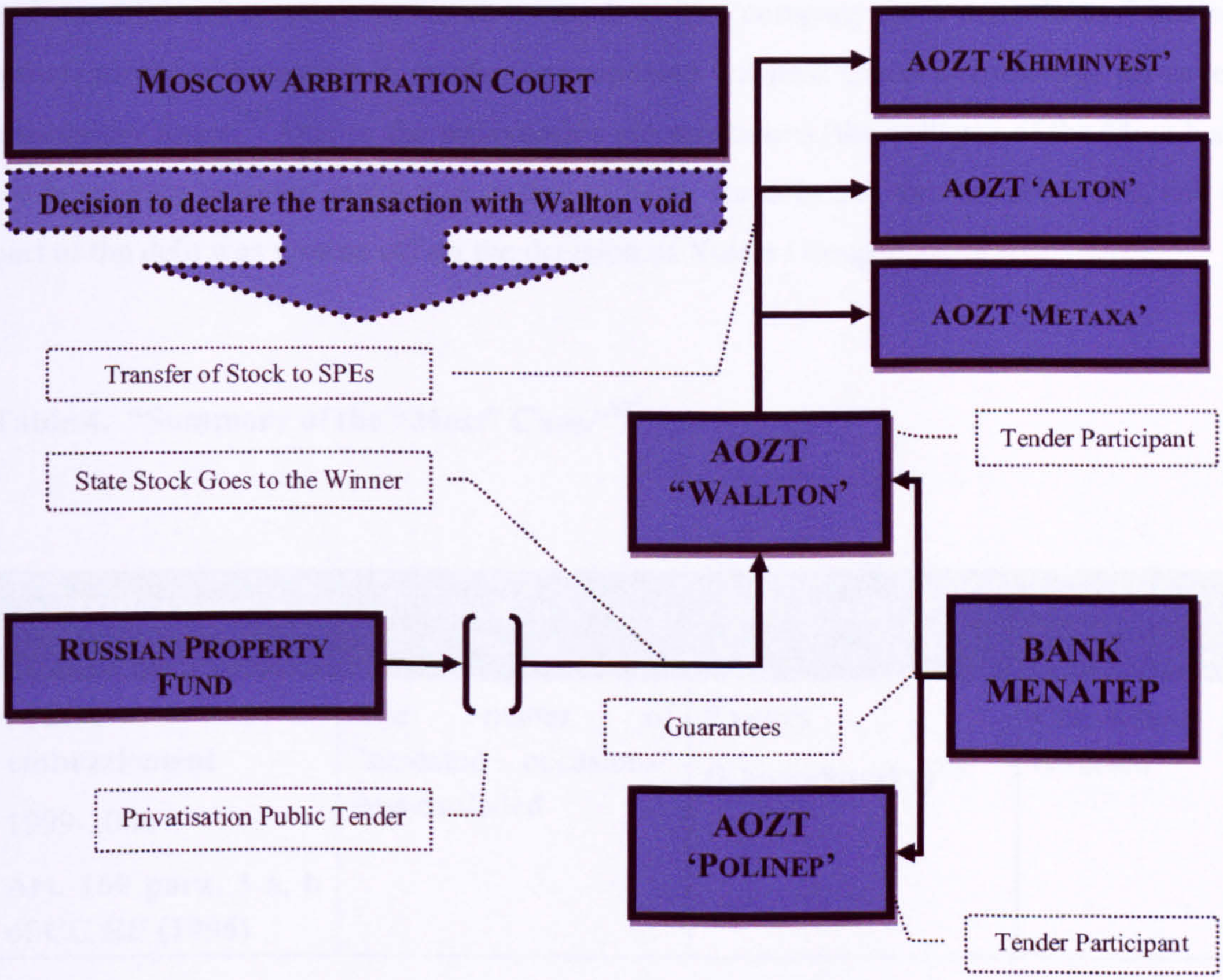
[568] PL Clateman, 'Yukos Affair, Part VII: Review of the Criminal Sentence and Appeal' (2006) 16 April 1-29, 9 <www.cdi.org/russia/johnson/Yukos-VII-Sentence-and-Appeal.pdf>accessed 29 March 2006.

[569] Khodorkovsky, 'Final Statement to Meshchansky Court' 3.

[570] See Tompson, 'Privatisation in Russia: Scope, Methods and Impact'.

conduct gave rise to a case full of legal ambiguities. As with the "Apatit trading" case, Khodorkovsky and Lebedev were convicted and sentenced.[571]

Figure 10. "The Scheme of the "NIUIF" Case."



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[571] *Russian Federation v Khokorkovsky et al (Judgement)* 57-58.

[572] --, 'The Devil's Advocate: the Pictures from the Exhibition - the NIIUIF Case'.

2.9. The "Most" Case.

In the "Most" Case Mikhail Khodorkovsky was accused of illegally taking 2,649,906,620 roubles from accounts belonging to YUKOS and some of its subsidiaries, and giving that money to Media Most group,[573] which was controlled by another oligarch Vladimir Gusinsky.[574] The problem is related to the recognition of the corporate groups and consolidated accounts in Russian case law. The company (as a consolidated business group) provided financing to another consolidated business group in exchange for several promissory notes.[575] Due to the unfavorable circumstances (the collapse of the Most bank) the borrowing business group was unable to repay the debt and the interest in full, and the part of the debt was written off on the decision of Yukos Group.[576]

Table 4. "Summary of the "Most" Case."[577]

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
MOST-embezzlement 1999-2000 **Art. 160 para. 3 a, b of CC RF (1996)**	The matter of "repeated occasions" was excluded	**7 years** (Khodorkovsky)[578]	Conviction reversed

[573] On Media Most group see Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 22.

[574] *Russian Federation v Khokorkovsky et al (Judgement)* 49-50.

[575] See Padva, 'Closing Arguements Given in the Meshchansky Court on April 5' 15-16.

[576] Sigal, 'Organised Business Group'.

[577] See Annex Two 5.

[578] See *Russian Federation v Khokorkovsky et al (Judgement)* 660-61.

The prosecutors declared that Khodorkovsky had been engaged in a scheme to funnel money from Yukos Oil Company to Vladimir Gusinsky, and in doing so caused the "organised group, illegally and gratuitously to remove and put into the hands of V.A. Gusinsky" monies belonging to Yukos and its shareholders, therefore committing a crime of misappropriation.[579] Khodorkovsky allegedly caused Yukos to loan RUR 2,649,906,620.00 (approximately $ 92 000 000) to Media Most Corporation and related companies ("Media Most") for the benefit of its largest shareholder, Gusinsky, in exchange for certain corporate notes and then wrote off the debt.[580]

The defence lawyers took the position that the agreements under which the "embezzled" funds were provided were public, official and compensated agreements.[581] The transfer of money was carried out, neither by the Defendant personally nor on his instructions. The transfer of money was carried out based on the authorization granted by the relevant managers of the company.[582]

The funds were transferred in exchange for interest-bearing notes of the Most bank, one of the largest banks in Russia at that time.[583]All funds granted under the agreements to the Most Group's companies were repaid by the borrowers.[584] The lawyers also pointed out that the General Prosecutor's Office had not filed claims against the managers of these enterprises in regard of the transaction, confirming, thus, the absence of *actus reus.*

In considering the cassation complaint, the Moscow City Court nullified the verdict and terminated the case because of the absence of *actus reus.*[585] Clateman commented on the reasons of this decision:

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[579] ibid 49.

[580] ibid 50.

[581] Khodorkovsky, 'Final Statement to Meshchansky Court' 4; Padva, 'Closing Arguements Given in the Meshchansky Court on April 5' 5.

[582] See Annex One 11.

[583] Khodorkovsky, 'Final Statement to Meshchansky Court' 4.

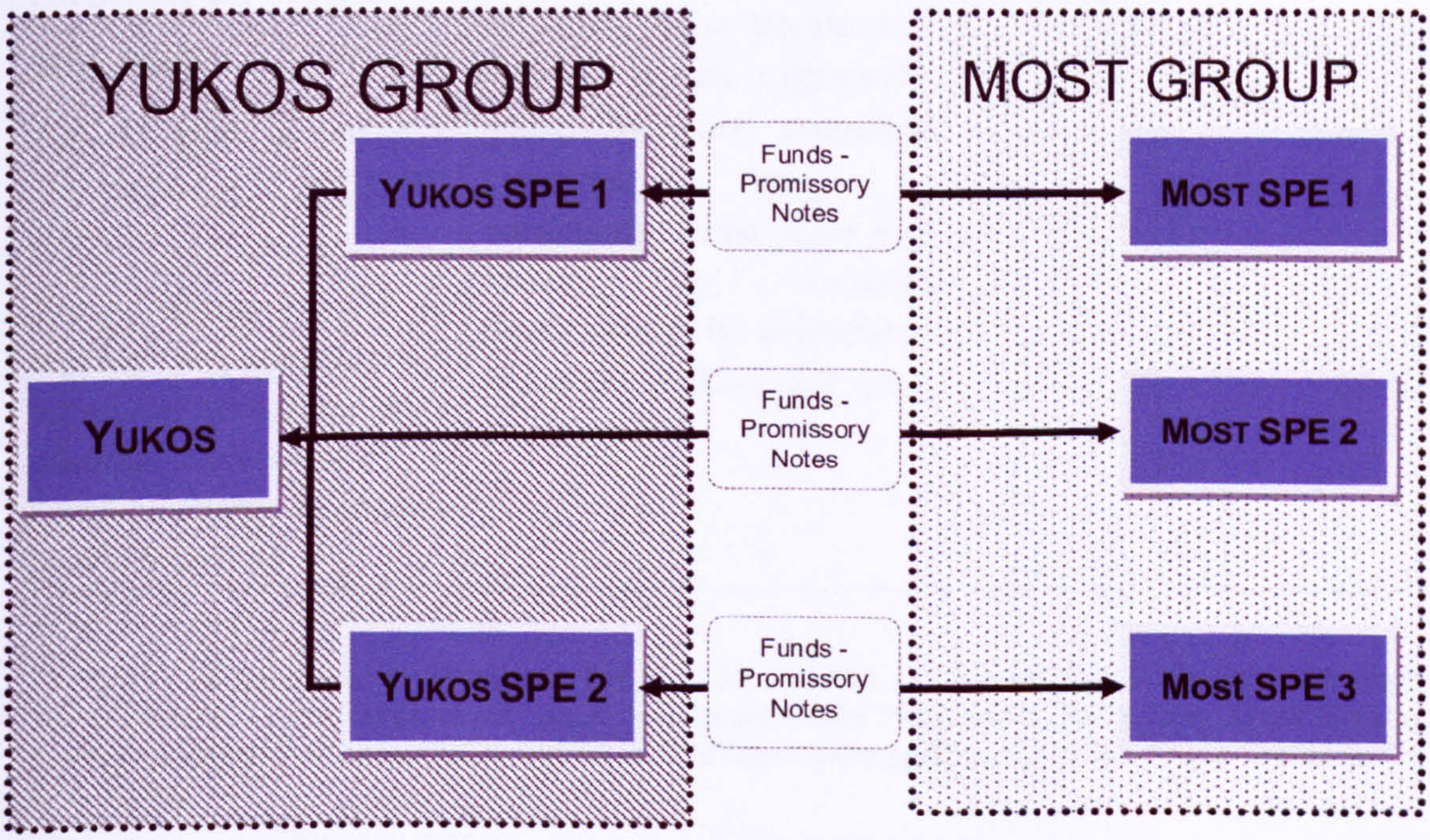
[584] ibid; Padva, 'Closing Arguements Given in the Meshchansky Court on April 5' 20.

[585] Court used the arguement that the funds could not be misappropriated in principle as they were allegedly acquired by illegal means and were not entrusted to Khodorkovsky. See *Kassatchionnoe Opredelenie Po Delu M.B. Khodorkovskogo, P.L. Lebedeva I A.V. Krainova [Russian Federation v MB Khodorkovsky, PL Lebedev, AV Kraynov (Cassation Decision)]* (Moscow City Court 22 September 2005)<http://www.khodorkovsky.ru/docs/3810__Opredelenie_2pdf>accessed 18 April 2006.

> ...The court identified these specific funds with the fruits of the tax schemes used by Yukos. Since these funds, as the fruit of a crime, were not legally owned by Yukos in the first place, the court reasons that K cannot be accused of illegally depriving Yukos of these funds. The problem with this arguement is that the court does not make clear how it succeeds identifying the specific funds channelled from Yukos to Media Most with the fruits of the tax evasion.[586]

The "Most" case demonstrates that Russian case law is far from recognising corporate\consolidated groups and treating the transactions between them as normal business practice. The existing ambiguities always create grounds for criminal cases.

Figure 11. "The Scheme of the "Most" Case."



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[586] Clateman, 'Yukos Affair, Part VII: Review of the Criminal Sentence and Appeal' 19-20.

[587] For the particularties of the transactions see Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges' 22-23.

2.10. The "ZATO"[588] Case.[589]

Khodorkovsky, Lebedev and several other individuals,[590] related to Menatep and Yukos, were charged with conspiring to evade taxes payable by businesses involved in marketing crude oil and petroleum products. [591]

Table 5. "Summary of the "ZATO" Case."[592]

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
ZATO- **corporate tax evasion** **1999-2000** Art. 33 para. 3 and Art. 199 para. 2 a, d of CC RF (1998) [Corporate tax evasion on repeated occasions by an organised group by prior criminal conspiracy in especially large quantities by other means]	Art. 33 para. 3 and Art. 199 para. 2 a, b of CC RF - organising of corporate tax evasion by an organised group by prior criminal conspiracy on a particularly large scale by failure to submit documents or by deliberate inclusion of false data into documents.	**5 years** (Khodorkovsky and Lebedev)[593]	The sentence upheld. 4 years 10 months

[588] "ZATO" or closed administrative area. See eg V Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia* (International Tax & Investment Center Publications 2003) <http://www.iticnet.org/publications/Special%20Report%20-%20ZATO%20Paper%20eng.pdf>accessed 20 August 2006. See also ZATO Law.

[589] For the tax part of the "ZATO" case see sections 4.5.4.1 and 4.5.4.2.

[590] Some of them are still on the Interpol search list. See A Krutilin, 'Criminal Alphabet of Yukos' (2007) <http://prigovor.com/info/37657.html>accessed 10 March 2007.

[591] *Bill of Indictment for Lebedev* 41-81; General Prosecutors Office, 'Obvinitel'noe Zaklyuchenie Po Obvineniyu Khodorkovskogo Mikhaila Borisovicha v Sovershenii Prestupleniya [Bill of Indictment for Khodorkovsky] (Extracts)' (2004) <www.khodorkovsky.ru/docs/71__Obvinitel_noe_zaklyuchenie_ FINdoc> accessed 13 March 2007, 19-29.

[592] See Annex One 7-8, Annex Two 4-5.

[593] See *Russian Federation v Khokorkovsky et al (Judgement)* 660-61.

ZATO – fraud **2000-2001** **Art. 159 para. 3 a, b of CC RF (1996)**	The matter of "repeated occasions" was excluded.	**7 years** (Khodorkovsky and Lebedev)[594]	Conviction upheld[595]

The prosecutors alleged that the Defendants and the Yukos group used dummy companies, which, for the purpose of tax evasion and in violation of Article 45 of the RF Taxation Code, paid taxes with promissory notes rather than with monetary funds.[596] The Defendants were also charged with fraud in connection with claiming refunds of tax overpayments that had been made in 1999. The prosecutors claimed that there was no entitlement to these refunds as they had been paid by promissory notes and the Applicant was charged under Article 159 (3) (a) and (b) of the Criminal Code.[597]

The Defendants claimed that they did not control or direct the dummy trading companies. These companies were lawfully registered in the ZATOs and lawfully transferred the promissory notes as a means of tax payment. The payment of taxes in non-monetary form was widespread until 1999 and was accepted as lawful by the RF Ministry for Taxes and Duties and the Ministry of Finance, as shown in their joint letter issued in December 1999.[598] Defendants pointed out that all of the promissory notes had been redeemed and therefore there was no pecuniary loss suffered by the ZATO at all, in fact the ZATO benefited from the payments received. Concerning the corporate tax fraud charge, the GPO did not dispute the fact that there had been an overpayment of tax. The overpayments were subsequently returned by the ZATO to the trading companies in full

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[594] See ibid.

[595] The Defendants was found guilty of this charge by the Meschansky Court. On appeal the Moscow City Court dismissed the charge but found him guilty on other grounds which had never been specified in the Bill of Indictment.

[596] See *Bill of Indictment for Lebedev* 41-81; *Bill of Indictment for Khodorkovsky* 19-29. On payments with promissory notes see Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 75-76.

[597] See ibid.

[598] See Annex One 7-8. See also Padva, 'Closing Arguements Given in the Meshchansky Court on April 6' 32-38.

compliance with the law. No damage was inflicted to the budget in the process of refunding the tax overpayments.[599]

The episode represents a typical case relating to the transitional period, when the Government used all possible means to collect the taxes due. Various regulations and clarifications made the situation with payment of taxes due by promissory notes unclear and ambiguous.

2.11. The "Personal Tax Evasion" Cases.

The defendants in this group of cases were Khodorkovsky and Lebedev (as an episode of the First Khodorkovsky Case) and several other individuals who were charged separately.[600]

Khodorkovsky and Lebedev used a technique that was widespread in Russia at that time.[601] The salary and bonuses of top-managers were paid to them partly as fees for independent consultancy services, provided under a separate agreement, to the company by which they were employed, or to a company belonging to the same corporate group.[602] This scheme allowed for the avoidance of the "social tax" payable on the salary fund. If a person, to whom the payments were made, was registered as a private entrepreneur with a special tax status enabling him to pay his taxes in a fixed form regardless to the income, a substantial portion of income tax could be avoided as well.[603]

Other individuals were charged with using a similar tax avoidance technique widely employed by the big Russian companies for their employees at the end of 1990s and

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[599] See Annex One 7-8.

[600] A Rodionov, 'A Look at Khodorkovsky and Lebedev's Taxes' (2005) 12 October Kommersant Online <http://www.kommersant.com/p616159/A_Look_at_Khodorkovsky_and_Lebedev_s_Taxes/>accessed 25 March 2007.

[601] ibid.

[602] See *Bill of Indictment for Lebedev* 52-58; *Bill of Indictment for Khodorkovsky* 30-34.

[603] Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 8-9.

beginning of 2000s.[604] According to the scheme, a substantial part of the employee's income was paid to him as an annuity payable pursue to the life insurance contract. The contract specified that an employee was entailed to a monthly payment after surviving a period of one month (so-called "survival insurance"). The insurance payment for a certain period was not taxable by personal income tax and, even when the tax legislation was amended; it helped the companies to avoid social tax on the salary fund.[605]

Therefore, all the named individuals committed large-scale personal tax evasion by means of the inclusion of knowingly distorted data in the tax declaration.[606]

Table 6. "Summary of the "Personal Tax Evasion" Cases."[607]

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
Entrepreneur Scheme **Individual tax evasion** **1998-1999** **Art. 198 para. 2 of CC RF (1998)** [Evasion of payment of a tax or insurance premium to state extra-budgetary funds committed by an individual by way of deliberate inclusion of false data into tax declarations, in especially large quantities.]	None	1 year 6 months (Khodorkovsky and Lebedev)[608]	Conviction in relation to 1998 reversed because of expiry of the Limitation period. Conviction for 1999 upheld Sentence reduced to 1 year and 4 months

[604] A Krutilin, 'Why Is Vasily Alexanyan Behind the Bars?' (2006) 26 November Prigovor.RU <http://prigovor.com/info/37479.html>accessed 19 March 2007; M Lepina and V Trifonov, 'Svetlana Bakhmina Gets Seven Years' (2006) 20 April Kommersant Online <http://www.kommersant.com/page.asp?idr=530&id=668151>accessed 20 March 2007.

[605] Krutilin, 'Why Is Vasily Alexanyan Behind the Bars?'.

[606] Rodionov, 'A Look at Khodorkovsky and Lebedev's Taxes'.

[607] See Annex One 9-10, Annex Two 3.

[608] See *Russian Federation v Khokorkovsky et al (Judgement)* 660-61.

Insurance Schemes **Individual tax evasion**[609] **2001-2002** **Art. 198 para. 2 of CC RF (1998)**	None	Two years[610]	Conviction in relation to 2001 and 2002 was re-labeled under Art. 198 para. 1 and reversed because of expiry of the Limitation period.[611]

Khodorkovsky and Lebedev[612] allegedly evaded personal taxes by registering as self-employed entrepreneurs, thereby making themselves eligible for the use of a simplified tax system.[613]

The prosecutors charged Khodorkovsky and Lebedev with illegal filing for transference to a simplified system of taxation, accounting and bookkeeping for the purposes of evasion of tax payments.[614] The defendants were also charged with including knowingly distorted data stating that they were providing consulting and managing services as entrepreneurs, which entitled them to obtain an exemption from income tax and fees to be paid to the Pension Fund.[615] The only reason they needed the exemption was to evade personal income tax.[616]

The prosecutors alleged that the defendants were fully aware that the funds they received from the company 'Status Services Limited' appeared to be their remuneration for

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[609] As an example on the basis of one of the verdicts. See Lepina and Trifonov, 'Svetlana Bakhmina Gets Seven Years'; T Smolenskaya, 'Yukos Lawyer Jailed for Embezzlement and Tax Evasion' (2006) 21 April Tax -News.com <http://www.tax-news.com/archive/story/Yukos_Lawyer_Jailed_ For_Embezzlement_And _Tax_Evasion_xxxx23385.html>accessed 27 September 2007.

[610] See Kommersant.com, 'Court Turns Down an Appeal of Yukos Ex-Lawyer' (2006) 25 August Kommersant Online <http://www.kommersant.com/p700085/r_500/Court_Turns_Down_an_Appeal_of_ YUKOS_Ex-Lawyer>accessed 10 October 2007.

[611] See ibid.

[612] Similar allegations were brought against several other individuals see Krutilin, 'Why Is Vasily Alexanyan Behind the Bars?'. See for the Shaknovsky's Sentence Y Biryukov, *Ubiistvo Bez Motiva [Murder without Motive]* (Olma Press, Moscow 2007) 124-47.

[613] See Annex One 9.

[614] *Russian Federation v Khokorkovsky et al (Judgement)* 32-43.

[615] ibid 35, 41.

[616] ibid 34, 39.

working for Rosprom and had to be taxed as any income earned.[617] Thus, having deliberately ensured conditions securing evasion of personal income tax and fees to be paid to the Pension Fund, the Defendants signed forged contracts with foreign companies 'Hinchley Ltd.' and 'Status Services Limited'.[618] Both included knowingly distorted data in the above contracts.[619]

Individuals involved in the insurance schemes were also charged with the inclusion of knowingly distorted data stating that they were genuinely obtaining non-taxable insurance payments, knowing that the funds they received from the insurance company actually appeared to be their remuneration for working for the companies of the Yukos Group.[620]

In Khodorkovsky and Lebedev's defence the lawyers extensively used political and social arguements. They said that not many people in Russia had independently declared their income from 1994 onwards as Khodorkovsky and Lebedev had done. Many entrepreneurs used similar schemes.[621] The tax authorities accepted the defendants' tax declarations and did not present him with any demands until criminal charges had been brought.[622]The defence also pointed out that no evidence of any reciprocal obligations with Rosprom or Yukos-Moscow was set forth in an employment agreement.[623] It was emphasised by the defence that no evidence of malicious intention or plot had also been submitted to the court.

As the individuals involved into the insurance schemes were mere middle level managers, their lawyers used different arguements. They stressed that their clients had to use the scheme as an essential part of their employment commitments. They also were not experts in taxation, so they did not know how to draw their annual tax returns and simply

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[617] ibid 36-37.

[618] ibid 33.

[619] ibid 33-34, 42.

[620] See eg Biryukov, *Murder without Motive* 97-98, 124-47.

[621] On personal tax-avoidance in Russia see: JL Franklin, 'Tax Avoidance by Citizens of the Russian Federation: Will the Draft Tax Code Provide a Solution' (1997-1998) (8) Duke J Comp & Int'l L 135-74; Vitkina and Rodionov, *Tax Evaders of Putin's Epoch* 209-22.

[622] See Annex One 10.

[623] See Khodorkovsky, 'Final Statement to Meshchansky Court'.

followed the advice provided by the Company. Their defence pointed out that all the accused had paid all the underpaid taxes and penalties voluntarily.[624]

Clateman represented a detailed analysis of Khodorkovsky and Lebedev's remuneration schemes in his articles on the Yukos case:

> The sentence sets forth various forms of evidence supporting its conclusion that these consulting contracts were "fake" and really represented pay for work at Yukos, Rosprom and Menatep.... All of the work performed in preparing applications for K and L to receive status as entrepreneurs and fill out their tax forms was performed by Yukos or Menatep employees.[625]

The personal tax evasion cases have created the precedents of challenging the core personal tax optimisation schemes, including the questionable practice of using secondment contracts. Actually the court, applying the "substance over form" doctrine,[626] which is rarely used in Russia, considered all the insurance contracts null and void and declared all the payments made under them a part of employees salary.[627] Episodes concerning personal tax evasion can exemplify the outcome of "pedagogical" justice, as Khodorkovsky's trial flagged the beginning of the unprecedented fight with so-called "grey" (illegal) salary schemes.[628]

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[624] Author's summary of the court speeches.

[625] Clateman, 'Yukos Affair, Part VII: Review of the Criminal Sentence and Appeal' 15-16.

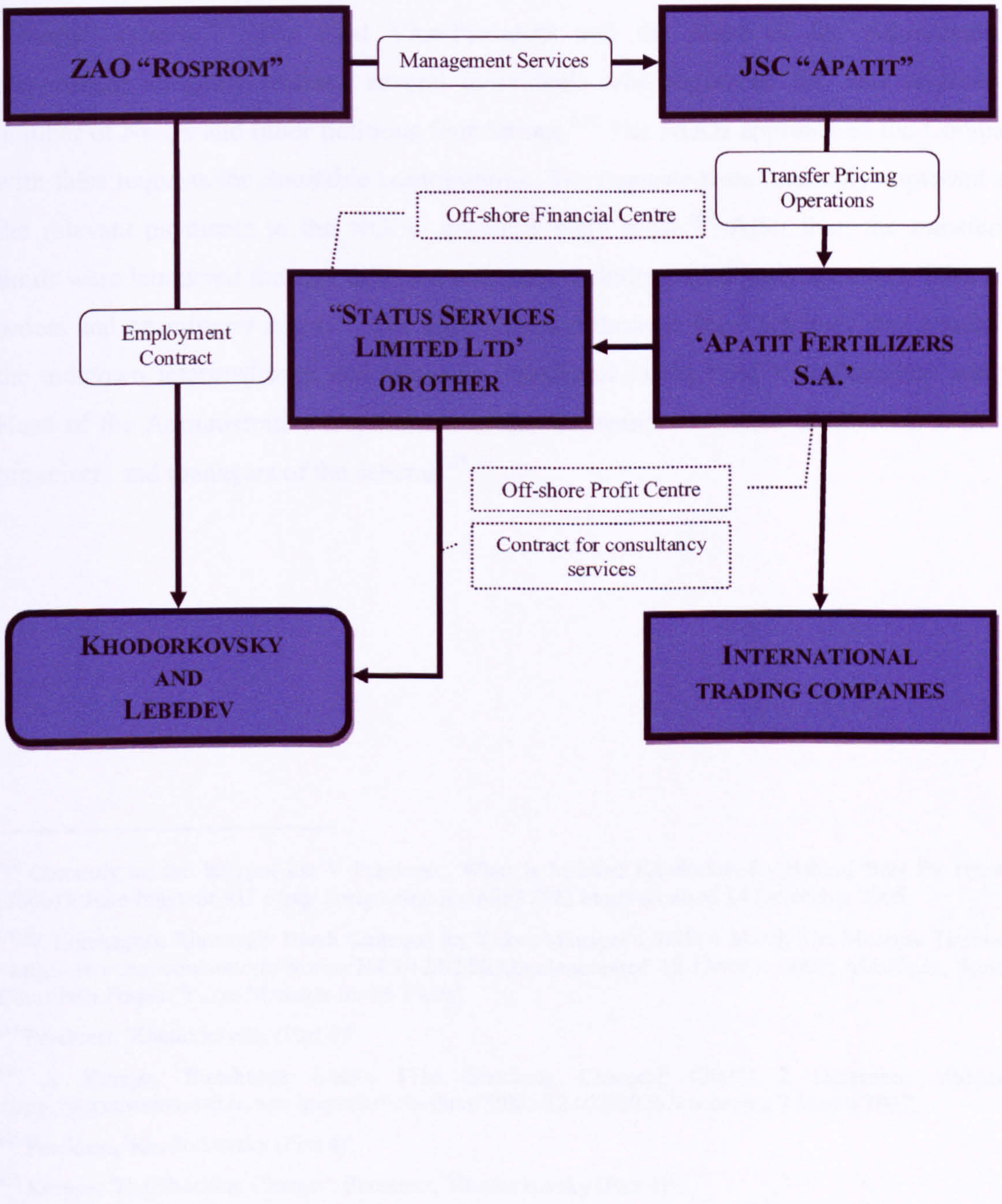
[626] On this and other international anti-avoidance doctrines see 174.

[627] See on the doctrine in Russia Clateman, 'Summary and Analysis of the "Statement on the Form of the Indictment Presented to Platon Lebedev"' and his other publications.

[628] For more details see Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison*; Rodionov, 'A Look at Khodorkovsky and Lebedev's Taxes'; Vitkina and Rodionov, *Tax Evaders of Putin's Epoch*.

Figure 12. "The Scheme of "Personal Tax Evasion" Case."

Khodorkovsky and Lebedev:



2.12. The "Charity" Case.

Two YUKOS officials (the First Vice-President[629] and the Head of the Administrative Department) and approximately a dozen outsiders who were allegedly providing services related to the laundering of the embezzled funds,[630]were charged with large-scale embezzlement and money laundering for the implementation of a laundering "charity" scheme.[631] The First Vice-President and the Head of the Administrative Department allegedly retained several individuals who registered for, and acquired, a number of NGOs and other fictitious foundations.[632] The NGOs approached the Company with false requests for charitable contributions. The requests were internally approved and the relevant payments to the NGOs' accounts were made.[633] After that, the transferred funds were laundered through different schemes, including third party accounts, false cash orders and promissory notes.[634] The cash obtained through these schemes was handed to the unknown intermediaries and allegedly transferred to the First Vice-President and the Head of the Administrative Department of the Company who were understood to be the organisers and managers of the scheme[635]

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[629] Currently on the Interpol list V Perekrest, 'What Is Mikhail Khodorkovsky Behind Bars for (Part 4)' (2006) 8 June Prigovor.RU <http://prigovor.com/info/37322.html>accessed 14 December 2006.

[630] V Korchagina, 'Unusually Harsh Sentence for Yukos Manager' (2005) 4 March The Moscow Times.com <http://www.moscowtimes.ru/stories/2005/12/02/003.html>accessed 15 October 2007; MosNews, 'Russian Court Jails Former Yukos Manager for 14 Years'.

[631] Perekrest, 'Khodorkovsky (Part 4)'.

[632] A Kornya, 'Strashnaya Staty'a [The Shocking Charges]' (2005) 2 December Vedomosti <http://www.vedomosti.ru/newspaper/article.shtml?2005/12/02/100267>accessed 7 March 2007.

[633] Perekrest, 'Khodorkovsky (Part 4)'.

[634] Kornya, 'The Shocking Charges'; Perekrest, 'Khodorkovsky (Part 4)'.

[635] Ukolov, 'The Case of Yukos: Trial Three'.

Table 7. "Summary of the "Charity" Case."

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
Embezzlement and money laundering 2004[636] **Art. 160 para. 4 of CC RF** [Large-scale misappropriation or embezzlement by an organised criminal group.] **Art. 174. 1 para. 4 of CC RF**[637] [Legalization of money or other property obtained in a criminal way by an organised criminal group.]	None	14 years for the Yukos manager.[638]	The sentence was upheld in its substantial part.[639]

[636] There is one more case in court concerning the same Yukos managers. See TASS, 'Money Laundering Case against Yukos Property Manager in Court' (2007) 5 April Legal Oil <http://www.legaloil.com/NewsItem.asp?DocumentIDX=1176116337&Category=news>accessed 25 April 2007.

[637] See eg I Paramonova, 'Yukos Money Was Laundered for Charity's Sake' (2005) 3 March Kommersant Online <http://www.kommersant.com/page.asp?id=551800>accessed 24 September 2007.

[638] See Mosnews, 'Prosecutors Seek Lengthy Jail Terms for Yukos Executives Accused of Money Laundering' (2005) 28 October Mosnews.com<http://p196.ezboard.com/fredcatsboardsfrm58.showMessage?topicID=2.topic&index=26>accessed 30 October 2006; Krutilin, 'Criminal Alphabet of Yukos'.

[639] See Y Zapodinskaya, '14 Years of Deprivation of Liberty for Alexey Kurtsin Is Upheld' (2006) 15 Chronicle of Political Persecution in Present Day Russia 7-8, 7-8 <http://www.khodorkovsky.info/docs/bulletin_60.pdf>accessed 10 October 2007.

The prosecutors alleged that 342 million roubles were transferred from the company's accounts under the guise of charity aid to fictitious nongovernmental organisations and foundations and later laundered.[640] Certain individuals registered these organisations in Moscow, Tula and other cities and channelled the embezzled funds through their accounts.[641]The investigators stressed that the majority of the money thus transferred was then transmitted to the First Vice-President and the Head of the Administrative Department and used for unknown purposes. [642]

Several of the accused individuals pleaded their guilt, partly or in full, saying that they had been involved in a series of the laundering operations and handed the cash obtained through them to unknown individuals.[643] However, the core accused (Head of the Administrative Department) denied all the charges and announced that he had simply performed his professional duties by signing orders to transfer the charitable payments.[644] His lawyers pointed out that the orders had been of a technical character and designated for the interim accounting procedures.[645] Moreover, all decisions to make payment were approved by the committee for consideration of corporate charitable projects comprised of respectable outsiders.[646] The defendant received no benefits in any form from the funds allegedly handed to the first Vice-President.[647]

The Head of the Administrative Department was sentenced to 14 years.[648] Other individuals have also been sentenced to various significant terms in spite of their confessions and assistance provided to the investigators. The case differs from the other Yukos-related cases, as it is based on commitments that took place after Khodorkovsky's

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[640] Ukolov, 'The Case of Yukos: Trial Three'.

[641] ibid; Perekrest, 'Khodorkovsky (Part 4)'.

[642] M Gessen, 'The Dear Departed Judiciary' (2005) 29 December The Moscow Times.com <http://www.themoscowtimes.com/stories/2005/12/29/006.html>accessed 7 March 2007; Kornya, 'The Shocking Charges'.

[643] See eg Kornya, 'The Shocking Charges'; MosNews, 'Prosecutors Seek Lengthy Jail Terms for Yukos Executives Accused of Money Laundering' (2005) 3 March Mosnews.com <http://www.mosnews.com/news/2005/10/28/yukstaffcharges.shtml>accessed 18 April 2007.

[644] Perekrest, 'Khodorkovsky (Part 4)'.

[645] ibid.

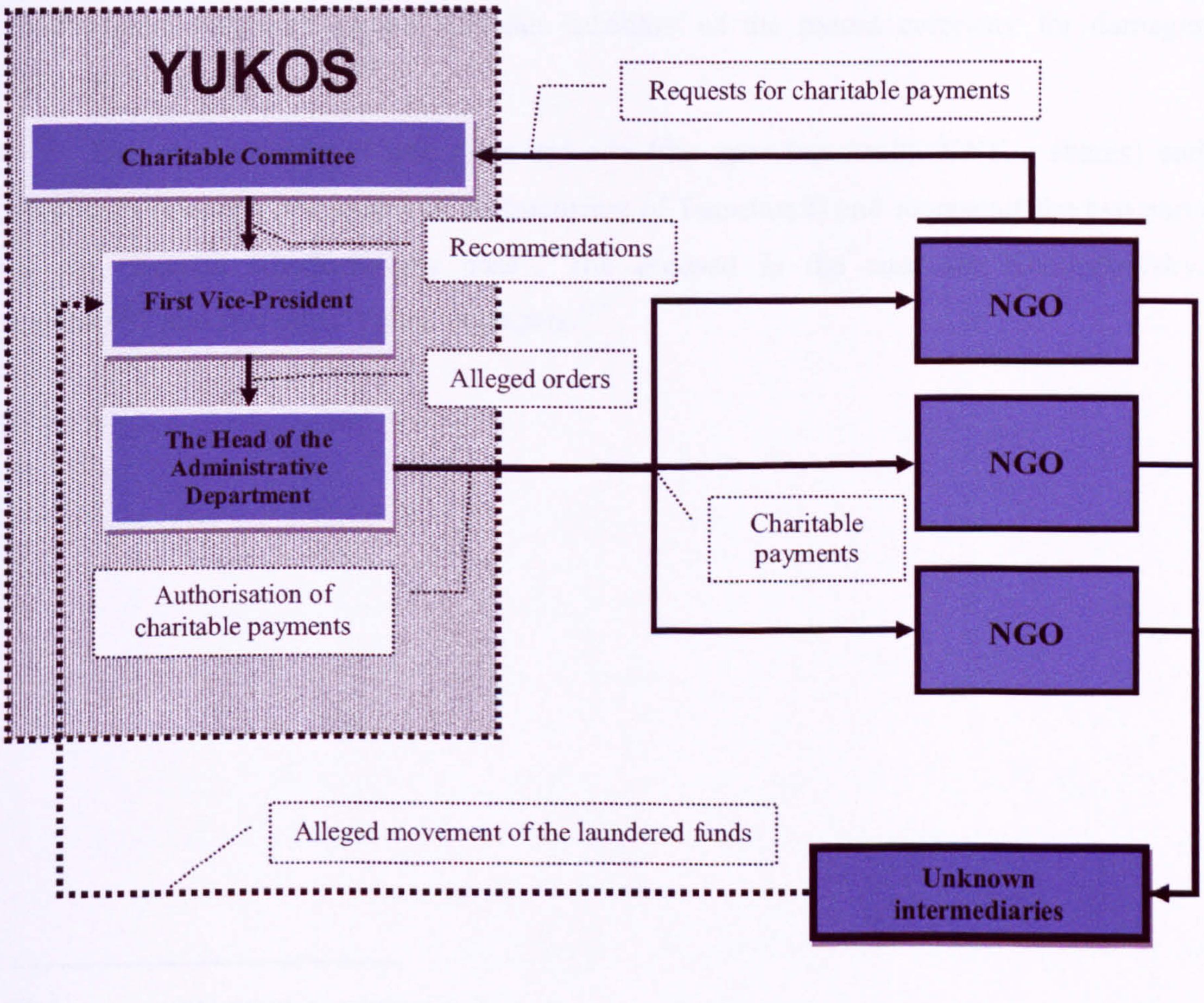
[646] Kornya, 'The Shocking Charges'.

[647] MosNews, 'Prosecutors Seek Lengthy Jail Terms for Yukos Executives Accused of Money Laundering'.

[648] MosNews, 'Russian Court Jails Former Yukos Manager for 14 Years'.

detention.[649] As the allegations of the prosecutors and legal assessment of the scheme are grounded mainly on the evidence and presence of intention of the Yukos' officials to commit an embezzlement, it is difficult to make any conclusion about either the ties of this case with the main Yukos case or its general validity.

Figure 13. "The Scheme of "Charity" Case."



[649] See Perekrest, 'Khodorkovsky (Part 4)'; Zapodinskaya, '14 Years of Deprivation of Liberty for Alexey Kurtsin Is Upheld'.

2.13. The "VNK" Case.

The VNK case was launched in 2000 initially to address an alleged management misconduct (minor offence), but several years later the investigators upgraded the charges to the large-scale embezzlement and after the commencement of the attack on Yukos and Khodorkovsky, new money laundering charges were brought.[650] The investigation reached its zenith in February 2007 when the relevant charges were brought against Khodorkovsky and Lebedev. The case is related to theoretical problems surrounding the conduct of international corporate groups and the liabilities of the parent company for damages incurred by its subsidiary.[651]

The case consists of one main episode (the operations with VNK's shares) and secondary episodes (the corporate restructuring of Tomskneft) and represents the two parts of the "Second Khodorkovsky case". The accused in the case are Khodorkovsky, Lebedev[652] and five other Yukos managers.[653]

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[650] Compromat.RU, 'VNK Assets Stripping'.

[651] A Shvarev, 'Kstati O Vase [Concering Vasya]' (2007) <http://www.howtotrade.ru/cgi-bin/forums/arch7/webbbs_config.pl/read/31935>accessed 5 March 2007.

[652] Khodorkovsky and Lebedev have been charged with VNK case as an episode of "The Second Khodorkovsky case" Y Schmidt, 'Press Statement on Khodorkovsky Charges' (2007) <http://www.robertamsterdam.com/2007/02/ra_exclusive_yuri_schmidt_pres.htm>accessed 20 December 2007.

[653] Krutilin, 'Criminal Alphabet of Yukos'.

Table 8. "Summary of the "VNK" Case."

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
Episode 1 **Embezzlement and money laundering** **1998 -2002** **Art. 160 para. 3 a, b of CC RF(1996)** **Art. 174 para. 3 of CC RF (1996)**[654] [Legalization of money or other property obtained in a criminal way by an organised criminal group.]	-	**No sentence**	None
Episode 2 **Embezzlement** **1998 -2002** **Art. 160 para. 2 v, para. 3 a, b of CC RF(1996)** [Misappropriation of other people's property in large quantities by an organised group by a person through his official position.]	Not significant	**7 years**	Conviction upheld. 6.5 years.

The first episode of the case ("VNK shares") is connected to the whole affair of the Menatep Group obtaining control of Yukos and other companies, which is regarded by the prosecutors as part of Khodorkovsky's organised criminal activities with his allies. According to the Summary of the Charges, in 1997 Menatep Group organised and implemented the acquisition of VNK shares in the course of a privatisation tender.[655] After

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[654] See footnote 655.

[655] General Prosecutors Office, 'General'naya Prokuratura Rossiiskoi Federatsii Zavershila Rassledovanie Ugolovnogo Dela v Otnoshenii Mikhaila Khodorkovskogo I Platona Lebedeva [The GPO Has Completed Its Investigation of Khodorkovsky and Lebedev's Criminal Case]' (2007) <http://www.genproc.gov.ru/ru/news/printshtml?id=5467>accessed 17 February 2007 (hereinafter – "*The Summary of the Charges*").

that Khodorkovsky and Lebedev, being unable to acquire the relevant amount of VNK's subsidiaries shares due to the adverse financial position of Menatep Bank, decided to employ a special scheme of acquisition.[656] Owing to the implementation of the scheme, the shares of the main VNK subsidiaries were transferred to the offshore shell companies in exchange for Yukos shares of much lower value. Upon completion of a series of transactions, Yukos became the sole owner of all the shares previously belonging to VNK. VNK was liquidated afterwards.[657]

The second episode of the case ("Tomskneft corporate restructuring") is of lesser significance than the first, and subordinate to it. The corporate restructuring of the VNK main production unit, Tomskneft, was conducted in parallel with the operations with the shares of the VNK subsidiaries. Due to this restructuring, Tomskneft's main production assets were transferred to the newly incorporated subsidiaries, the shares of which were sold below their fair market price and paid for with Yukos promissory notes.[658] However, before the final privatisation tender of 38% of the VNK stock, Yukos, which was under pressure from the Federal Property Fund, sold the companies back to Tomskneft, and retained Tomskneft's main production assets, which had been sold to Yukos earlier.[659]

In the first, more complex, episode the prosecutors alleged that by the end of 1997 the organised group led by Khodorkovsky, who was acting on behalf of the commercial organisations under the group's control, participated in auctions for the purchase and sale of blocks of shares, acquiring in the process 54% of VNK shares.[660] In 1998 Khodorkovsky, Lebedev and the other members of the organised group conspired to acquire a majority shareholding in the said joint-stock company, with which they began acquiring the shares of its subsidiaries.[661] As Bank Menatep was unable to provide the necessary financing, Khodorkovsky and Lebedev instructed their subordinates to prepare and sign share exchange agreements, falsely showing equal value of the exchanged shares,

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[656] ibid.

[657] Krutilin, 'Why Is Vasily Alexanyan Behind the Bars?'; Shvarev, 'Concering Vasya'.

[658] M Lepina, 'Sudebnoe Razbiratel'stvo Po Delu Svetlany Bakhminoi Zatyanulos' [Bakhmina's Case Is Delayed]' *Kommers* (Moscow 31 March 2006) 1.

[659] V Korchagina, 'Yukos Lawyer Sentenced to 7 Years' *MosTimes* (Moscow 20 April 2006) 3.

[660] *The Summary of the Chargers.*

[661] ibid.

between VNK and the Cypriot shell companies under the organised group's control.[662] With the aim of giving a semblance of validity, false independent appraisal reports were prepared showing the lowered value of the VNK shares and the raised value of the Yukos shares.[663] Therefore, Khodorkovsky, Lebedev and the other members of the organised group managed to misappropriate a thirty eight percent block of the subsidiaries' shares belonging to VNK, valued at more than 3 billion roubles. According to the prosecutors, it resulted in significant damages to the state, who owned 38% of the VNK shares, and who had a beneficial interest in the shares of the subsidiaries that belonged to VNK.[664] Due to the transactions, organised and conducted by the criminal group, the state's shares were significantly depreciated. The prosecutors also pointed out that in order to obtain the right to their strategic and operational direction, Khodorkovsky together with the members of the organised group, incorporated management companies controlled by them for Yukos, VNK and their subsidiaries. They also appointed former employees of Rosprom and Bank Menatep to manage these incorporated management companies.[665]

As there have been no court proceedings concerning the main episode of the VNK case, all legal aspects of this episode will be reviewed in the pending second Khodorkovsky-Lebedev trial. However, the Company's officials in their press-statement pointed out that Yukos did not believe that any of the employees of the Company accused in the "VNK case" could have committed the alleged crimes. They stressed that Yukos was managed in accordance with appropriate standards of corporate governance, and that the procedures for performing asset transactions adopted by the Company do not allow for "asset stripping" or "misappropriating" any of the assets of the Company. All actions of the Company's employees, which were considered by the General Prosecutor's Office in the "VNK case" as criminal, were consistent with Russian legislation.[666]

In the second trial on the VNK case, the lawyers defending a Yukos middle-level lawyer, who was at the same time a non-executive member of the Tomskneft directors'

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[662] ibid.

[663] ibid.

[664] ibid.

[665] ibid.

[666] Yukos, 'Statement: Yukos Refutes Continuing Unfounded Russian Government and Administration Allegations' (2005) <http://www.yukos.com/vpo/news.asp?year=2005&month=5>accessed 15 March 2007.

board, stressed that all transitions with the assets of Tomskneft had been approved by the corporate bodies and were reflected in the corporate audited accounts. They pointed out no civil claims regarding the transactions had ever been brought neither by the state, nor by other shareholders. The transactions had been conducted based on the independent appraisal reports. The defence's most important arguement, which confirmed the absence of intention to commit misappropriation, was the fact that the assets had been transferred back to Tomskneft.[667] All employees and service providers involved in the deals had acted in accordance with the corporate standards and regulations.[668]

The VNK case raises several complex corporate law and governance problems, which still have to be addressed by either the legislator or case law. The most important of them are:

(a) recognition of corporate group principles and consolidated accounts in Russian case law;

(b) protection of the rights of the state as a minority shareholder by civil and criminal means;

(c) application of the recently adopted anti-money laundering legislation in complex, politically motivated cases.

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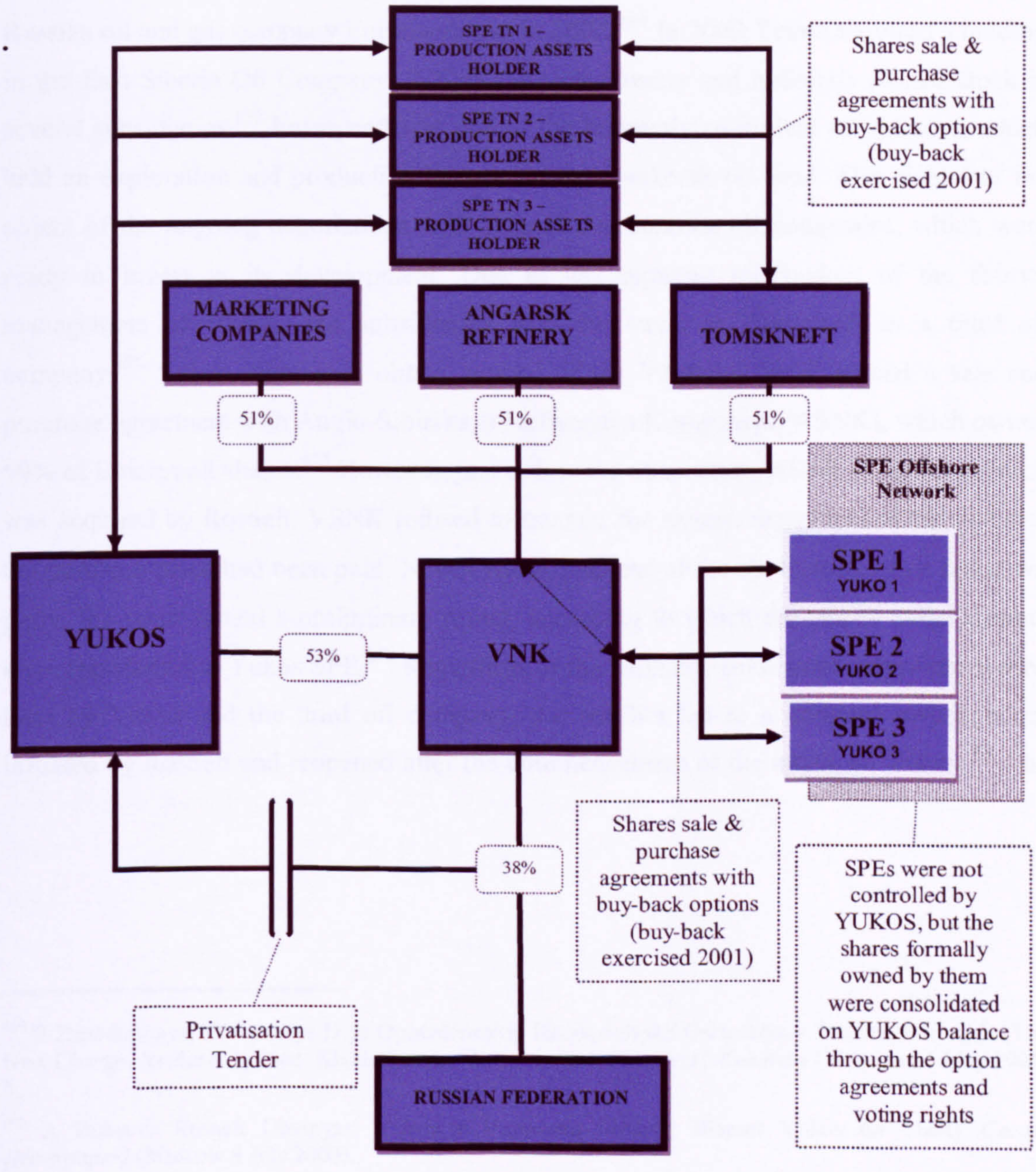
[667] Kommersant.com, '"Tomskneft" Refuses to Blame Yukos ' (2005) 9 September Kommersant Online <http://www.kommersant.com/p609880/Tomskneft_Refuses_to_Blame_YUKOS/>accessed 22 March 2007.

[668] Yukos, 'Statement: Yukos Refutes Continuing Unfounded Russian Government and Administration Allegations'.

Figure 14. "The Scheme of the "VNK" Case."



2.14. The "Eniseyneftegas Shares" Case.

This case concerns the masterminding the embezzlement of 19.7% of shares in the Russian oil and gas company Eniseineftegaz in 2002. [669] In 2000 Yukos acquired a holding in the East Siberia Oil Company, (VSNK), which directly and indirectly owned stock in several subsidiaries.[670] Eniseyneft was one of the indirectly controlled subsidiaries, which held an exploration and production licence on the Vankorsk oil field. This field was the object of the ongoing negotiations with several international oil companies, which were ready to invest in its development. Due to the apparent misconduct of the former management of VSNK, the subsidiaries sold the stock in Eniseyneft to a third oil company.[671] Yukos, aiming to obtain control of the Vankorsk field, signed a sale and purchase agreement with Anglo-Sibirskaya Neftyanaya Kompaniya (ASNK), which owned 59% of Eniseyneft shares.[672] However, just before the transaction, ASNK controlling stock was acquired by Rosneft. VSNK refused to transfer the shares, regardless of the fact that the purchase price had been paid. Nevertheless, because of the application of an unknown party, the court issued a preliminary ruling, according to which the shares under dispute were transferred to Yukos SPE.[673] Regardless of the amicable settlement agreement signed later by Yukos and the third oil company, the conflict led to a criminal investigation, initiated by Rosneft and reopened after the commencement of the attack on Yukos.[674] The

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[669] E Zapodinskaya, 'Obvineniya Dlya Opravdannykh: Khodorkovskii Ostanetsya v Tyur'me Navsegda [The New Charges for the Acquitted: Khodorkovsky Will Stay in Jail Forever]' *Kommers* (Moscow 14 May 2005) 3.

[670] A Dobrov, 'Rosneft Obvinyaet Yukos v Vorovstve [Rosneft Blames Yukos for Theft]' *Gazeta [Newspaper]* (Moscow 8 July 2003).

[671] ibid.

[672] E Zapodinskaya, 'British Lawyer Refused to Question Russian Attorneys' (2005) 20 December Kommersant Online <http://www.kommersant.com/p636966/r_1/British_Lawyer_Refused _To_Question_ Russian_Attorneys/>accessed 12 March 2007.

[673] Dobrov, 'Rosneft Blames Yukos for Theft'.

[674] Zapodinskaya, 'British Lawyer Refused to Question Russian Attorneys'.

charges were brought against one former Vice-President of Yukos and one of the lawyers of the advocate bureau retained by Yukos.[675]

Table 9. "Summary of the "Eniseyneftegas Shares" Case."

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISION
Large-scale Fraud and Falsification of Evidence. **2000** **Art. 159 para 3 of CC RF** [Acquisition of other people's property by way of deceit by an organised group in large quantities.] **Art. 303 para 3 of CC RF** [Falsification of documental evidence.]	None	**No sentence**	None

This case is distinct from the rest of the Yukos-related cases, as it has been indirectly reviewed by the British Court during the hearing on the Vice-President's extradition. The court identified several significant legal peculiarities and omissions in the documentation.[676]

> ... It can be noted that for approximately a year the Russian Federation pursued a Mr [a lawyer] alleging that he was solely responsible, for this fraud. Further it can be pointed out that at the times that these frauds are alleged to have taken place, Mr [Vice-President] was either not a member of the board or had no responsibility for the acquisition of oil which gives rise to the fraud.[677]

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[675] Kommersant.com, 'Russia Attracts British Lawyer to Get Extradition for Yukos Official' (2005) 8 November ibid <http://www.kommersant.com/page.asp?idr=500&id=624325>accessed 3 March 2007; Zapodinskaya, 'British Lawyer Refused to Question Russian Attorneys'.

[676] Reuters, 'Russian Oil Manager Won't Be Extradited' (2005) <http://www.tiscali.co.uk/news/newswire.php/news/reuters/2005/12/23/topnews/russianoilmanagerwon39tbeextradited.html>accessed 16 March 2007.

[677] *Russian Federation v Temerko.*

The court refused the extradition request on the grounds of "political motivation",[678] and also noticed the ambiguous character of the prosecutors' arguementation.[679]

Although the case has never been heard in the Russian courts, some legal arguements were used by the defence in interviews and public statements. It was stressed that it was merely a civil case based on a private relationship between the two parties.[680] Yukos paid for the notorious shares that should have excluded the embezzlement charges.[681]Moreover, the parties had signed an amicable settlement and, according to its provisions, Yukos organised the buy-back of the previously alienated shares. The lawyers' key arguement was the fact that the operations with shares, seen as embezzlement by the prosecutors, had been conducted in accordance with the court decision.[682]

This case represents an example of a "civil" case, which might have been solved in the Arbitration Court, but due to the politically motivated attack on the Company was upgraded to a criminal case, which had little chance of success.

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[678] This decision is also discussed in Chapter 3.6.5.

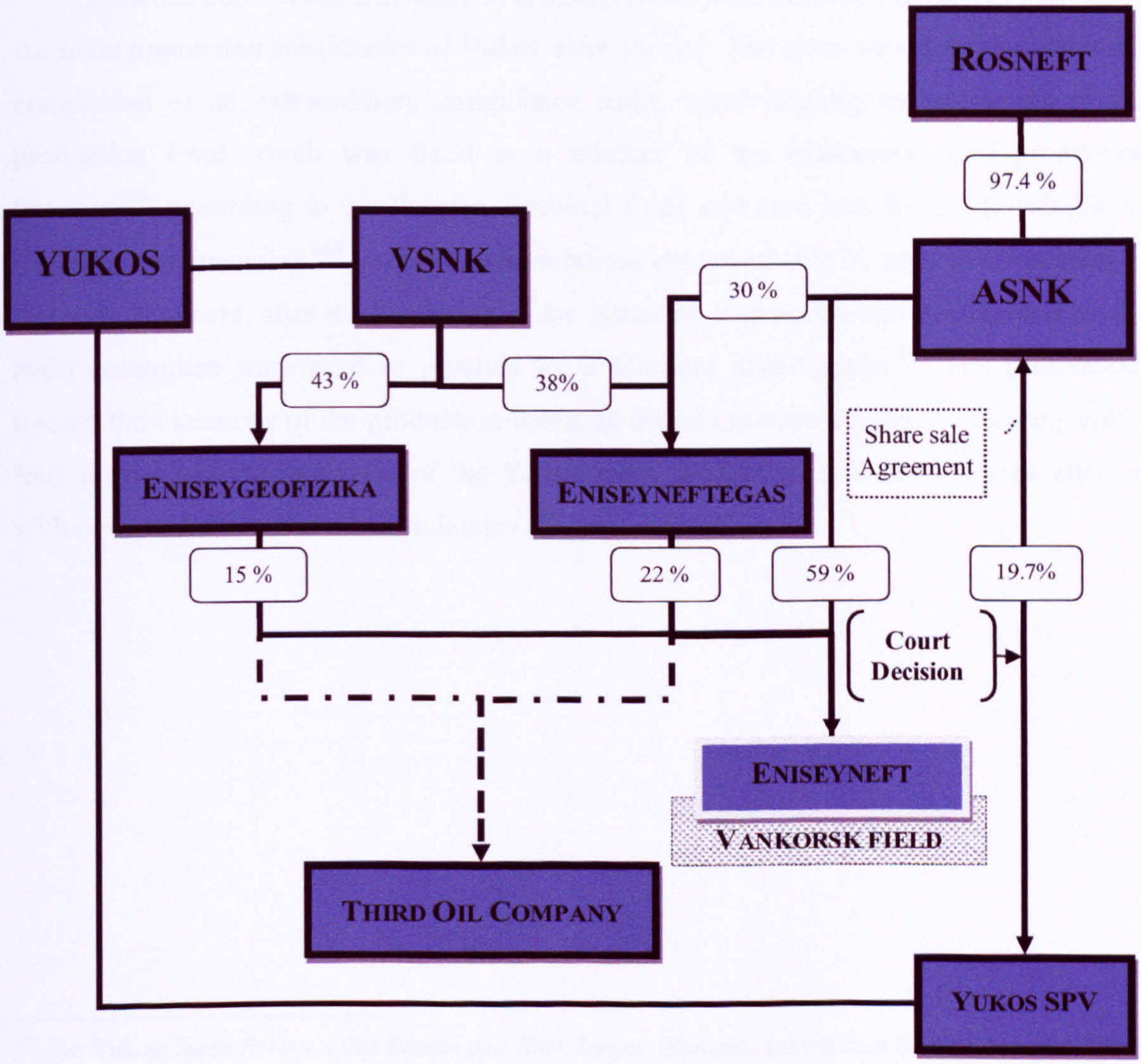
[679] See also E Zapodinskaya, 'Cyprus Court Didn't Extradite Yukos Accused' (2006) 17 October Kommersant Online <http://www.kommersant.ru/doc.aspx?docsid=713715>accessed 30 October 2007.

[680] Dobrov, 'Rosneft Blames Yukos for Theft'.

[681] ibid.

[682] See Kommersant.com, 'Russia Attracts British Lawyer to Get Extradition for Yukos Official' (2005) 8 November Kommersant Online <http://www.kommersant.com/page.asp?idr=500&id=624325>accessed 3 March 2007; Zapodinskaya, 'The New Charges for the Acquitted: Khodorkovsky Will Stay in Jail Forever'.

Figure 15. "The Scheme of the "Eniseyneftegas Shares" Case."



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[683] See Dobrov, 'Rosneft Blames Yukos for Theft'. By "%" identified the percentage of stock, owned by a holder.

2.15. The "Overproduction" Case.

Between 2003-2006, a number of criminal cases were launched in the regions where the main production subsidiaries of Yukos were located. The cases were launched after the completion of an extraordinary compliance audit, which highlighted violations of the production level which was fixed in a number of the exploration and production licences.[684] According to the Russian Criminal Code and case law, this is punishable as illegal entrepreneurship.[685] Usually such violations are punishable by fines or revocation of licences. However, after the beginning of the attack on Yukos, the reports prepared by the audit committee were used as grounds for a criminal investigation.[686] The prosecutors treated the violations of the production levels as illegal entrepreneurship.[687] Consequently, four former general managers of the Yukos main production subsidiaries were charged with overproduction and other violations.[688]

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[684] See Yukos, *Yukos Review. 2003 Results and 2004 Targets* (Business Information Service, Moscow 2004); Compromat.RU, 'Riski Beilina Yu.A. [Beilin's Risks]' (2006) <http://www.compromat.ru/main/hodorkovskiy/bejlin1.htm>accessed 9 March 2007.

[685] According to the principle set up in Res of SC № 23. See also A Gapeev, 'Skvazhnaya Zhidkost' Na Troikh [Porous Liquid for Three]' (2006) <http://lenta.ru/articles/2006/03/23/yukos>accessed 16 March 2007

[686] See --, 'Ministry Says Yugansk Overproducing Crude' *MosTimes* (Moscow 2004).

[687] See ibid; M Cherkasova and Y Dorokhov, 'Prigovorchiki v Stroyu: Dela Yukosa Postavleny Na Potok [The Line of Sentences: The Yukos Cases Are Being Put on the Conveyor]' (2005) 27 April Kommersant Online <http://www.kommersant.ru/doc.html?path=/daily/2005/075/26647579.htm>accessed 29 April 2006.

[688] S Gomzikova, A Bondarenko and V Svin' in, 'Novaya Metla Metet Yukos Po Staromu [New Broom Sweeps Yukos... In the Old Way]' (2006) 13 March Nezavisimaya Gazeta [The Independent Newspaper] <http://www.ng.ru/events/2006-06-30/7_uk os.html>accessed 20 April 2007.

Table 10. "Summary of the "Overproduction" Case."

INDICTMENT	VERDICT	SENTENCE	CASSATIONAL DECISIONS
Illegal entrepreneurship 2000-2006 **Art. 171 para 2 (illegal entrepreneurship) of CC RF (1996).** [Operating an illegal enterprise without registration or a special permit (licence), in cases where such permit (licence) is obligatory, or with the breach of licensing terms, committed by an organised group, if this deed has caused large damage to individuals, organisations, or the State, or is attended by profit-making on a especially large scale.]	Fully upheld[689]	Deferred sentences from 1, 5 to 3, 5 years[690]	

[689] See eg Kommersant.com, 'Director of Former Yukos Subsidiary Given Suspended Sentence' (2005) 28 July Kommersant Online <http://www.kommersant.com/p596794/Director_of_Former_YUKOS_Subsidiary_Given_Suspended_Sentence>accessed 24 October 2007; Kommersant, 'Pavel Anisimov Poshel Po Tret'emu Delu [The Third Case of Pavel Anisimov]' *Kommers* (Moscow 21 June 2006) 2.

[690] See Kommersant.com, 'Director of Former Yukos Subsidiary Given Suspended Sentence'; E Mangileva, 'Glava Samaraneftegaz Stal Dvazhdy Sudimym [The Director of Samarneftegas Sentenced Twice]' (2007) 26 February Kommersant Online <http://www.kommersant.ru/doc.aspx?docsid=745490>accessed 12 October 2007.

The violations of the licence agreement provisions were evident, but the Company did its best to mitigate the damage. The defence pointed out that the violations were the result of a state policy focused on the over stimulation of oil and gas production. Such violations are prevalent in Russia and almost every oil and gas company faces the same problem, but solves it without facing criminal prosecution.[691] The Company also filed applications with the Ministry of the Natural Resources, asking the officials to reconsider the levels of production, but due to the bureaucratic procedure it did not obtain the approvals.[692]

Nevertheless, all four top-managers were charged and sentenced to different terms.[693] The case underlines selectivity in the Yukos case, as violations of production licences provisions were common in Russia, but only Yukos managers were prosecuted.[694]

2.16. The Cases Launched Concerning Events Taking Place after the Commencement of the Attack on Yukos.

2.16.1. The American Former-Management Embezzlement and Money Laundering Case.

On August 17, 2006, the Attorney General's Office initiated a criminal case under Art. 160, 174 of the Russian Criminal Code (misappropriation or embezzlement of entrusted other people's property and legalization (laundering) of funds and other property acquired in an illegal way) against the former Yukos president Steven Theede and several senior managers of the company: the financial director Bruce Misamore and managing

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[691] See D Gololobov, 'Korporativnyi I Gosudarstvennyi Shantazh [Corporate Greenmail and State Blackmail]' in P Barrenboim (ed), *Pravovaya I Sudebnaya Reforma I Konstitutsionnaya Ekonomika [Legal Reform, Judicial Reform and Constitutional Economy]* (Tikhomirov publishing, Moscow 2004) 179-90.

[692] Cherkasova and Dorokhov, 'The Line of Sentences: The Yukos Cases Are Being Put on the Conveyor'.

[693] See Krutilin, 'Criminal Alphabet of Yukos'.

[694] Gomzikova, Bondarenko and Svinin, 'New Broom Sweeps Yukos... In the Old Way'.

adviser David Godfrey, and also the director of Group Menatep Ltd., Tim Osbourne.[695] The case was launched after the unsuccessful attempt to stop the sale of Mazeikiu Nafta refinery.[696] The prosecutors alleged that the American management with the assistance of Menatep Group restructured the off-shore network of the Company in such a way that the substantial part of the overseas assets remained under the control of the former manager.[697] The accused have issued a statement that the allegations are of a political nature and the case comprises a part of the Yukos case.[698]

This case represents a complicated story where corporate governance issues are interrelated with politics and human rights. However, it is undeniable that Russian minority shareholders and creditors of the Company have been deprived of the significant proceeds from the sale of the offshore assets due to the actions of the management, motivated by the "protection of western minority shareholders".[699]

2.16.2. Embezzlement and Money Laundering in Tomskneft.

After the beginning of the bankruptcy procedure, Tomskneft issued promissory notes to the sum of $ 200 million and exchanged them for promissory notes of the bank, which were later transferred to other entities (laundered).[700] Subsequently, the former general manager of Tomskneft and several external service providers were charged with

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[695] General Prosecutors Office, 'Vozbuzhdeno Esce Odno Ugolovnoe Delo Protiv Byvshikh Rukovoditelei Kompanii Yukos [One More Case against the Former Yukos Managment]' (2006) <http://www.genproc.gov.ru/ru/news/print.shtml?id=4488>accessed 5 March 2007.

[696] O Pleshanova, N Skorlygina and D Rebrov, 'Dutch Fortune // Most of the Money from the Sale of Yukos' Western Assets Will Go to Group Menatep' (2006) 18 August Kommersant Online <http://www.kommersant.com/p698534/Dutch_Fortune/>accessed 22 March 2007.

[697] See Gololobov and Tanega, 'Yukos Risk'.

[698] Ostrovsky, 'Russia Accuses Former Yukos Chiefs of Asset Theft'; Pleshanova, Skorlygina and Rebrov, 'Dutch Fortune // Most of the Money from the Sale of Yukos' Western Assets Will Go to Group Menatep'.

[699] Pleshanova, Skorlygina and Rebrov, 'Dutch Fortune // Most of the Money from the Sale of Yukos' Western Assets Will Go to Group Menatep'; Gololobov and Tanega, 'Yukos Risk'.

[700] N Volosatova and N Sergeev, 'Prokuratura Dobyla Tomskneft' [The Prosecutors Get Tomskteft]' (2007) 18 January Kommersant Online <http://www.kommersant.ru/ doc.html?docId=7 34771>accessed 20 March 2007.

embezzlement and money laundering and money laundering in an organised group (Article 160 para 4, Article 174.1. para 4 of CC RF).[701] The case is still under investigation. [702]

2.17. Conclusion.

The Yukos case started more than five years ago commencing from the meeting held by Putin with the oligarchs in February 2003. However, the case raises even more questions now than when it commenced five years ago, concerning the grounds for the cases, the identities of the accused, the overlap between the cases, and the prosecutor's arguements and the strategies employed by the defence.

The review of the Yukos-related cases, conducted in this chapter, is not supposed to give definitive answers to all, or even a significant part of them. Although the Yukos case may look like an unsystematic mixture of different episodes, partly connected by the figures of Khodorkovsky and Lebedev, comprehensive analysis demonstrates the persistant presence of certain principles and regularities that run through the case as a whole. This analysis, is not supposed to criticise or foresee any judicial decisions on the Yukos case. It is aimed exclusively at showing the principal legal framework of the case and rules governing its development.

The Khodorkovsky – Yukos case was in significant part based on the illegal privatisation cases such as "Apatit" and "NIUIF" which refer to the early period of spontaneous privatisation and subsequent period of "hot" transition in the Russian economy. It was at that time that the newly emerging "oligarchy" groups tried to survive in free market conditions, grabbing privatised assets and competing without any distinct written rules, using corruption and political ties where possible to achieve their goal. The policies of those Financial-Industrial groups in that period were based on two main strategies: to snatch and to hold on tight to the spoils of the transition, obtaining the maximum profit from their gains, which could be used for further purchases. When

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[701] Krutilin, 'Criminal Alphabet of Yukos'.

[702] Volosatova and Sergeev, 'The Prosecutors Get Tomskteft'.

hundreds of companies were privatised every day, there were no opportunities to either understand the vague rules, or follow them.

Bank Menatep just followed the general trend, sometimes even more aggressively than others. Apatit and "NIUIF" were acquired to be incorporated in to one of the production holdings (groups) or sold later to a strategic investor. The bank had no intention to invest additional funds in outdated investment programmes while the situation with the companies remained unclear, and at this time, almost nobody in Russia actually complied with the investment programmes. The bank, like many other players in the privatisation rush, played its own game with a weak corrupt state, which had neither the power nor the intention to force the powerful oligarchy structures to play according to unclear rules.

The efforts undertaken by bank Menatep, using controlled shell companies to save its investments in Apatit and "NIUIF" when purchases had formally failed to fulfill the compulsory investment programmes were widely in use at that time. When the arbitration courts terminated the share purchase agreements it turned out that the shares had already been sold to the other shell companies. As the bank did not formally control the shell companies involved in the deal, it publicly "washed its hands" of it. There were other irregularities connected with formal fulfillment of investment programmes, like the transfer of investment funds back and forth in the "NIUIF" case.

All of them were settled through semi-formal negotiations with the state officials and a number of "compromise" agreements as in the "Apatit" case. However, when "new broom" in the form of Putin appeared and Khodorkovsky and his business were put under scrutiny, all the privatisation skeletons were taken out of the closet.

It is evident that the substantial arguements of the prosecutors do not stand up to criticism from the standpoint of the rule of law because it is difficult to say which law should be applied when, and the privatisation laws were quite ambiguous and vague. However, the attempts of the defence lawyers to use arguements of personal non-involvement of the defendants in the alleged criminal commitments, and subsequent performance results of the companies, cannot conceal the evidential presence of the intentional pre-planned formal violation of the "spirit" and "letter" of the privatisation laws and regulations, regardless to their vagueness and imperfection.

The second distinct group of cases, which bear certain similarities, is the group of cases concerning transitional operational and corporate schemes of the Menatep and Yukos-controlled companies. These are the "Apatit trading" case, the "VNK" case, the "Most case" and the "Eniseyneftegas shares" case. Regardless to the distinctions in the substantive legal characteristics, all of them bear one principal similarity: these cases stem from the creative usage of different questionable corporate techniques, which have been criticised by champions of advanced corporate governance. Most of these techniques are well-known to the international business community and have been well researched and regulated. However, in the transitional period of the 90s in Russia, these techniques were not controlled or regulated. Moreover, Russian case law and business practice used only a formal, literal approach to the business schemes, completely ignoring substance over form and economic substance doctrines, although they were formally, but vaguely fixed in the relevant statutes.

For example, the "Apatit trading" case is based on the allegedly illegal transfer pricing scheme, when JSC "Apatit" sold the bulk of its product to specially created trading companies, which, according to the prosecutors, siphoned off all the company's profit. In the absence of economic and financial methods of determining a fair market price and, in the absence of well-developed minority-shareholder protection techniques, this scheme functioned without any problems, like thousands of similar schemes around Russia. However, when assessed from the position of current Russian judicial policy and case law, this scheme looks rather questionable.

The third group of cases includes only tax cases, which represents the "backbone" of the Yukos case, and will be reviewed in a separate chapter. The only remark that is necessary to make here, is that the personal tax cases are based on similar grounds to the rest of the cases that are related to the creative application of questionable corporate "optimisation" schemes. The personal tax optimisations schemes, used by the managers and employees of Yukos exemplify the literal approach to tax legislation that ignored the "substance over form" doctrine and other international anti avoidance doctrines.[703] The willful blindness of the authorities made the application of such schemes during the period of transition permissible, but these practices were halted when the state showed its "teeth".

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[703] See section 4.5.

Thus, the Yukos-related tax cases are just the outcome of the optimisation malpractices of the 1990s, scrutinized by "pedagogical" justice.

In the fourth group of cases, comprising of the Yukos case, the legal substance is obvious, but the evidential base is vague, ambiguous or insufficient. The best example is the ""Charity" case. If the Yukos officials had intentionally preplanned the embezzlement of company's funds it would have been considered an offence of embezzlement and further money laundering. However, the "Charity" case presents a significant problem because the lack of evidence of the initial fraud, and the general political thrust, makes it difficult to come to any conclusion as to whether or not criminal commitment took place.

On summarising the conclusions on the separate groups of cases, it is clear that the Yukos case, in its substance, represents a group of investigations and subsequent trials on the questionable business and political practices, applied by the "oligarchy" groups through the 1990s to early 2000. The reasons, which led to these investigations and to the prosecution of particular individuals are not always evident, and lay in the political, rather than legal, sphere. All the Yukos-related cases, raise questions of the Rule of Law in Russia and the problem of whether transitional justice is just, and have been addressed in other chapters of this dissertation. However, they can be regarded to a certain extent as a questionable attempt to restore the principle of equality of justice, which was forgotten in the "oligarchy" period. The general complexity of the Yukos case and its transitional and political character makes it difficult to analyse it from the position of traditional jurisprudence and further analysis, after the case's full completion and after a change of the existing political regime in Russia, is necessary.

Chapter 3.

Political Motivation in the Yukos Case.

3.1. Political Factors in the Yukos Case.

Political risk is a salient feature of emerging markets.[704] This axiom has found its perfect reflection in the Yukos case. Many independent experts understand the YUKOS affair as a story of a government-led assault on a private Russian company that was owned by a small group of politically ambitious individuals.[705] However, others have evaluated the case as being far more complicated than it may seem.[706] In Russian society the common view seems to be that Khodorkovsky may be guilty of the criminal charges brought against him, but he is a political prisoner because he alone among the oligarchs has been held accountable for his crimes.[707]

The main difficulty in analysing the 'Yukos affair' is the overlap of its numerous plots and aspects. The 'Yukos affair's multidimensionality and ambiguity makes it difficult to restrict analysis to one particular interpretation or one definitive cause.[708] All these characteristics find their reflection in the discussion of the political nature of the case.

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[704] Goriaev and Sonin, 'Prosecutors and Financial Markets' 1.

[705] ibid.

[706] See C Gurdgiev, 'The Bad and the Ugly from Moscow.' (2005) www.Techcentralstation.com <www.Techcentralstation.com>accessed 20 December 2007.

[707] DM Bernardelli, 'Russian Rule-Ette: Using Khodorkovsky's Criminal Trial to Assess the State of Russian Judiciary' (2008) 31 BC Int'l & Comp L Rev 85-99, 98.

[708] Kononczuk, *The "Yukos Affair", Its Motives and Implications* 35.

3.1.1. Particular Political Grounds for the Attack on Yukos.

A brief analysis of the political situation in spring 2003 reveals several issues. After the period of "compromise", (2000-2003),[709] the "Siloviki" group began increasing its influence on the Russian President and on the political situation. They were looking for new sources of finance, i.e. the businesses owned by oligarchs.[710] The aims of the existing "oligarchy" system were not in line with the aims of the "Siloviki" group, who set out to destroy it in order to gain ultimate control over strategic businesses.[711] Therefore, a victim had to be chosen, to demonstrate how dangerous the new elite were.

Yukos and Khodorkovsky were the obvious choice. According to individuals directly involved in the Yukos affair,[712] the Company, headed by Khodorkovsky, had made several key manoeuvres that may have provoked the attack on the Company and its core shareholders. Firstly, the company had prepared itself for a possible listing of the ADR Level II/III on the New York Stock Exchange and prepared for a Eurobond issue.[713] Secondly, on completing the unprecedented merger with Sibneft, the Company announced its plans to merge with one of the world oil majors, aiming to create a top rank oil and gas juggernaut, which was sure to exert political influence.[714] Thirdly, several of the Company's core shareholders who were closely involved in the Company's management, announced their political plans.[715] These factors seemed threatening to the President's allies[716] and signalled the attack on the core shareholders of the Company by the "Siloviki". This attack was headed by the Deputies of the Head of the Administration

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[709] C Wheeler, 'Is Russian Oil Tycoon Stepping on the Toes of President Putin?' *The Globe and Mail (Canada)* (Toronto 19 July 2003) 3.

[710] Fortescue, *Russian's Oil Barons and Metal Magnates* 108-09.

[711] ibid 109, 48; Amsterdam and Peroff, 'White Paper' 58, 62.

[712] eg see footnote 714.

[713] Amsterdam and Peroff, 'White Paper' 18.

[714] Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' 16.

[715] Shamseeva, 'Yukos's Affairs and the Yukos Case'.

[716] See also V Perekrest, 'What Is Mikhail Khodorkovsky Behind Bars for (Part 5)' (2006) 26 July Prigovor. RU <http://prigovor.com/info/37306.html>accessed 14 December 2006.

Sechin and Ivanov, Putin's closest allies since his KGB service.[717] They understood that even an impeccably planned attack would fail unless they ruined the Khodorkovsky financial empire, and to do that they had to ruin Yukos.

One company with strong intentions to get its hands on Yukos's production and refining assets was Rosneft.[718] Rosneft was a state–controlled, secondary level company, headed by Khodorkovsky's personal enemy Bogdanchikov, and it served as the organisational and financial platform for the attack.[719] After Sechin's appointment as the Head of Rosneft's Board of Directors, the intention became a state approved strategy.[720]

In the context of the attack on Khodorkovsky and Yukos, it should be noted that several months before its beginning, a series of official documents acknowledged the civil, not criminal, nature of the allegations that were being considered against Mr Khodorkovsky in 2003. These documents included reports and memoranda from the Russian Procurator-General and the Russian Ministry of Internal Affairs, as well as correspondence with the Presidential Administration. The documents also indicate that the alleged activities constituted no violation of Russian competition law.[721] Nevertheless, this knowledge did not stop the attackers.

In May 2003, Khodorkovsky faced an attack from the Kremlin's heavy ideological artillery,[722] the council of national strategy, composed of eminent political analysts who issued a report: "Oligarch Revolution under Preparation in Russia".[723] The report enumerated several oligarchic "sins". Firstly, the oligarch class had become a Russian elite that was neither nationally, nor socially responsible. Secondly, oligarchs were always motivated by their financial interests and never by Russia's strategic interests as a geo-

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[717] Amsterdam and Peroff, 'White Paper' 66-67.

[718] See B Aris and I Watson, 'Rosneft Still Faces a Long Hard Road to Market; the Kremlin's Showcase IPO Is Beset with Legal Problems and Concerns About Value' *The Business* (Moscow/London 18 June 2006).

[719] Tompson, *Putin and the 'Oligarchs': A Two-Sided Commitment Problem*, 8; Amsterdam and Peroff, 'White Paper' 40-41.

[720] See Y Zarakhovich, 'Inside the Yukos Endgame' (2004) 22 August Time <http://www.time.com/time/magazine/article/0,9171,901040830-685965,00.html>accessed 25 October 2007; Aron, 'What Does Putin Want?'.

[721] See Amsterdam and Peroff, 'White Paper' 18.

[722] Fortescue, *Russian's Oil Barons and Metal Magnates* 109-10.

[723] Perekrest, 'Khodorkovsky (Part 5)'.

strategic and ethno-cultural entity. The report claimed that the oligarchs displayed a nihilistic attitude toward the state; they stimulated illegal activities in economic life.[724] Thirdly, due to oligarchic modernization, the structure of Russian economy had become a raw and transit economy.[725]

There are at least three main political reasons, which led to the commencement of the case:

1. The personal political ambitions of Khodorkovsky and his allies. This included the intention to obtain immunity through an alliance with an international oil giant and the plans to seize power inside Russia by using parliamentary and corruption mechanisms.[726]

2. The general strengthening of state capitalism and the new oligarchy-siloviki group, which badly needed business opportunities for expansion.[727]

3. Conflicts with other oligarchy[728] or business[729] groups and a general negative attitude to oligarchs in Russia.[730]

3.1.2. The Main Political Condition for the Attack on Yukos.

The Yukos case could not have been launched without the existing nexus between the status of the Rule of Law in Russia and the real political powers of the ruling elite.[731]

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[724] See ibid.

[725] ibid.

[726] See L Aron, 'Crime and Punishment for Capitalists' (2003) 30 October AEI 2 <http://www.aei.org/news19370>accessed 10 March 2007.

[727] See The Economist, 'The Making of a Neo-KGB State'; The Economist, 'Putin's People' (2007) 23 August Economist.com <http://www.economist.com/opinion/displaystory.cfm?story_id=9687285>accessed 24 August 2007.

[728] See Perekrest, 'Khodorkovsky (Part 5)'.

[729] Shevtsova, 'Implications of the Yukos Scandal for Russian Domestic Politics'; Tompson, *Putin and the 'Oligarchs': A Two-Sided Commitment Problem* 9.

[730] See V Shlapentokh, 'Wealth Versus Political Power: The Russian Case' (2003) <http://www.cdi.org/russia/johnson/7438-10.cfm>accessed 9 February 2007.

[731] See eg I Bremmer and S Charap, 'The Siloviki in Putin's Russia: Who They Are and What They Want' (2006-07) 30 (1) Wash Quart 83–92, 86-88; A Kolesnikov, 'Sechin Kak Metafora [Sechin as a Metaphor]' (2008) 20 May Gazeta.Ru <http://www.gazeta.ru/column/kolesnikov/2728776.shtml>accessed 20 May 2008.

Understanding the degree of the distortion of the Rule of Law and its suppression by the political power is crucial to gaining an understanding of the underlying events, and processes, which determine the very substance of the political regime and the framework of the Russian judicial system.[732] The Yukos case, and similar cases, can arise only when such disproportion exists and it allows the elite to manipulate the judicial system in its own interest.[733]

The state of positive law in Russia has little relevance to the Khodorkovsky and Yukos story, as the Russian law system is well developed and can successfully be used both to protect individual rights and freedoms and to steer the economic system.[734] However, as Dmitry Medvedev stressed: "We must achieve true respect for the law and end the legal nihilism that is seriously hindering modern development."[735] His statement shows the main problem in Yeltsin's and Putin's epochs was a lack of respect for the law.[736] The law was understood only as a powerful tool in the hands of the ruling elite, who could bend it in any way possible, using it either for prosecution of political and economic opponents, or for making members of the political elite immune against criminal prosecution.[737] The entire legal system had become an instrument of the political authorities, even though "insofar as the political authorities do not exercise their power, private and public life are regulated either by the traditionally prevailing or newly enacted law."[738]

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[732] See eg W Burnham, 'The New Russian Criminal Code: A Window onto Democratic Russia' (2000) 26 Rev Cent & E Eur L 365-424; PJ De Muniz, 'Judicial Reform in Russia: Russia Looks to the Past to Create a New Adversarial System of Criminal Justice' (2004) 11 Willamette J Int'l L & Dis Res 81-122.

[733] See eg N Lechbitskaya, 'Open Letter to Deputy of Presidential Administartion I. Sechin and Prosecutor General Y. Tchaika' (2008) <http://delya-rape.livejournal.com/223582.html>accessed 14 May 2008.

[734] See eg J Kahn, 'Law and Legal System of the Russian Federation' (2008) 33 (2) Rev Cent & E Eur L 239-47.

[735] --, 'Mr. Medvedev's Rule' (2008) 8 May Washingtonpost.com <http://www.washingtonpost.com/wp-dyn/content/article/2008/05/07/AR2008050703372.html>accessed 8 May 2008.

[736] See eg FJM Feldbrugge, 'The Rule of Law in Russia in a European Context ' in FJM Feldbrugge (ed), *Russia, Europe, and the Rule of Law* (Law in Eastern Europe, Brill, 2006); GB Smith, 'The Procuracy, Putin, and the Rule of Law in Russia' in FJM Feldbrugge (ed), *Russia, Europe, and the Rule of Law* (Law in Eastern Europe, Brill, 2006) 1-15.

[737] See eg --, 'Russian Defence Minister's Son to Come Off Clear after Running over Elderly Lady' (2005) 24 May Pravda.RU <http://english.pravda.ru/hotspots/crimes/8292-1/>accessed 1 June 2008.

[738] E Fraenkel, *The Dual State* (Oxford University Press, New York 1941) 57.

Putin's doctrine of power concentration and managed democracy has increased the misbalance between the principles of the Rule of Law and political powers that existed during Yeltsin's governance.[739] The lack of respect for the law and the instrumentalisation of the Russian judiciary[740] contradicts the international principles of the Rule of Law.[741]

Weakness of the Rule of Law and the corresponding subordination of the Russian judicial system to the ruling elite was the main condition for the Yukos case. As soon as Khodorkovsky became to be seen as a threat to the ruling elite, he was immediately prosecuted together with his companies and friends, and the legal system was used as an instrument for his suppression and prosecution. Moreover, even after the political influence on the judicial system on the Yukos case ended, the system continued pursuing the established trend as it had to protect its own decisions.[742] The instrumental leverage of the legal system allowed the representatives of the new elite, specifically the Siloviki and Sechin, to structure the Yukos case in such a way that it would not look political, simply using "economic" and violent crime charges: "everyone knows" MBK is a genuinely "bad guy". He stole billions from the Russian people and refused to comply with the new rules established by President Putin."[743] Such an approach also allowed Russian officials to attempt to represent Khodorkovsky and his allies as criminals, insisting that the case had no political element.[744] However, as set out in the subsequent sections, this strategy had limited and temporary success.[745]

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[739] See eg Kasparov, 'Putin's Gangster State'; The Economist, 'The Making of a Neo-KGB State'.

[740] See eg Amsterdam and Peroff, 'White Paper' 64-65.

[741] See in general Russian Axis, *The Judicial System of the Russian Federation*; Washington Post, 'Potemkin Justice; Mr. Putin's Legal System at Work'.

[742] See Presscenter, 'Timeline of Events' (2007) <http://www.khodorkovsky.info/timeline/>accessed 30 March 2007.

[743] BW Bean, 'The Rule of Law in Russia: Getting Khodorkovsky' (2006) 3 (2) TDM 4.

[744] See eg The Moscow Times, 'Putin Says Yukos Case All About Murder' (2003) 22 September The Moscow Times.com 5 <http://www.themoscowtimes.com/stories/2003/09/22/041.html>accessed 21 March 2007; V Putin, '"Elargir L'otan, C'est Ériger De Nouveaux Murs De Berlin"' (2008) 31 May Le Monde <http://www.lemonde.fr/europe/article/2008/05/31/vladimir-poutine-elargir-l-otan-c-est-eriger-de-nouveaux-murs-de-berlin_1052123_3214.html#ens_id=1051598>accessed 31 May 2008.

[745] See eg RIA Novosti, 'Khodorkovsky's Case Not Political - Prosecutors' (2007) 2 February RIA Novosti <http://en.rian.ru/russia/20070209/60483608.html>accessed 6 June 2008; RR Amsterdam, 'Khodorkovsky Case Update: Politics Increasingly Transparent' (2008) 23 January Jursit <http://jurist.law.pitt.edu/forumy/2008/01/khodorkovsky-case-update-politics.php>accessed 25 January 2008.

3.1.3. The State and Putin's Reaction to the Case.

Putin's position on the Khodorkovsky/Yukos case was particularly important as he personified the position of the state in the conflict. He was also perceived by the international media as being Khodorkovsky's opponent. It is important to see how his words confirm the ideas regarding the instrumentalisation of the Russian judiciary.

In the context of the defendants' extensive arguementation, Putin's arguements looked rather limited and narrow.

In 2003, for example, when the legal and political campaign directed against the owners of Yukos was in its early stages, Putin maintained his silence for several months despite calls for him to take a stand. As a result, even Yukos' strongest supporters remained reluctant to attack Putin directly, preferring to blame the campaign on the out-of-control Siloviki and to pin their hopes for an early and satisfactory resolution of the conflict on presidential intervention.[746]

In Yukos-related speeches and interviews, Putin abstained from comments related to the substance of the case, choosing to remain within the formal limits appropriate for a head of state. For an example of Putin's comments on the Yukos case, alluding to the U.S. prosecutions against Enron Corp. officials, he said, "I assure you, nothing extraordinary is happening here.... The difference is that people with a fortune this size have never been criminally charged [in Russia] - unlike in other countries," Putin said in a meeting with Italian journalists in Moscow: "Everyone should understand once and for all - the law should be followed all the time, and not just when you're caught."[747] Another time Putin drew the journalists' attention to the violent side of the Yukos story: "The case is about Yukos and the possible links of individuals to murders in the course of the merging and expansion of this company... In such a case, how can I interfere with prosecutors' work?"[748] Later, in Rome he added that the investigation into Yukos stemmed from the

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[746] Tompson, *Putin and the 'Oligarchs': A Two-Sided Commitment Problem* 4.

[747] K Murphy, 'Jailed Tycoon Claims Abuses by the Kremlin' *LA Times* (Los Angeles 4 October 2003) 3.

[748] The Moscow Times, 'Putin Says Yukos Case All About Murder'.

government's desire "to bring order to the country and to fight corruption,"[749] It is important to note that Putin's position was based on the exclusivity of the Yukos case: "It is necessary to stress that there will be no generalizations, analogies, precedents, especially relating to privatisation results, in connection with the case."[750] It is evident that this statement contradicted the international perception of the Rule of Law. Nevertheless, the majority of Putin's statements on the Khodorkovsky/Yukos case were focused on everybody's equality before the law, presumption of innocence in application to the Yukos officials and the "rule of law" in the Yukos case in general.[751]

Putin also stuck to the point that no nationalization or forced sale of the Company would be possible, until the liquidation procedure began. For example, on November 5, 2003, President stated: "The state surely does not want to destroy [Yukos]" and confirmed it on June 17, 2004 by pointing out: "Russian authorities, the government, and the economic officials of our country are not interested in seeing Yukos go bankrupt."[752]

After his resignation as President, Putin came back to the Yukos topic several times, answering questions regarding Khodorkovsky's future. Although he said the Khodorkovsky could be pardoned by the new president, he also stressed that Khodorkovsky "had grossly and openly violated the law "and the he and his allies "had been involved in violent crimes".[753]

The position of the General Prosecutors Office remained within the limits, established by the Putin: "Just crimes - no politics."[754] Other official agencies did not even dare to comment. Nevertheless, analysis of Putin's speeches in comparison with the

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[749] RFE/RL, 'Putin Says Yukos Affair Is a Part of Anticorruption Effort' (2003) 4 (45) RFE/RL Reports <http://www.rferl.org/reports/securitywatch/2003/11/45-121103.asp>accessed 22 March 2007.

[750] People's Daily, 'Russian President Putin Not to Interfere in Yukos Case' (2003) 27 October People's Daily Online <http://english.people.com.cn/200310/27/eng20031027_126966.shtml>accessed 23 March 2007.

[751] Pravda.RU, 'Everyone Equal before Law, Putin Says' (2003) 27 October Pravda.RU <http://newsfromrussia.com/main/2003/10/27/50804.html>accessed 24 March 2007; Prime TASS, 'Putin Says Yukos Heads Not Guilty until Proven' (2003) 13 November Prime TASS <www.supportmbk.com/documents/legal.cfm >accessed 25 March 2007.

[752] Amsterdam and Peroff, 'White Paper' 47.

[753] Putin, "Elargir L'otan, C'est Ériger De Nouveaux Murs De Berlin".

[754] See eg *Bill of Indictment for Lebedev* ; General Prosecutors Office, 'One More Case against the Former Yukos Managment'.

general timeline of the case shows that the development of the attack on Yukos was dependent on the "bulldogs under the carpet fight"[755] between the main Kremlin groups.[756]

Analysis of Putin and the state's position on the case shows that it has been structured in accordance within the rules of a "special undercover KGB operation", aimed at securing the effective prosecution of Khodorkovsky, the seizure of Yukos' assets, the concealment of the political substance of the case and the representation of it as a mere criminal case.

3.2. Literature Review.

The political nature of crime and justice has been clearly recognized;[757] therefore a general study of the interaction between crime and politics may be unlimited. Hence, in order to limit the observation of the available literature, the sources used in this chapter can be divided into three groups, corresponding to the main research "pillars":

3.2.1. Political Crime and Political Criminals.

Louis Proal postulated a broadened view of political crimes.[758] His definition covered criminal offences committed in the course of political activities, such as theft from

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[755] Winston Churchill once likened Kremlin politics to watching two dogs fight under a carpet — you know there's a furious spat going on but can't see what's happening. See S Schmemann, 'Meanwhile: A Guide to What's Happening in Russia' (2006) 18 December International Herald Tribune <http://www.iht.com/articles/2006/12/18/opinion/edserge.php>accessed 20 October 2007.

[756] See also Defence Lawyers of Mikhail Khodorkovsky, Platon Lebedev and Alexei Pitchugin' Constitutional and Due Process Volations in the Khodorkovsky/Yukos Case' (2004) Robert Amsterdam Blog <http://www.amsterdamandperoff.com/docs/yukos_white_paper.pdf>accessed 20 March 2006; Amsterdam and Peroff, 'White Paper'.

[757] See eg R Quinney, 'Crime in Political Perspective' (1964) 8 Am Behav Scientist 19-22, 20 (please note that later his views changed. See Criminal Justice, 'World of Criminal Justice on Richard Quinney' (2006) <http://www.bookrags.com/biography/richard-quinney-cri/>accessed 25 September 2007).

[758] See L Proal, *Political Crime* (D. Appleton and Company, New York 1898).

public funds, corrupting police officers, or misuse of power by officials.[759] Giddings, who introduced the English translation of Proal's book, took a different approach in defining the political criminal. Although Giddings did not exclude offences committed by governments and politicians for political advantage, he also emphasized the fact that only the "powerless" can commit genuine political crimes. Giddings referred primarily to crimes against governments, such as treason, insurrection, and rebellion, but he defined the concept of the political criminal according to crimes, not classes of criminals.[760]

One way of defining political crime is to simply list a series of offences (acts), which the author considers "political." For example, Elliott indicates that "the major types of political offenders may be subsumed under the categories of (1) traitors, (2) spies, (3) draft evaders, and (4) conscientious objectors."[761] However, the definition of political crime by simple reference to a special list was criticised by Void,[762] Clinard and Quinney,[763] and Turk, [764]who saw it just as one element of criminal typology.

The theories on "pure political crime" are divided into "subjective" and "objective" theories. The "subjective" theories include two categories: those concerned with the motives of the offender, and those concerned with the final aim of the actor: the intention.[765]

The offender's motive is considered by a number of theorists as the sole and definitive criterion in defining "political crime".[766] For example, Cavan placed ideological criminals on the opposite end of a continuum from underworld criminals, pointing out that "the key motivation for the ideological deviant seems to be a desire to establish a better social order for themselves and often for the nation."[767] His theory actually reflected the

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[759] S Schafer, 'The Concept of the Political Criminal' (1971) 62 (3) JCrim LC& PS 380-87, 383.

[760] ibid (quoting Giddings' introductions to Proal's book).

[761] MA Elliot, *Crime in Modern Society* (Harper, New York 1952) 183.

[762] See GB Vold, 'Some Basic Problems in Criminological Research' (1953) 17 FedProbation 37-42.

[763] See MB Clinard and R Ouinney, *Criminal Behavior Systems: A Typology* (Holt, Rinehart & Winston, New York 1973).

[764] See AT Turk, *Criminality and Legal Order* (Rand McNally, Chicago 1969).

[765] N Passas, 'Political Crime and Political Offender: Theory and Practice' (1986) 8 (1) Liv L Rev 23-36, 26.

[766] For example, Rossel, Holzendorf, Clarke. See ibid.

[767] RS Cavan, 'Underworld, Conventional, and Ideological Crime' (1964) 55 JCrimLC& PS 235-40, 239.

earlier findings of other theoreticians. For example, Maurice Parmelee viewed the concept of the political criminal as a confrontation between the government and those who are against its policy "in interest of the public."[768] Willem Bonger contended that the political criminal acts "for the benefit of society," for "the oppressed classes, and consequently [for] all humanity."[769]

Ingraham and Tokoro defined two types of political crime based on a combination of act and motivation: (1) acts which, by their very nature, tend to injure the state or its machinery of government either internally or externally; (2) all criminal acts, regardless of kind, which have as their motive or object some rearrangement of political power within the state and which entail at the same time both an attack on the state and the private interests of its citizens.[770]

Clinard and Quinney significantly corrected this position by pointing out that a definition of political crime must include both crimes against government and crimes by government.[771] For crimes against government, they stressed the need for a "purposive, voluntaristic conception of man", emphasizing the noble goals espoused by these offenders.[772]

Political crime was also discussed by Merton[773] and Schafer[774] as nonconformist, ideological, and convictional behavior. According to their theory the necessary elements of political crime are (1) the desire to influence existing public policy or power relations between groups through the commission of the crime, and (2) the predominance of concern for group or societal welfare over considerations of personal gain.

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[768] M Parmelee, *Criminology* (MacMillan, New York 1918) 454 or M Parmelee, *Criminology* (Kessinger Publishing, New York 2007).

[769] WA Bonger, *Criminality and Economic Conditions* (Indiana U.P., Bloomington 1916) 648.

[770] BL Ingraham and K Tokoro, 'Political Crime in the United States and Japan: A Comparative Study' (1969) 4 Issues Criminology 145-70, 146.

[771] Clinard and Ouinney, *Criminal Behavior Systems: A Typology* 154.

[772] ibid 163-64.

[773] See RK Merton, 'Social Problems and Sociological Theory' in RK Merton and RA Nisbit (eds), *Contemporary Social Problems* (Harcourt, Brace & World, New York 1966) 793-845.

[774] See S Schafer, *The Political Criminal: The Problem of Morality and Crime* (Free Press, New York 1974).

3.2.2. Political Trials.

In the professional literature on political justice, Kirchheimer provides an extensive discussion.[775] Kirchheimer's approach was international and historical, but his conception of political justice was limited to political trials, ignoring the possibility of political justice being meted out by police or correctional authorities.[776] Kirchheimer identified three types of political trials:

A. The trial involving a common crime committed for political purposes and conducted with a view to the political benefits, which might ultimately accrue from successful prosecution;

B. The classic political trial: a regime's attempt to incriminate its foe's public behavior with a view to evicting him from the political scene;

C. The derivative political trial, where the weapons of defamation, perjury, and contempt are manipulated in an effort to bring disrepute upon a political foe.[777]

Following Kirchheimer, Becker discussed political trials as "the utilization of the judicial structure to engage political forces in combat by trial, and to dispose of opponents either permanently or temporarily."[778] Becker established a four-part classification of political trials based on the nature of the charge and the fairness of the proceedings: "it seems possible and desirable to identify and distinguish among (1) political trials, (2) political 'trials,' (3) 'political' trials, and (4) 'political trials'."[779]

Professor Judith Shklar's position regarding the role of international and domestic political trials played an important role in the theory of political trials. Shklar stressed that some international trials might help in promotion of the rule of law and democratic values,

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[775] WW Minor, 'Political Crime, Political Justice, and Political Prisoners' (1974-1975) 12 Criminology 385-98, 392.

[776] ibid.

[777] O Kirchheimer, *Political Justice: The Use of Legal Procedure for Political Ends* (Princeton Princeton, N.J. 1961) 46.

[778] TL Becker, *Comparative Judicial Politics* (Rand McNally, Chicago 1970) 373.

[779] TL Becker (ed), *Political Trials* (Bobbs-Merrill, Indianapolis 1971) xiii.

like the Nuremberg trial.[780] However, she flatly denied that domestic political trials could have a valuable role in a liberal constitutional order.[781] Professor Shklar also opinioned that courts could convict people only for past acts and not on the basis of future threats.[782]

Subsequent writings of political theorists, including Otto Kirchheimer,[783] did not depart much from Shklar's conclusions. Abel and Marsh[784] argued that political trials may generate good political outcomes but they defined the political trial so broadly as to encompass virtually any case in which the court's political views may play a role in the decision.[785]

3.2.3. Political Prisoners.

Liazos emphasized the importance of the systemic analysis of social problems rather than the approach based on personal attribution proposed earlier by Ross and Staines[786]:

> Only now are we beginning to realize that most prisoners are *political prisoners*—that their "criminal" actions (whether against individuals, acts such as robbery, or conscious political acts against the state) result largely from current social and political conditions, and are not the work of "disturbed" and "psychopathic" personalities[787]

Aptheker suggested that there are four groups of individuals who should be considered political prisoners. These are (1) political leaders who are victimized by police frame-ups, (2) civil disobedients and political criminals, (3) innocent victims of class, racial, and national oppression who lack adequate legal or political redress, and (4)

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[780] JN Shklar, *Legalism: Law, Morals, and Political Trials* (Harvard University Press, Cambridge 2006) 155-70.

[781] ibid 220.

[782] ibid 215.

[783] See in general Kirchheimer, *Political Justice: The Use of Legal Procedure for Political Ends*.

[784] See in general CF Abel, FH Marsh and BK Johnpoll, *In Defence of Political Trials* (Greenwood Press, Westport, CT 1994).

[785] EA Posner, 'Political Trials in Domestic and International Law' (2005) 55 Duke LJ 75-131, 91-92.

[786] R Ross and GL Staines, 'The Politics of Analyzing Social Problems' (1972) 20 SocProb 18-40.

[787] A Liazos, 'The Poverty of the Sociology of Deviance: Nuts, Sluts, and Perverts' ibid 20 103-20, 108.

prisoners who develop political consciousness and are therefore discriminated against by prison administrators and parole boards.[788]

Goodell and Minor pointed out that there were two logical bases for defining political imprisonment. According to them, a *political prisoner* is one who is imprisoned as a result of political crime or political justice (political criminals and victims of repression).[789]

Recognizing the difficulties in establishing the distinction between political crime and ordinary crime, Forsythe emphasized the importance of distinguishing between ordinary and political prisoners, seeing the latter as the special type of criminal:

> Indeed, notwithstanding the conceptual difficulties, there seem to be important aspects of world politics that can only be described as pertaining to political prisoners. It is evident that governments do regard a type of detainee as special - special in the sense of being different from other prisoners. In general, he is different because he is viewed by the government as a direct or indirect threat to the government, and therefore he is persecuted.[790]

He also pointed out that the subject of political prisoners was eminently characteristic of the world politics in the last third of the twentieth century, emphasizing the importance of the institution.[791]

3.3. "Political Motivation": Definitional Aspects.

The key problem in Khodorkovsky-Yukos case is the problem of its political motivation, which has been widely recognised in the West but has been completely denied by Russian officials.[792]

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[788] B Aptheker, 'The Social Functions of the Prison in the United States' in AY Davis (ed), *If They Come in the Morning* (Signet, New York 1971) 51-59, 58.

[789] C Goodell, *Political Prisoners in America* (Random House, New York 1973) 10-11; Minor, 'Political Crime, Political Justice, and Political Prisoners' 394.

[790] See D Forsythe, 'Political Prisoners: The Law and Politics of Protection ' (1984) 21 CompJuridRev 4.

[791] DP Forsythe, 'Political Prisoners: The Law and Politics of Protection' (1976) 9 Vand J Transnat'l L 295-322, 322.

The starting point in the research on political motivation and political motivated prosecution is the recognition of the general political nature of crime and justice. Quinney has stated that,

> As an instrument of social control, criminal law is most importantly characterized by its politicality. That is: 1) specific rules of conduct are created by a recognized, legitimate authority, 2) designated officials interpret and enforce the rules, and 3) the code is binding on all persons within a given political unit. Criminal law is thus an aspect of politics, one of the results of the process of formulating and administering public policy.[793]

Regardless to the recognition of the general political nature of criminal law, the question regarding the definition of "political motivation" is a difficult one. Officials and organisations, dealing with the politically motivated crimes and politically motivated prosecution[794] operate with different terminology, amongst which the most widely known are "political prisoners", "political trials" and "political refugees".[795] According to some academics, asserting the political nature of a crime is virtually a mission impossible.[796] Almost the only point agreed upon is that 'political' as an adjective qualifies the mental element of the crime, and that the political motive alone does not make the crime political. Apart from this, in the domestic practices of major jurisdictions there only exists a general understanding that "politics is about government".[797] The underlying reason for the absence of a clear definition of "political element" is explained by David Forsythe, who points out that governments are generally reluctant to permit outside determination of issues that may undermine the authority of the government, or increase the authority of a non-national institution. Governments are especially reluctant to permit such determination

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[792] See eg M Mainville, 'Yukos's Khodorkovsky Expected to Be Found Guilty' (2005) 25 April The Sun <http://www.nysun.com/article/12732>accessed 23 September 2007.

[793] Quinney, 'Crime in Political Perspective' 20.

[794] On the definition of prosecution see M Bagaric and J McConvill, 'Refugee Law: The Irrelevance of the Framers'intentions ' (2005) 14 Nottingham LJ 1-18, 17.

[795] See eg *Schtraks v Government of Israel* [1964] AC 556, 561. See also MC Bassiouni, *International Extradition: United States Law and Practice* (5th edn, Oxford University Press, New York 2007) 167.

[796] G Gilbert, *Aspects of Extradition Law (International Studies in Human Rights)* (Brill, London 1991) 118.

[797] A Rasulov, 'Criminals as Refugees: The "Balancing Exercise" And Article 1 F (B) of the Refugee Convention' (2002) 16 Geo Immigr LJ 815-33, 819.

when the issue raised implies governmental persecution or touches upon governmental security.[798]

The terminology related to political crimes and political motivation is used in the law of extradition[799] and asylum and the law of human rights.[800] Political offenders are singled out for special protection in the law of extradition for both pragmatic and humanitarian reasons.[801] Their preemptive exclusion from the purview of extradition obligations is viewed as a necessary element of non-intervention in the internal conflicts of other states.[802] Non-extradition of political offenders also serves to prevent the surrender of a person to a jurisdiction where his/her fair trial may be prejudiced by political considerations.[803]

Refugee law deals with political offenders more obliquely.[804]Initially, the 1951 Convention allowed substantial state discretion in determining who was a refugee, including the question of whether political offenders meet the definition.[805] Later this concept changed for two reasons. First, refugee status determination in the West became increasingly judicialized. It was no longer premised on largely unfettered state discretion but become primarily a matter of individual entitlement within a domestic legal system,

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[798] Forsythe, 'Political Prisoners: The Law and Politics of Protection' 299.

[799] J Hathaway, *The Law of Refugee Status* (Butterworths, Toronto 1991) 221.

[800] D Weissbrodt, 'International Trial Observers' (1982) 18 Stan J Int'l L 27-122, 62.

[801] See BS Chimni, 'Globalization, Humanitarianism and the Erosion of Refugee Protection' (2000) 13 J Refugee Stud 243-63, 252-58; G Griffith and C Harris, 'Recent Developments in the Law of Extradition' (2005) 6 Melb J Int'l L 33-54, 45.

[802] See eg SR Chowdhury, 'Response to the Refugee Problems in Post Cold War Era: Some Existing and Emerging Norms of International Law' (1995) 7 Int'l J Refugee L 100-18, 115; JW Dacyl, 'Sovereignty Versus Human Rights: From Past Discourses to Contemporary Dilemmas' (1996) 9 J Refugee Stud 136-65, 136-40.

[803] See eg --, 'Political Legitimacy in the Law of Political Asylum ' (1985) 99 (2) Harv L Rev 450-71, 450-51.

[804] Chimni, 'Globalization, Humanitarianism and the Erosion of Refugee Protection' 252.

[805] See eg P Weis, 'Development of Refugee Law' (1982) 3 Mich YBI Legal Stud 27-42, 28-32; CJ Harvey, 'Reconstructing Refugee Law' (1998) 3 J CL 159-90, 162.

albeit predicated upon falling within an 'international' definition.[806] Second, the end of the Cold War made the refugee's role in stigmatizing 'enemy' states obsolete.[807]

Regardless of the absence of clear definitions, the difference between a political criminal and a victim of political prosecution has to be clearly identified. In the Yukos case this difference is evident as Khodorkovsky's alleged crimes have never been seen as political even in their tiniest aspect either by the investigators nor Khodorkovsky's allies or himself.[808] Khodorkovsky's supporters insist that these crimes either lack *actus reus,* or Khodorkovsky's connection to them has never been proved.[809] The most powerful arguement of Khodorkovsky and Lebedev's defence is the procedural violations, with regard to their client's right to a fair and open trial, etc.[810] Therefore, presence of the "politically motivated prosecution" in the Yukos and Khodorkovsky case can be formally established in two routes:

i. When Khodorkovsky, Lebedev or somebody with a connection to Yukos has been regarded as a victim of the political trial and later recognized as "political prisoners"[811] or

ii. When an individual, belonging to the Yukos "social group"[812] has been granted political asylum[813] or his extradition has been refused based on the "political offence" exception[814] or both.

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[806] M Bagaric and P Dimopoulos, 'Refugee Law - Time for a Fundamental Re-Think: Need as the Criterion for Assistance' (2003) 9 Canterbury L Rev 268 -93 262, 73.

[807] See Hathaway, *The Law of Refugee Status* n 3, 7-8; R Rogers and E Copeland, *Forced Migration: Policy Issues in the Post-Cold War* (Fletcher School of Law and Diplomacy, Tufts University, Medford, Massachusetts 1993) 98.

[808] See Khodorkovsky, 'Final Statement to Meshchansky Court'.

[809] See eg Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges'.

[810] See eg Amsterdam and Peroff, 'White Paper' 16-29.

[811] See eg All Russian News.com, 'Legal Experts Have Declared Khodorkovsky the Political Prisoner' (2007) 8 February All Russian News.com <http://allrussiannews.com/news/08-february-2007-legal-experts-have-declared-khodorkovsky-the-political-prisoner.html>accessed 30 March 2007.

[812] See eg *Russian Federation v Kartasov Vladislav Nicolay* [2008] Nicosia Dis Court App № 2/07 (In the Matter of the 95/70 Extradition Law) (Cyp).

[813] See --, 'DJ Lithuanian Court Confirms Russian Banker's Asylum Status'.

[814] See eg Kommersant.com, 'Cyprus Court Didn't Extradite Yukos Accused' (2006) 17 October Kommersant Online <http://www.kommersant.com/p713715/r_500/YUKOS_extradition>accessed 12 April 2008.

The role of the Russian authorities was to insist that Khodorkovsky had been charged and sentenced without any element of selectivity and without underlying political motives and no significant procedural violations have never taken place.[815]

Therefore, the presence of elements of "politically motivated" prosecution in the Yukos case can be ascertained through the analysis of the internationally recognized concepts of 'political refugee', 'political asylum' and 'political prisoner' in application to the case and the individuals involved.

3.4. Extradition and Asylum. The Political Offence Exception.

The situation with the extradition and asylum is legally simpler than with laws on human rights, as refugee status can be granted by the government of the country or the extradition request can be declined or accepted by the court.[816] Therefore, certain formal results can be ascertained.

Despite the number of similarities, there are differences between extradition and asylum in their approach to the "political" aspect.[817] While extradition law operates between states and is inclined towards bilateralism and reciprocity, the law of refugee protection is a branch of law in which "states do not have any interests of their own; they merely have, one and all, a common interest, namely, the accomplishment of those high purposes that are the raison d'être [of this branch of law]." [818]

The problem of "politics" in the extradition and asylum sphere is related to the problem of political crime or the so-called "political offence exception".[819]

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[815] See eg The Moscow Times, 'Putin Says Yukos Case All About Murder'.

[816] Bassiouni, *International Extradition: United States Law and Practice* 193.

[817] See eg ibid 193-201.

[818] Rasulov, 'Criminals as Refugees: The "Balancing Exercise" And Article 1 F (B) of the Refugee Convention'.

[819] See eg D Bouffard, 'Extradition - Political Offence Exception' (1981-1982) (6) Suffolk Transnat'l LJ 147-61; M Kellett, 'Extradition - the Concept of the Political Offence ' (1986) 8 LLR 1-22; RS Phillips, 'The

It is an accepted principle in international extradition law that political offences may not give rise to extradition.[820] The *Model Treaty on Extradition* states that extradition shall not be granted if, inter alia, 'the offence for which extradition is requested is regarded by the requested State as an offence of a political nature'.[821] So, the exception is universally accepted.[822] As the late British Judge Sir Hersch Lauterpacht observed, "In the legislation of modern states there are few principles so universally adopted as that of non-extradition of political offenders."[823]

Theoreticians emphasised the significance of the "political offence" exception as a political instrument dressed in legal robes:

> The political offence exception was crafted to delicately balance the receiving State's concern for the fugitive's welfare with its general aversion to involvement in the political affairs of the requesting State. The grafting of these interests onto a legal framework, with resolution vested in the judicial branch, may be designed to provide a "legal cloak" for what is essentially a political judgement. That cloak conveniently excuses the country's political branches from the knotty dilemma of having to deny extradition, thereby sparking a diplomatic confrontation.[824]

There are several universal principles pertaining to the "political offence exception"

1) The courts have deliberately refrained from any attempt to formulate an exhaustive definition of what constitutes an offence of a political character.[825] Gilmore pointed out:

Political Offence Exception and Terrorism: Its Place in the Current Extradition Scheme and Proposals for Its Future' (1996-1997) 15 Dick J Int'l L 337-60.

[820] Kellett, 'Extradition - the Concept of the Political Offence' 2-20; Interpol, 'Extradition - Some Benchmarks' (2003) <http://www.interpol.int/Public/ICPO/LegalMaterials/FactSheets/FS11.asp>accessed 23 March 2007.

[821] Model Treaty on Extradition GA Res 116 (1990) UN GAOR 45th Sess UN Doc A/RES/45/11b

[822] CM Bassiouni, 'Ideologically Motivated Offenses and the Political Offenses Exception in Extradition - a Proposed Juridical Standard for an Unruly Problem' (1969-1970) 19 (2) DePaul L Rev 217-65, 244; BA Wortley, 'Political Crime in English Law and in International Law' (1971) 45 Brit YB Int'l L 219-53, 220.

[823] Phillips, 'The Political Offence Exception and Terrorism: Its Place in the Current Extradition Scheme and Proposals for Its Future' 340.

[824] DM Lieberman, 'Sorting the Revolutionary from the Terrorist: The Delicate Application of The "Political Offence" Exeption in the U.S. Extradition Cases' (2006) 59 Stan L Rev 181-210, 190 quoting G Gilbert, *Transnational Fugitive Offenders in International Law:Extradition and Other Mechanisms (International Studies in Human Rights)* (Springer, New York 1998) 204-05.

[825] WC Gilmore, 'Extradition and the Political Offence Exception: Reflections on United Kingdom Law and Practice' (1992) 18 Commw L Bull 701-18, 704.

It has come to be regarded as something of an advantage that there is to be no definition of the term 'political offense'. The advantage seems to be that it leaves the court free to grant or deny extradition according to the respective merits of the fugitive and the requesting government, but this judicial opportunism is at the cost of any consistent principle and involves the abandonment of the *raison d'etre* of the political offense exception. Yet the fault for this lies only partially with the courts. It is not so much that they have failed to elucidate a complex concept; rather the concept itself is not an appropriate tool for the work required of it.[826]

2) The epithet 'political' indicates that 'the requesting State is pursuing [the fugitive] for reasons other than the enforcement of the criminal law in its ordinary, what I may call its common or international aspect.'[827]

3) 'The latest and most authoritative test [of whether an offence is political] is whether the fugitive, the alleged offender, could claim with any prospect of success, political asylum.'[828]

The definition of a political offence is an issue that has intrigued countries since the signing of the first extradition treaty.[829] Despite the lack of universal acceptance of a single definition, almost all international extradition treaties include language prohibiting extradition for crimes which are political in character.[830] Most treaties, bilateral and multilateral, do not attempt to define the term exhaustively.[831] The definitions contained in these treaties were initially so general as to be impossible to apply literally.[832] Therefore the inclusion of such language in treaties and the task of defining the parameters of the exception has been left to the judiciary of each country.[833] Nevertheless, the term

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[826] JR Young, 'The Political Offence Exception in the Extradition Law of the United Kingdom: A Redundant Concept' (1984) 4 Legal Stud 211-22, 216.

[827] *Schtraks v Government of Israel* [1964] AC 556, 591.

[828] Young, 'The Political Offence Exception in the Extradition Law of the United Kingdom: A Redundant Concept' 216.

[829] See for the details Bouffard, 'Extradition - Political Offence Exception' 150.

[830] ibid.

[831] Bassiouni, 'Ideologically Motivated Offenses and the Political Offenses Exception in Extradition - a Proposed Juridical Standard for an Unruly Problem' 243-44.

[832] G Griffith and C Harris, 'Recent Developments in the Law of Extradition' (2005) 6 Melb J Int'l L 33-53, 43.

[833] CM Bassiouni, *International Extradition and World Public Order* (Oceana Pubns New York 1974) 371.

"political offence", as used in extradition, has received a broader interpretation then in other areas of law.[834] Lora Deere commented on this interpretational problem:

> The difficulty connected with political offenses arises mainly from the fact that, in connection with extradition, an exceptional extension is given to the conception "political offense." Ordinarily, by a political offense is meant a purely political offense, *i.e.,* one not accompanied by any offense against the ordinary law; but in connection with extradition the conception is frequently extended to cover *ancillary* offenses, *i.e.* offenses against the ordinary law connected with political acts or events.[835]
>
> It is uncontroversial that it is intended to cover non-violent crimes such as slander of a head of state or offenses based on political protest. However, outside this area of clear exception, there is little consensus regarding which crimes, particularly crimes including violence, should fall within its confines.[836]

According to academics, surprisingly few occasions have arisen in practice in which the judiciary have had an opportunity to reflect upon the appropriate description of a political offence.[837]

Extradition law provides some of the most important resources for defining political prisoner status. This is primarily through state judicial interpretations of the political offence exception. Although there is no single definition available regarding political offences there are some broadly shared principles. All definitions agree that political offences are not limited to those involving solely anti-government opinions or non-violent expressions; acts which involve common law or statutory crimes may also be deemed political.[838]

The changing global landscape of the past several decades has prompted a reexamination of the political exception's scope.[839] An increasing number of countries now display intolerance for the exploitation of their immigration and asylum procedures by

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[834] LL Deere, 'Political Offenses in the Law and Practice of Extradition' (1933) 27 Am J Int'l L 247-70, 248.

[835] ibid.

[836] Griffith and Harris, 'Recent Developments in the Law of Extradition' 43.

[837] Gilmore, 'Extradition and the Political Offence Exception: Reflections on United Kingdom Law and Practice' 704.

[838] GJ McDougall and CES Soderbergh, 'The Release of South Africa's Political Prisoners: Definitions and Expectations' (1990) 4 Temp Int'l & Comp LJ 1-22, 8.

[839] Lieberman, 'Sorting the Revolutionary from the Terrorist: The Delicate Application of The "Political Offence" Exeption in the U.S. Extradition Cases' 182.

former political leaders, military officials, revolutionaries, and terrorists to avoid domestic prosecution.[840] Some scholars noted the irony between the origins of the doctrine and its modern application. As Professor Gilbert argued, "The exemption was aimed to protect people fighting for liberal democracy, yet the same language is still applied today to persons intent on destroying liberal democracy."[841] For example, the State parties to the 1977 European Convention on the Suppression of Terrorism (European Terrorism Convention), agreed to exclude certain acts from the political offence exception, inter alia, "an offence involving kidnapping, the taking of a hostage or serious unlawful detention," and "an offence involving the use of a bomb, grenade, rocket, automatic firearm or letter or parcel bomb if this use endangers persons."[842] The European Union, in agreeing to the new extradition convention, accepted the idea that the political offence exception might be safely eliminated because sufficient human rights mechanisms were already in place to protect a fugitive who may be at risk.[843] The 1996 European Union Convention Relating to Extradition between the Member States abolished the political offence exception altogether for extraditions between EU governments.[844]

Bassiouni, in his book on international extradition, quotes two recent decisions of the Paris Court of Appeal, ordering extradition of the individuals involved in a kidnap-murder, regardless to the political element, and points out that European courts are beginning to narrow down the exception.[845] However, outside the European context, many states remain reluctant to abandon the political offence exception. At best, they define certain particularly violent offences as beyond the scope of political justification.[846]

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[840] Bassiouni, *International Extradition: United States Law and Practice* 709-10.

[841] Gilbert, *Transnational Fugitive Offenders in International Law: Extradition and Other Mechanisms (International Studies in Human Rights)* 209.

[842] G Vermeulen and TV Beken, 'New Convention on Extradition in the European Union: Analysis and Evaluation' (1997) 15 Dick J Int'l L 265-95, 291-92.

[843] RE Rao, 'Protecting Fugitives' Rights While Ensuaring the Prosecutionand Punishment of Criminals: An Examination of the New EU Extradition Treaty' (1998) 21 BC Int'l & Comp L Rev 229-44, 243-44.

[844] Vermeulen and Beken, 'New Convention on Extradition in the European Union: Analysis and Evaluation' 291-92.

[845] Bassiouni, *International Extradition: United States Law and Practice* 711.

[846] JC Hathaway and CJ Harvey, 'Framing Refugee Protection in the New World Disorder' (2001) 34 Cornell Int'l LJ 257-321, 283.

Closely related to extradition law is refugee law. [847] For example, in one of the leading UK cases *T. v. Home Secretary* one of the judges remarked:

> Indeed, it appears from the travaux préparatoires that the framers of the convention had extradition law in mind when drafting the convention, and intended to make use of the same concept, although the application of the concept would be for a different purpose. [848]

Political asylum is itself founded upon two rationales. The predominant of these, the human rights principle, justifies asylum as being for the protection of the right to political freedom. The other, the principle of non-intervention, is based on the proposition that one state should not intervene in the affairs of another. Consistent adherence to political asylum should enable a state to avoid the appearance of taking sides between disputing parties in another state.[849] The decision to grant political asylum is an executive act and may be complicated by considerations of party or national interest, sometimes indeed in apparent breach of the principles of non-intervention. [850]

The Refugee Convention of 1951 and its 1967 Protocol seek to protect the political fugitive. The difference in application of the two bodies of law is a matter of legal technicalities. The key phrase of the 1951 Convention states that it applies to one whom:

> As a result of events . . . and owing to well founded fear of being persecuted for reasons of race, religion, nationality, membership of a particular social group or political opinion, is outside the country of his nationality and is unable or, owing to such fear, is unwilling to avail himself of the protection of that country; or who, not having a nationality and being outside the country of his former habitual residence as a result of such events, is unable or, owing to such fear, is unwilling to return to it. [851]

Persecution "for reasons of political opinion" implies that an applicant holds an opinion which has been expressed or has come to the attention of the authorities. For refugee and asylum purposes, submissions about persecution based on political opinion

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[847] See eg ibid 273-74.

[848] *T v Secretary of State for the Home Department* [1996] AC 742, 778.

[849] Young, 'The Political Offence Exception in the Extradition Law of the United Kingdom: A Redundant Concept' 212.

[850] ibid.

[851] Convention Relating to the Status of Refugees (1951) 189 UNTS 137 (Refugee Convention)

cover any opinion perceived to challenge governmental authority.[852] There may be situations in which the applicant has not given any expression to his opinions. Due to the strength of his convictions, however, it may be reasonable to assume that his opinions will eventually find expression and that the applicant will, as a result, come into conflict with the authorities.[853] Therefore, political opinion may be express, implied or imputed.[854]

As refugee law and the law of extradition do not play identical roles in international law, and because non-extradition and a grant of refugee status are not identical remedies, they approach the problem of "political" persecution from the different "ends": The "political offence exception" in extradition law provides that the individual cannot be extradited due to the political nature of his offence, as the prosecution for the "political" offence will also be "political"; refugee law says that an individual cannot go back to his country because of fear of prosecution for his political opinion, which is supposed to be also "political". Both of these institutions are criticised by academics and are subject to public scrutiny for potentially "harbouring" terrorists. Nevertheless, they still play an important role in international politics and law, allowing for the establishment of a "political" treatment element in application to the certain individual and providing them with adequate protection.

3.5. Human Rights Protection.

In the area of human rights protection, the most known terms are "political prisoner" and "prisoner of conscience".

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[852] A Jones and A Doobay, *Jones and Doobay on Extradition and Mutual Assistance* (3nd edn, Sweet & Maxwell, London 2005) 200.

[853] UNHCR, *Handbook on Procedures and Criteria for Determining Refugee Status under the 1951 Convention and the 1967 Protocol Relating to the Status of Refuges* (UNHCR, Geneva 1992) para 82.

[854] Jones and Doobay, *Jones and Doobay on Extradition and Mutual Assistance* 200.

The concept of "political prisoner" leads to problems of definition that are not completely solvable. There is no definition free from problem, and therefore there is no adequate legal basis for a general approach to legal protection of political prisoners.[855]

Amnesty International has adopted the term "prisoner of conscience" to depict those individuals it views as political prisoners. It considers "people detained anywhere for their beliefs, colour, sex, ethnic origin, language, or religious creed" who have neither used nor advocated violence, including those who have been detained without being charged or without trial, to be "prisoners of conscience."[856] In other words Amnesty International defines a political prisoner as "any prisoner whose case has a significant political element'.[857]

According the academics, the definition adopted by Amnesty International is an example of the "persecuted individual" school of thought. This approach defines a political prisoner as "one prosecuted by a government because of that person's 'political' beliefs."[858] An acknowledged problem with this definition is that it is often difficult to determine whether prosecution is being used as a means of persecution since the decision of whether to prosecute is generally a subjective one.[859]

A different school of thought utilizes a "government security" definition for political prisoners. According to this definition, "any person detained for constituting a threat to the security of the government" is considered a political prisoner.[860] As an example can be taken the U.S. State Department definition of "political prisoner", which includes persons who are prosecuted even under an ostensibly internationally acceptable law when the charges are trumped-up or the trial is unfair.[861]A number of problems exist with such type

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[855] Forsythe, 'Political Prisoners: The Law and Politics of Protection' 318.

[856] J Power, *Amnesty International: The Human Rights Story* (Mcgraw-Hill, New York 1981) 21-22.

[857] Amnesty International, 'Russian Federation: The Case of Mikhail Khodorkovskii and Other Individuals Associated with Yukos' (2005) <http://web.amnesty.org/library/print/ENGEUR460122005>accessed 10 March 2007.

[858] Forsythe, 'Political Prisoners: The Law and Politics of Protection' 297.

[859] JL Taubner, 'Political Prisoners in the United States' (1992) 18 New Eng J on Crim & Civ Confinement 63-89, 65.

[860] Forsythe, 'Political Prisoners: The Law and Politics of Protection' 298.

[861] See Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' 11.

of definitions. They do not apply to political prisoners who have been "framed" on charges unrelated to government security interests, nor do they apply to those who have purportedly been detained under a false pretext of "non-security reasons." United States former Attorney General Richard Kleindienst said: 'There is enough play at the joints of our existing criminal law - enough flexibility - so that if we really felt that we had to pick up the leaders of a violent uprising, we could. We could find something to charge them with and we would be able to hold them that way for a while.'[862]

The "government security" concept is based on the assumption that a political prisoner is a person held in confinement because of his associations or actions related to the government of society. According to Acoli, the operative word in this concept is "government." It shows that the political prisoner is held for political reasons: matters related to government rather than matters related to law.[863]

The definition proposed by Parliamentary Assembly of the Council of Europe (PACE) represents a mixture of the "government security" approach and the "persecuted individual" definition. PACE has adopted objective criteria developed by a group of experts to define "political prisoners." According to PACE:

> A person deprived of his or her personal liberty is to be regarded as a political prisoner:
>
> • if the detention has been imposed in violation of one of the fundamental guarantees set out in the European Convention on Human Rights and its Protocols, in particular freedom of thought, conscience and religion, freedom of expression and information, freedom of assembly and association;
> • if the detention has been imposed for purely political reasons without connection to any offence;
> • if, for political motives, the length of the detention or its conditions are clearly out of proportion to the offence the person has been found guilty of or is suspected of;
> • if, for political motives, he or she is detained in a discriminatory manner as compared to other persons; or,

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[862] Forsythe, 'Political Prisoners: The Law and Politics of Protection' 298.

[863] S Acoli, 'Unique Problems Associated with the Legal Defence of Political Prisoners and Prisoners of War (Pp/Pows)' (1996-1997) 24 SU L Rev 113-20, 113.

• if the detention is the result of proceedings which were clearly unfair and this appears to be connected with political motives of the authorities.[864]

An examination of state practice leads to a relatively broad definition of political prisoner status. That definition would include all those jailed because their political beliefs, associations or deeds are considered a threat to state security, including all those who acted with political motives during and or as part of some form of uprising. Even those crimes, which are related to, as opposed to being in strict pursuit of, political goals are deemed within the category if there is a preponderant political motivation. These norms judge neither the validity of the political motivation nor the tactics. Rather, the mere existence of the antagonism between individual and government may be sufficient to call the person a political offender.[865]

Considering the definitions for political crime, political criminals, and political justice given in his papers, William Minor comes to the conclusion that a political prisoner is one who is imprisoned as a result of political crime or political justice.[866] Political justice is the discriminatory application of the machinery of criminal justice to the disadvantage of specific individuals or groups because they are perceived as threatening to the power of the established regime. According to Minor the "machinery of criminal justice" includes lawmaking, police practices, bail setting, imprisonment, parole procedures, and all other activities of the criminal justice system, not just the criminal trial.[867]

Therefore, the term “political trial” is subordinate to the term “political justice”. In this context Kirchheimer uses the term “derivative political trial”, i.e. a trial, where the weapons of defamation, perjury, and contempt are manipulated in an effort to bring disrepute upon a political foe.[868]

Following Kirchheimer, Becker discusses political trials as "the utilization of the judicial structure to engage political forces in combat by trial, and to dispose of opponents

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[864] Parliamentary Assembly of the Council of Europe, Committee on Legal Affairs and Human Rights, *Political Prisoners in Azerbaijan* (Doc No 9826 App 1, 6 June 2003)

[865] McDougall and Soderbergh, 'The Release of South Africa's Political Prisoners: Definitions and Expectations' 4.

[866] Minor, 'Political Crime, Political Justice, and Political Prisoners' 394.

[867] ibid 393.

[868] Kirchheimer, *Political Justice: The Use of Legal Procedure for Political Ends* 46.

either permanently or temporarily."[869] Posner commented on political trials emphasising the presence of the same characteristics: 'On this definition, a political trial occurs when the government uses the judicial process against its opponents ... who have not violated formal, generally enforced laws or who have violated only formal laws against political dissent.'[870]

So, theoreticians stress the essential element of political trials: usage of judicial process for suppression of opponents who committed no formal violation of the law. [871]

The definitions of "political justice" and "political trial" supplement the last paragraph of PACE definition of the term "political prisoner".[872]

3.6. Khodorkokovsky and other Yukos-related Individuals as "Political Prisoners" and "Prisoners of Conscience".

3.6.1. Structural Analysis of the Arguements of Khodorkovsky and Yukos Defendants on "Political Motivation" Aspect of the Case.

The political prosecution issues in the Khodorkovsky-Yukos case have been addressed by different Russian NGOs, international foundations, experts, judicial bodies and governments. Such a variety of opinions appears misleading and may give the impression that political motivation in Khodorkovsky-Yukos case has been ultimately recognised not only by the international community, but also by all possible judicial and political bodies, which are involved in human rights protection and that they have the recognised authority to issue opinions regarding political prosecution. This is not the case.

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[869] Becker, *Comparative Judicial Politics* 373.

[870] Posner, 'Political Trials in Domestic and International Law' 87.

[871] Political trials should be distinguished from transitional trials. Transitional trials occur when a newly democratic state tries officials of the old regime for acts that were lawful at the time they were performed. See ibid 133.

[872] On political trials see R Martin-Achard, 'Political Trials and Observers' (1971) 6 Int'l Comm'n Jur Rev 24-31; Weissbrodt, 'International Trial Observers'.

The majority of these opinions can be regarded only as opinions of independent third parties without any legal or political significance at all. Those who, like Amnesty International, are recognised foundations for granting "political prisoner" (prisoner of conscience) status, have not formed their opinions yet, or their opinions are not as favorable for Yukos and Khodorkovsky as their defenders may expect.

There are four main types of Khodorkovsky and Yukos defendants[873] such as: 1) their lawyers;[874] 2) political allies;[875] 3) independent journalists;[876] 4) political and economic experts.[877] All arguements used by them can be divided in the three groups: general arguements, concerning the situation in Russia, arguements related to Khodorkovsky's political and public activities, and arguements related to the investigation and fair trial.[878]

The core goal of this arguement is to demonstrate the presence of a strong political factor in the case.[879] Russian law does not contain any provisions against political prosecution except in very general statements in the Constitution saying that anybody can be prosecuted only for the crime that he has really committed and in accordance with the procedure, established by the law.[880] Therefore all the actions of the Khodorkovsky's defendants in Russia were focused on creating an "aura" of political motivation around the case and putting political pressure on the Russian authorities, related to the presence of the

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[873] Excluding, of course, themselves and the former Yukos officials. See eg Khodorkovsky, 'Final Statement to Meshchansky Court'.

[874] See eg K Moskalenko, 'Russia on Trial' (2004) 16 December Wall St J 3; Amsterdam and Peroff, 'White Paper'.

[875] See eg Delyagin, *The Yukos Case as a Mirror on the "Dictatorship of Squalor"*.

[876] See eg C Belton, 'Khodorkovsky Says Sechin Led Yukos Attack' (2005) 5 August The Moscow Times.com 3 <http://www.themoscowtimes.com/stories/2005/08/05/011.html>accessed 15 April 2006; C Belton, 'The Arrest That Proved a Turning Point' (2006) 25 October The Moscow Times.com <http://www.themoscowtimes.com/stories/2006/10/25/002.html>accessed 5 April 2007.

[877] See eg L Aron, 'The (Russian) Empire Strikes Back' (2003) 22 November American Enterprise Institute for Public Policy Research 1-5 <http://www.aei.org/include/pub_print.asp?pubID=19405>accessed 22 March 2007; Shlapentokh, 'Wealth Versus Political Power: The Russian Case'.

[878] For the details see Appendix 10.

[879] See eg Defence Attorneys of Mikhail Khodorkovsky, 'Political Persecution of Mikhail Khodorkovsky: Comments on MBK's Arrest'; Amsterdam and Peroff, 'White Paper'.

[880] See Constitution RF (1993) art 19, 46-49.

potential "political prisoners" in the country.[881] The documents, submitted by the lawyers to the Russian courts, and statements made by the opposition politicians and journalists were used during the international public hearing and at conferences.[882] They were then submitted to international human rights organisations, including Amnesty International[883] and more importantly, they were submitted to the courts of other jurisdictions in the Yukos-related (mostly extradition) cases and to the European Court of Human Rights.[884] The purpose of such submission in extradition cases was the confirmation of the political prosecution of Khodorkovsky's allies under the "umbrella" of the Yukos case and in compliance with the European treaties and laws of a particular country.[885] The decisions of the extradition and other courts, were submitted to the European Court of Human Rights with the same goal: to prove violation of Article 18 of the convention - "Limitations on use of the restrictions of rights", i.e. that Khodorkovsky's and his friend's detention, prosecution and sentencing have been "for other purposes"; namely to strip Khodorkovsky of his assets, and to silence him as a political threat to the Presidential Administration.[886]

The arguements concerning the situation in Russia, have been reviewed in the section on the Rule of Law in Russia, history of the company and the first section of this chapter. All of them confirm that the state of the Rule of Law, the retreat of the democratic freedoms and the growing strength of the *Siloviki* regime, created the conditions for a politically motivated and selective prosecution in Russia.

The arguements related to Khodorkovsky's political and public ambitions, can be summarised in an assessment of whether Khodorkovsky's political and public activities

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[881] See eg "Common Action" Initiative Group, 'On Persons Being Prosecuted for Political Reasons in the Russian Federeation' (2004) 3 June "Common Action" IG Presscenter 1 <http://odgroup.narod.ru/>accessed 2 March 2007; All Russian News. Com, 'Legal Experts Have Declared Khodorkovsky the Political Prisoner'.

[882] See eg "Common Action" Initiative Group, 'Public Hearings in Connection with Khodorkovsky - Lebedev and Pichugin - "Yukos" Case and Socio-Political Situation in Russia'" (2004) Lebedev presscenter 32 <http://www.lebedevtrial.com/pdfs/publik_eng.pdf>accessed 3 March 2007.

[883] Group Sovest, '"Sovest" Group Appeal to the Organisation «Amnesty International» on Recognition of Mikhail Khodorkovsky as Political Prisoner' (2006) <http://amnesty.sovest.org/20060626_ AppealAI_ full_eng.htm>accessed 26 June 2006.

[884] See eg *Schmidt's Witness Statement [Russian Federation v Temerko]* (Bow Street Magistrates' Court 12 December 2005).

[885] See eg *Russian Federation v Dmitry Maruev et al*; *Russian Federation v Temerko.*

[886] See eg *Khodorkovsky (2) v Russia* (App no 11082/06) ECHR (21 September 2006).

could represent any threat to the Siloviki regime and to Putin personally.[887] Both Khodorkovsky's opponents and supporters, agree that his political activities, including the strengthening of his position in the Duma, the sponsorship of the opposition political parties, the development of educational and charitable projects and his closeness to the certain Western circles, played an important role in his prosecution.[888] Some researchers add also an anti-Semitic position of *Siloviki*.[889] However, this arguement has been spoilt by Khodorkovsky himself. In his final speech in the courtroom, he completely denied harbouring political ambitions.[890] The more precise position on these arguements is that leaders of the Siloviki coalition, including the notorious Igor Sechin, managed to persuade Putin that Khodorkovsky represented a significant political threat.[891]

Khodorkovsky's supporters have gained particular success in promoting the third group of arguements, concerning the right to a fair and open trial, degrading treatment, access to counsel and other similar violations.[892] Their concerns have been heard at an international level and have been supported by numerous governmental and public organisations, amongst those the most important are PACE, the U.S. Senate and, partly, Amnesty International. The international concerns have ultimately crystallised in the recent statement of Amnesty International "New Trial of Mikhail Khodorkovsky and Platon Lebedev Must Meet International Fair Trial Standards", which names areas of particular international attention such as: (i) the right to adequate time and facilities to prepare defence and (ii) the harassment of the legal team.[893] Khodorkovsky's supporters have greatly contributed to the events unfolding around other Yukos-related individuals, for

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[887] See eg --, 'The Tycoon and the President' (2005) May 19 Economist.com 5 <http://www.cdi.org/russia/johnson/9290-26.cfm>accessed 2 March 2007.

[888] See eg Perekrest, 'Khodorkovsky (Part 5)'; Perekrest, 'Khodorkovsky (Part 4)'; Amsterdam and Peroff, 'White Paper'.

[889] Kvurt, 'Selective Prosecution in Russia - Myth or Reality' 133-34.

[890] Khodorkovsky, 'Final Statement to Meshchansky Court'.

[891] See eg M Franchetti, 'Jailed Tycoon Mikhail Khodorkovsky 'Framed' by Key Putin Aide' (2008) 18 May Times online <http://www.timesonline.co.uk/tol/news/world/europe/ article3953694.ece?print=yes&r..> accessed 18 May 2008.

[892] The best benchmark is the recent ECHR decision on the Lebedev case. See *Lebedev v Russia* (4493/04) (Unreported, 25 October 2007) ECHR.

[893] Amnesty International, 'Russian Federation: New Trial of Mikhail Khodorkovskii and Platon Lebedev Must Meet International Fair Trial Standards' (2007) <http://web.amnesty.org/library/pdf/EUR460522007ENGLISH/$File/EUR4605207.pdf>accessed 7 December 2007.

example, in the case of Vassily Alexanian.[894] On the problem of the denial of his access to the medical services, the European Court of Human Rights has issued three rulings.[895] The arguementation concerning the procedural violations in the Khodorkovsky and Lebedev case is also supported by the European Court of Human Rights, which enumerated several procedural violations in its recent decision on the first Lebedev case.[896]

As can be seen from the brief analysis of the defendants' arguementation there are several elements for establishing "political motivated prosecution" in the Khodorkovsky and Yukos cases. An exception to this is Khodorkovsky's personal reluctance to recognise his political ambitions. The arguements of the most authoritative bodies on the political motivation aspect in the Yukos case are reviewed in detail below.

3.6.2. Factors, Undermining the Political Motivation Arguementation in the Yukos Case.

For a comprehensive picture of the "political motivation" position in the Yukos case, it is important to summarise the arguements that may prejudice the political motivated persecution arguementation in the case, during court hearings or public debates. Amongst these factors the most evident are:

1. Yukos and its core shareholders, like other oligarchy groups, pursued the policy of close connections with the State and its institutions. The Group not only actively recruited former high rank officials, but also successfully transferred its high rank managers to the Government and the Duma.[897]

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[894] See St. Petersburg International Collegium of Advocates, 'Vasily Aleksanyan Case Information' (2008) <http://www.mka-london.co.uk/docs.asp>accessed 1 May 2008.

[895] See V Alexanyan, 'Testimony before the Supreme Court of the Russian Federation' (2008) 22 January Robert Amsterdam Blog <http://www.robertamsterdam.com/2008/01/vasily_alexanyan_addresses_the.htm> accessed 24 January 2007.

[896] See *Lebedev v Russia.*

[897] See Appendix 14.

2. Khodorkovsky had always been a one of the most visible and active members of the "oligarch" club,[898] a member of the notorious "Club of Seven"[899] and a participant in all the important meetings with both presidents.[900]

3. The company promoted itself and its top managers as a company with a "state mentality" that found its expression in sponsorship and participation in the state-promoted programmes.[901]

4. Since the beginning of the attack on the Company none of its top managers has ever made any remarks which could be understood as remarks "against the State or the President."[902]

5. Whilst in detention, Khodorkovsky desperately attempted to employ his favourite strategy of negotiation to achieve a compromise with the President or "Siloviki" that would allow him to lose a part, but keep the whole. This strategy can be ascertained from his publications that were 'written' in detention. For example, in his message "Liberalism in Crisis: What Is to Be Done?" He writes:

> For many of our businessmen (though certainly not all), Russia is not their homeland, but merely a free hunting ground.
>
> ... The president is an institution that guarantees the country's territorial integrity and stability...
>
> We must accept that 90 percent of the population considers the results of privatisation to be unjust, and its beneficiaries not to be legitimate owners...[903]

6. In 2003-2004, whilst still under the indirect control of the "old" cores shareholders, Yukos made repeated attempts to reach a settlement agreement with the State and pay a fraction of its tax bill.[904]

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[898] See Helque, 'The Oligarchs and the President: A Farce in Three Acts'.

[899] See M Ivanov, 'The Power of Seven' (2001) July ibid 56.

[900] See Hoffman, *The Oligarchs: Wealth and Power in the New Russia* 100-27, 77-442.

[901] --, 'Yukos Is One of the Founders of a New International Energy Prize' (2002) 5 (11) YUKOS Rev 25-27, 25.

[902] The U.S. Council on Foreign Relations, 'A Conversation with Simon Kukes' (2004) <http://www.cfr.org/publication/6759/conversation_with_simon_kukes.html>accessed 9 April 2007 (Kukes' interview).

[903] M Khodorkovsky, 'A Turn to the Left' (2005) 1 August Vedomosti <http://www.khodorkovskytrial.com/pdfs/mbk_left.pdf>accessed 14 September 2006.

[904] Gateway to Russia, 'Yukos Agrees to Become State Company' (2004) <http://www.gateway2russia.com/st/art_243419.php>accessed 7 April 2007; Kommersant.com, 'Yukos Asking for Mercy' (2004) 15 June

The above arguements have been used by the media and Khodorkovsky's opponents to prove that the political factor in the case, while appearing strong, is simply a result of manipulation.[905]

3.6.3. The Position of the Council of Europe.

The most significant international initiative was the PACE decision to appoint a special representative for the preparation of the independent report on the Case for the Assembly. A former German Minister of Justice, Mrs Sabine Leutheusser-Schnarrenberger, was appointed as a Special Rapporteur. She travelled to Russia, conducted several meetings with Russian officials, Khodorkovsky's lawyers and other people involved in the Case, and submitted her report to the Parliamentary Assembly of the Council of Europe.[906]

In her report, Mrs Leutheusser-Schnarrenberger pointed out that facts, pointing to serious procedural violations committed by different law enforcement agencies against former leading Yukos executives, had been corroborated during her visits, whilst some allegations appear to have been exaggerated by the defence team.[907] However, on balance, the findings put into question the fairness, impartiality and objectivity of the authorities, which appear to have acted excessively in disregard of fundamental rights of the defence guaranteed by the Russian Criminal Procedure Code and by the ECHR.[908]

The most important violations, enumerated in the report are:

Kommersant Online <http://www.kommersant.com/p-1031/YUKOS_Asking_for_Mercy/>accessed 20 March 2007.

[905] See eg Komisar, 'Yukos Kingpin on Trial. Billionaite Mikhail Khodorkovsky Faces the Music in Moscow. Are the Charges Politically Motivated?'.

[906] Presscenter, 'Timeline of Events' (2003) <http://www.khodorkovsky.info/timeline/>accessed 3 March 2007; S Leutheusser-Schnarrenberger, *The Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives* (2004) para 1-4, 62-68 <http://assembly.coe.int/Documents/WorkingDocs/Doc04/EDOC10368.htm>accessed 15 April 2006.

[907] Leutheusser-Schnarrenberger, *Prosecution of Leading Yukos Executives* summary.

[908] ibid 76-79.

- shortcomings in medical attention to several former Yukos executives in prison in the face of serious concerns about their health;[909]

- unjustified restrictions on the publicity of certain court proceedings;[910]

- several violations pertaining access of lawyers to their clients;[911]

- search and seizure of documents in the defence lawyers' offices, summons of lawyers for questioning on their clients' cases and alleged eavesdropping against defence lawyers;[912]

- denial of bail (regarding Khodorkovsky);[913]

In respect of the general situation unfolding around the Company, the Rapporteur summarised:

> ...the presence of an interest of the State that exceeds its normal interest in criminal justice being done and includes such elements as: to weaken an outspoken political opponent, to intimidate other wealthy individuals, and to regain control over "strategic" economic assets - can hardly be denied.
>
> This assessment is based on the conjunction of (a) the accumulation of procedural violations and the absence of adequate safeguards against government interference in court proceedings, (b) information pointing at Yukos executives being deprived of their main assets, and (c) other items relevant to the "political" or "economic" circumstances of the proceedings against the leading Yukos executives.[914]

In a matter of the "political" circumstances surrounding the attack on Yukos and its leading executives, the Rapporteur focused on Khodorkovsky's financial support for opposition groups, Yukos as business competitor of State-controlled Rosneft and Gazprom and a campaign of intimidation against Mr Khodorkovsky and his associates.[915]

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[909] ibid 8-15.

[910] ibid 45-51.

[911] ibid 31-42.

[912] ibid 31-37.

[913] ibid 16-19.

[914] ibid 57-58.

[915] ibid 69-77.

The Parliamentary Assembly of the Council of Europe, in its Resolution passed in January 2005, established violations of the rule of law in the legal proceedings against Khodorkovsky and Lebedev.[916]

> ...the circumstances surrounding the arrest and prosecution of the leading Yukos executives strongly suggest that they are a clear case of non-conformity with the rule of law and that these executives were – in violation of the principle of equality before the law – arbitrarily singled out by the authorities...
>
> Intimidating action by different law-enforcement agencies against Yukos, its business partners, and other institutions linked to Mr Khodorkovsky and his associates and the careful preparation of this action in terms of public relations, taken together, give a picture of a co-ordinated attack by the state.[917]

The Parliamentary Assembly has requested from the Committee of Ministers, i.e. the Governments of Europe, to call upon the Russian Federation to introduce necessary judicial reforms with a view to strengthen its independence.[918]

The general importance of the PACE findings for the Khodorkovsky defence cannot be overestimated. Although, their "quasi-legal" nature is evident, the PACE Resolution has been used in numerous statements and applications, aimed at establishing the political motivation in the Case.[919]

3.6.4. European Court of Human Rights and the Yukos Case: a Long Way to Run.

There are several applications filed with ECHR by Yukos-related individuals and the Yukos Oil Company itself, [920] concerning different types of violations, made during the

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[916] Parliamentary Assembly of the Council of Europe, 'The Circumstances Surrounding the Arrest and Prosecution of Leading Yukos Executives' Resolution 1418 Doc No 14 (2005) <http://assembly.coe.int/Documents/AdoptedText/ta05/ERES1418.htm_ftn1>accessed 15 April 2007 (hereinafter - "PACE Res № 1418") para 8.

[917] ibid para 9-11.

[918] ibid para 16-17.

[919] See eg Osborne, 'Testimony before the Senate Foreign Relations Committee 'Democracy on the Retreat in Russia'".

[920] See the data on the main Yukos-related ECHR applications in Appendix 12.

Khodorkovsky-Yukos case.[921] These applications are mainly based on the arguements, quoted in the previous paragraphs, detailed and supplemented by various arguements and factual data.[922] The problem with the European Court of Human Rights cases is the general slowness in reviewing the application, which diminishes the practical significance of the ECHR decisions for applicants.[923]

In October 2007, the European Court of Human Rights reviewed the first case brought before the court by the Yukos- related individuals. The case of Platon Lebedev, who was sentenced to eight years together with Khodorkovsky, concerned the issues of his arrest and preliminary detention. The European Court of Human Rights found that Russia had violated the former Yukos executive [Platon Lebedev]'s rights by holding him before trial without the necessary legal orders. The court decision mentioned five violations of Article 5 of the Convention, pointing out that one time Lebedev was in detention for a week without any court decision, several times the decisions on his detention were taken in his absence, and several times the Moscow City Court delayed the review of Lebedev's appeals on extension of his detention.[924] It ordered Russia to pay him €10,000, or about $15,500, in compensation.[925] Although the decision does not say anything about the political motivation of the case, simply mentioning procedural violations that are quite common in Russia, the reaction of the Russian authorities was vigorous. The Russian Ministry of Justice announced that Russia would file a request under the Rule 73 of the Court[926] that the case be referred to the Grand Chamber.[927] It shows that the battle between

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[921] There are more applications on the Yukos-related cases already filed with ECHR, but some of them can be regarded as "secondary", being under "umbrella" of the core ones. See eg Kommersant.com, 'Yukos Executive Goes to European Court' (2007) 4 July Kommersant Online <http://www.kommersant.com/p779832/YUKOS_Trial_Pereverzin/>accessed 5 July 2007; Presscenter, 'Lebedev Submits Third Appeal to Strasbourg'.

[922] See for the main arguements of the ECHR applications Appendix 13.

[923] The recently decided first Lebedev's case was filed almost four years ago, so the group of applications filed by Khodorkovsky and Lebedev in 2006, are likely to be reviewed in 2010 when their first term almost expires. See also Gololobov and Tanega, 'Yukos Risk' 574-76.

[924] See *Lebedev v Russia* (App No. 4493/04) (2007) ECHR <http://www.echr.coe.int>accessed 27 October 2007.

[925] The Associated Press, 'Human Rights Court: Yukos Manager's Rights Breached During Arrest' (2007) 25 October International Herald Tribune<http://www.iht.com/articles/ap/2007/10/25/europe/EU-GEN-European-Court-Russia.php>accessed 25 October 2007.

[926] See Resistry of the Court, Rules of the Court (2007) <http://www.echr.coe.int/NR/rdonlyres/D1EB31A8-4194-436E-987E-65AC8864BE4F/0/RulesOfCourt.pdf>accessed 22 October 2007.

Khodorkovsky and his allies and Russia in the European Court of Human Rights is likely to begin.[928]

3.6.5. "Political Motivation" and International Case Law.

Although the issues of "political motivation" in the Yukos/Khodorkovsky case have been addressed by several political, human rights bodies and even governments,[929] international case law provides just a few examples when presence of "political motivation" in the Khodorkovsky case would have been recognised by western courts.

There are several remarks and comments that have been made by different courts while reviewing Yukos-related cases, which may help the other courts to confirm the presence of "political motivation" in the case. For example, the U.S. Bankruptcy court in the Chapter 11 case noted "...it appears likely that agencies of the Russian government have acted [in the Ygansknefteqas action] in a manner that would be considered confiscatory under United States law."[930]

The core decisions confirming the presence of "political motivation" in the Khodorkovsky/Yukos case, have been brought in the Bow Street Magistrates' Court[931] in

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[927] M Lepina and A Miklashevskay, 'Lebedev Upheld in Strasbourg Court' (2007) 26 October Kommersant Online <http://www.kommersant.ru/doc.aspx?docsid=818951>accessed 28 October 2007.

[928] See Platon Lebedev's Defence Team, 'Platon Lebedev Statement' (2007) 25 October Robert Amsterdam Blog <http://www.robertamsterdam.com/2007/10/platon_lebedev_statement.htm>accessed 25 October 2007.

[929] See eg Platon Lebedev Press Center, 'U.S. State Department Details Human Rights Concerns of Yukos Case' (2007) Platon Lebedev Press Center <http://www.lebedevtrial.com/support/human_rights/state_7 March2007.cfm>accessed 30 March 2007.

[930] *Re Yukos Oil Company* 2005 WL 517959 (Bankr SD Tex 2005) 408.

[931] The Bow Street Magistrates' Court was closed on July 14, 2006, with the caseload moved to Horseferry Road Magistrates' Court, now renamed City of Westminster Magistrates' Court. See BBC, 'Bow Street Court Closes Its Doors' (2006) 14 July BBC News <http://news.bbc.co.uk/1/hi/england/london/5179270.stm> accessed 26 December 2007.

the two extradition cases.[932] In both cases, the Russian Federation sought extradition of the Yukos-related individuals for financial crimes.[933]

In the proceedings, the defence advanced the following arguements to prevent the extradition of the individuals, who were pursued by the Russian Federation:

Section 81(a) (extraneous considerations) [of the Extradition Act of 2003] - the request is made "for the purpose of prosecuting him or punishing him on account of his...political opinions".[934]

Section 81(b) (extraneous considerations) [of the Extradition Act of 2003] - says that "he [the persecuted person] might, if returned be prejudiced at his trial or punished, detained or restricted in his personal liberty by reason of his political opinions".[935]

Section 87 [of the Extradition Act of 2003] - Human Rights – it is said that his [the persecuted person] rights under the European Convention particularly under Articles 3, 6 and 18 will be violated if he is returned and that he would not receive a fair trial.[936]

Having considered the positions of the parties, the Court rejected both requests for extradition, pointing out in the case of Russian Federation v. Maruev and Chernisheva:

> ...Khodorkovsky was seen as a powerful political opponent of Mr Putin. In view of the facts ... I am satisfied that It is more likely than not that the prosecution of Mr Khodorkovsky is politically motivated. As the allegation against these defendants is on the basis of a conspiracy with Mr Khodorkovsky, in my view it is the inevitable conclusion that the Prosecution of these two defendants is also politically motivated.[937]
>
> This remark has emphasised the problem experienced by the Russian judicial system:
>
> ... in respect of this particular case, I am satisfied that it is so politically motivated that there is a substantial risk that the Judges of the Moscow City court would succumb to political interference in a way which would call into question their independence. I have therefore after very careful consideration

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[932] *Russian Federation v Dmitry Maruev et al*; *Russian Federation v Temerko*. For a comprehensive list of Yukos-related extradition cases see Appendix 11.

[933] See Russia Attracts British Lawyer to Get Extradition for Yukos Official' *Kommers* (Moscow 8 November 2005) 3.

[934] *Russian Federation v Temerko* 2.

[935] ibid.

[936] ibid.

[937] ibid 4.

> come to the conclusion that a fair trial of these two defendants is likely to be prejudiced by their political opinions and the opinions of those associated with them.[938]

The arguementation used by the Judge was primarily based on the two reports to the Council of Europe, whose rapporteurs had been monitoring Russia's obligations,[939] and the experts' opinions, concerning the problems of the Russian judicial system:[940] 'There was a long established pattern in the USSR of political leaders using criminal prosecutions (and often the mere threat of prosecution) as tools in struggles with their colleagues and opponents.' This pattern has continued in post-Soviet Russia...'[941]

One of the arguements, used extensively in the Temerko case, was the interrogation of defence lawyers, considering which the judge quoted the statement of one of Khodorkovsky's lawyers Yuri Schmidt.[942] This arguement was supplemented by the Professor Bowring's statement on his personal intimidation in a Russian airport, when his visa was cancelled and he was deported.[943] In Russian *Federation v Temerko* the Judge stated:

> I have come to the conclusion that the motivation for the charges against Mr Temerko is inextricably entwined with the motivation for the prosecution of Mr Khodorkovsky. I therefore find that the prosecution of Mr Temerko is politically motivated and the request for his extradition is made for the purpose prosecuting or punishing him on account of his political opinions.[944]

Based on the two core cases, decided in the UK,[945] and similar arguementation (Council of Europe Parliamentary Assembly Resolution No 1418, etc.), the Supreme Administrative Court of Lithuania overruled the Vilnius District Administrative Court in the case *Prosecutor General's Office of the Republic of Lithuania v The Migration*

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[938] ibid 5.

[939] ibid 4.

[940] See *Russian Federation v Maruev et al Bowring's Exp Rep* (Bow Street Magistrates' Court 14 January 2005).

[941] ibid 6-7.

[942] *Russian Federation v Temerko* 5.

[943] ibid.

[944] ibid.

[945] On other Yukos-realted extradition cases see MosNews, 'Russia Asks Extradition of Former Yukos Executive Held in Italy'; Kommersant.com, 'Khodorkovsky Accomplice Freed in Cyprus'; Krutilin, 'Criminal Alphabet of Yukos'.

Department, which granted the refugee status to one more Yukos-related individual I. Babenko, and stated:

> ..the data collected in the materials of the request for asylum prove, without a doubt, that the so–called "Yukos (Mikhail Khodorkovsky's)" trial in the Russian Federation was politicized, i.e., the circumstances of the criminal prosecution suggest that the interest of the State's action in these cases goes beyond the mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent and to regain control of strategic economic assets.[946]

In Cyprus, The Nicosia District Court, reviewing an extradition case of another Yukos manager Vladislav Kartashov also remarked:

> In this case it is not important to determine whether (Kartashov) has any political views or whether he participated in any way in the political life in Russia...What is important is that the charges brought against him fall within the wider framework of the Yukos case. As a manager of a company connected with Yukos, the respondent must be considered as a member of the class of the "oligarchs", a class which the Russian authorities set as their political aim to dissolve...[947]

The most recent and most significant decision, based on the arguement of the presence of the political prosecution, is the Decision of the Swiss Supreme Court on several Russian requests on mutual assistance sent to Switzerland between 2003-2006. The court declared that the political and discriminatory nature of the proceedings in Russia (against Khodorkovsky) was reinforced by the violations of guarantees respecting human rights and the right to a defence, apparently committed during the full length of the case. [948] The decision said that Russian authorities' pursuit of what was once Russia's largest oil company had a "political and discriminatory character . . . underlined by the infringement of human rights and of the [infringement of the] right to defence."[949] The legal actions against the company were organised, according to the ruling: "by the powers in place with the goal of putting to heel the class of rich people known as 'oligarchs' and sidelining

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[946] *No. A14-2193/06* (The Supreme Administrative Court of Lithuania 15 October 2006).

[947] *Russian Federation v Kartasov Vladislav Nicolay* [2008] Nicosia Dis Court App № 2/07 (In the Matter of the 95/70 Extradition Law) (Cyp) 53.

[948] See C Binham, 'Swiss Court Refuses Russian Bid for Yukos Assets' (2007) 24 August The Lawyer.com <http://www.thelawyer.com/cgi-bin/item.cgi?id=128027&d=122&h=24&f=46>accessed 24 August 2007; Thomson Financial, 'Swiss Court Refuses Russian Govt Legal Assistance in Yukos Case' (2007) <http://www.hemscott.com/news/latest-news/item.do?newsId=48500918741984>accessed 23 August 2007.

[949] Bundesgerich [BGer] [Federal Court] 13 August 2007 14 para 3.

potential or declared political adversaries".[950] The Swiss court noticed that the facts surrounding the allegations remained obscure.[951] The court finally declared that judicial assistance could not be granted, in compliance with article 2 of the Swiss federal law on international judicial assistance in criminal matters.[952]

Another decision, criticizing the tax attack on Yukos and indirectly confirming presence of the political motivation in the Yukos case, was brought in the Dutch court.[953] On the Yukos bankruptcy procedure in Holland the court stated:

> ...the way in which the additional tax assessment owed by Yukos Oil was assessed first by the Russian Tax Ministry and subsequently by the tax court cannot stand the test of criticism. ..The subsequent hearing before the tax court and the appeal are in violation of the fundamental principles of due process of law as generally accepted in the Netherlands and outlined in article 6 ECHR, but which also apply outside the sphere of applicability of that article of the convention. ..The conclusion must be, therefore, that in the course of the determination of the tax it owed to the Russian State, Yukos Oil was deprived of a fair trial.[954]

Therefore the existing international case law shows that courts of different jurisdictions tend to recognise the presence of "political motivation" element in the Yukos-related extradition cases, although the high-ranking international judicial instances, such as ECHR have not yet had their say.

3.6.6. The Position of Amnesty International and Others.

The discussions concerning the recognition of Khodorkovsky as a "political prisoner" began soon after his detention. Several attempts have been made by different

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[950] ibid 17 para 4.

[951] ibid 16.

[952] ibid.

[953] See Kommersant.com, 'Yukos Isn't Bankrupt in Holland' (2007) 1 November Kommersant Online <http://www.kommersant.com/p820973/Yukos_bankrupt_Holland/>accessed 5 November 2007; Reuters, 'Dutch Court Voids Yukos Bankruptcy in Netherlands'.

[954] *Godfrey et al/ Yukos Oil Company et al* Rechtbank (Rb) [District Court of Amsterdam] Amsterdam 31 oktober 2007, 355622/HA ZA 06-3612 (Neth) 15 <http://www.zoeken.rechtspraak.nl>accessed 19 November 2007.

NGOs to declare Khodorkovsky and his allies "political prisoners". Amongst them were the "Common Action Initiative", [955] the "All Russian Social Movement For Human Rights",[956] "Sovest (Conscience)",[957] and groups of the Russian writers, artists and academics[958] together with human rights advocates.[959] Some of them went as far as granting the status of "political prisoner" to Khodorkovsky and Lebedev independently.[960] Due to the internationally recognised status of Amnesty International as the top-level authority in this area, the relevant submissions have been filed with its head office.[961]

One of the most important decisions, emphasizing the existence of "political motivation" in the Khodorkovsky case was the Resolution of the U.S. Senate "Expressing the view of the Senate on the trial, sentencing, and imprisonment of Mikhail Khodorkovsky and Platon Lebedev".[962] In this Resolution, the Senate, amongst other things, stressed several points, important for the "political status" of the Khodorkovsky/Yukos case:

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[955] "Common Action" Initiative Group, 'On Persons Being Prosecuted for Political Reasons in the Russian Federeation'.

[956] All-Russian Social Movement "For Human Rights", 'Appeal for Recognition of RF Citizens Mikhail Khodorkovsky and Platon Lebedev as Political Prisoners' (2004) Presscenter 9 <http://www.lebedevtrial.com/pdfs/ammnesty_8-3-04.pdf>accessed 21 March 2007.

[957] Group Sovest, 'On Recognition of Russian Citizens Mikhail B. Khodorkovsky and Platon L. Lebedev Political Prisoners (Appeal to Amnesty International)' (2005) <http://www.sovest.org/gb/appeal_to_ MA_ 220205_gb.htm>accessed 10 April 2007.

[958] L Akhedzhakova and others, 'Leading Cultural and Scientific Figures Demand Political Prisoner Status for Mikhail Khodorkovsky' (2005) Moscow Human Rights Bureau <http://www.khodorkovsky.info/ human_rights/archive/133313.html>accessed 20 March 2007.

[959] Prominent Members of Russian Civil Society, 'Appeal of the Representatives of Russian Civil Society' (2005) Presscenter 3 <http://www.khodorkovsky.info/docs/civil_society_appeal.pdf>accessed 22 November 2006.

[960] See International Society for Human Rights, *Human Rights Court to Review Verdicts on Khodorkovsky and Lebedev - Judiciary and Media in Russia Follow Line of the Kremlin* (International Society for Human Rights, Frankfurt 2005) <http://www.mbktrial.com/pdfs/ISHR.pdf>accessed 20 November 2006.

[961] On the status and mandate of Amnesty International see KE Cox, 'Should Amnesty International Expand Its Mandate to Cover Economic, Social, and Cultural Rights' (1999) 16 Ariz J Int'l & Comp L 261-84.

[962] See Expressing the sense of the Senate on the trial, sentencing and imprisonment of Mikhail Khodorkovsky and Platon Lebedev S Res 322 [109th] (2005).

1) The criminal justice system in Russia has not accorded Khodorkovsky and Lebedev fair, transparent, and impartial treatment under the laws of the Russian Federation;[963]

2) The criminal cases against Khodorkovsky, Lebedev, and their associates are politically motivated;[964]

3) In cases dealing with perceived political threats to the authorities, the judiciary of Russia is an instrument of the Kremlin, and such a judiciary is not truly independent.[965]

As seen from the resolution, the issues of the Rule of Law in Russian in general and the judicial system in particular were the focus of Senate attention.

However, after lengthy consideration, Amnesty International refused to recognize Khodorkovsky as a political prisoner, although it did call the trial of the former Yukos CEO as politically motivated.[966] The position of the INGO looked rather obscure as Amnesty International has criticised the Russian government before,[967] including the Khodorkovsky case as well.[968] In its statement, Amnesty International emphasized several important points:

- Russian human rights organisations and individuals believe that Khodorkovsky is being persecuted for his political activities.

- A court in the United Kingdom in one of the extradition hearings concluded: "it is more likely than not that the prosecution of Khodorkovsky is politically motivated".[969]

- PACE noted that the circumstances of the arrest and prosecution of leading Yukos executives suggest that the interest of the State's action in these cases goes beyond the

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[963] ibid 3.

[964] ibid 4.

[965] ibid 4.

[966] A Arutunyan and O Liakhovich, 'Amnesty International: Khodorkovsky Not a Political Prisoner' (2007) 12 The Moscow News.com 1 <http://english.mn.ru/english/issue.php?2005-15-12>accessed 30 March 2007.

[967] Amnesty International, *Rough Justice: The Law and Human Rights in the Russian Federation* (Amnesty International Publications 2003) 100.

[968] See Amnesty International, 'Russian Federation' (2005) <http://www.amnestyusa.org/countries/russian_federation/document.do?id=80256DD4...>accessed 9 March 2007.

[969] *Russian Federation v Dmitry Maruev et al.*

mere pursuit of criminal justice, to include such elements as to weaken an outspoken political opponent, to intimidate other wealthy individuals and to regain control of strategic economic assets.

However, finally Amnesty International only demanded a fair trial for Khodorkovsky, regardless of the state's political basis for the accusations:[970] "Nevertheless, irrespective of whether or not the charges are politically motivated, the Russian authorities must ensure that Mikhail Khodorkovsky and his associates receive a fair trial."[971]

Later, on the conviction of Khodorkovsky and Lebedev, Amnesty International issued one more statement pointing out that:

> Amnesty International believes that the concerns in these cases are indicative of wider problems in the criminal justice system in the Russian Federation relating to the independence of the judiciary; access to effective legal counsel; conditions of detention; and the use of torture and ill-treatment in order to extract confessions.[972]

There are several reasons on which Amnesty based its position. One of Khodorkovsky's lawyers commented that Amnesty International could not declare Khodorkovsky a political prisoner because he was wealthy.[973] The second reason is that Amnesty International now pays more attention to the application of fair trial rules to everyone, rather than exclusively to political prisoners.[974] The third point was that the NGO had no proof that Khodorkovsky was in prison solely because of his peaceful political activities.[975] That was quite evident from Khordorkovsky's final statement,[976] in

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[970] Amnesty International, 'Russian Federation: The Case of Mikhail Khodorkovskii and Other Individuals Associated with Yukos'.

[971] ibid.

[972] Amnesty International, 'Russian Federation: On the Conviction of Mikhail Khodorkovskii and Platon Lebedev' (2005) 148 Public Statement 2 <http://www.amnestyusa.org/news/document.do?id=80256DD400782B8480256FE000>accessed 30 March 2007.

[973] O Popova, 'Schmidt: Prosecution Slapped Its Head' (2005) 4 April Delo <http://get.adsmart.ru/366/4.html>accessed 25 March 2007.

[974] A Kuznetsov, 'Khodorkovskomu Ne Udalos' Stat' Uznikom Sovesti [Khodorkovsky Failed to Be Declared "Prisoner of Conscious"]' (2007) 3 April Lenta.RU <http://lenta.ru/articles/2005/ 04/14/amnisty/>accessed 27 March 2007.

[975] Arutunyan and Liakhovich, 'Amnesty International: Khodorkovsky Not a Political Prisoner'.

[976] See Khodorkovsky, 'Final Statement to Meshchansky Court'.

which he attempted to assure Putin that he had no political plans and that he was harmless to his regime and deserved a suspended sentence.[977] Therefore, Amnesty International found the political element in Khodorkovsky insufficient to declare him a "political prisoner", even though they recognized the presence of "politically motivated prosecution" and a "political trial". Possibly, having reviewed the appeals filed by the Russian human rights organisations, [978] Amnesty International may reconsider its position as there are powerful arguements for and against Khodorkovsky's recognition as a political prisoner, but for now the situation regarding his status remains unclear, regardless of the positions of human rights activists. [979]

3.7. Conclusion.

The problem of political motivation is recognised as the core "pillar" of the Khodorkovsky-Yukos case. The real fight between the defence lawyers and the prosecution unfolds around this "pillar". Since the beginning of the case the defence lawyers have been attempting to prove, both publicly and legally, the presence of a strong political thrust in the case. As the Khodorkovsky–Yukos case branched out, the political rhetoric began to be extensively used by the lawyers representing other victims of the prosecution.

Although the political motivation in the case is recognised by the independent mass media, NGOs and deeply felt by the some sections of the public, its legal recognition still encounters significant problems. These problems stem both from the complicated and ambiguous system of contemporary legislation and international case law related to political crime, political justice and the specifics of the Khodorkovsky-Yukos case. As

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[977] On the Khodorkovsky's position see eg Khodorkovsky, 'Personal Property and Freedom'; M Khodorkovsky, "I Am Not at All Sure Whether Putin Is Going to Thank Them for That" (2007) 1 <http://www.khodorkovsky.info/statements/134795.html>accessed 25 March 2007.

[978] Arutunyan and Liakhovich, 'Amnesty International: Khodorkovsky Not a Political Prisoner'.

[979] L Alekseeva, 'My Ne KPSS - My Ne Soglasny S Amnesti Internashional [We Are Not the Communist Party - We Disagree with Amnesty International]' (2006) Natsional'nyi Zhurnal [National Journal] <http://nationaljournal.ru/interview/2007-02-09/ ukosalekseeva/17>accessed 20 March 2007; All Russian News.com, 'Legal Experts Have Declared Khodorkovsky the Political Prisoner'.

mentioned previously, the main condition for the case was the state of the Russian Rule of Law, which allowed the instrumentalisation of the Russian judicial system and put it under the close control of the new Russian political elite.

The key problem in the sphere of political crime and justice is the complete absence of internationally recognised definitions of these notions. There is no recognised legal definition for the term "political persecution", thus its substance can be perceived only through the other notions, related to political criminology such as: "political crime", "political prisoner" and "political justice". However, whilst being subject to the lengthy discussions, these terms also lack clarity, which raises problems in application of the relevant concepts in practice.

A number of theoreticians have concluded that there is a lack of a conventional definition of "political crime", and such a definition can hardly be created. The core reason for this is the general unwillingness of almost all the states to create such an international playing field that would interfere with their internal and external politics, leaving their governments no room for political manoeuvring.

Although being subject to continuous academic scrutiny, the notion of a "political crime" is of practical importance. It is as important as the definitions of "political offence exception" and "serious non-political" crime, which are key in circumstances of extradition. Having a long and ambiguous history, the "political offence exception" serves to prevent the extradition of those who are suspected of being prosecuted for motives, other than their real commitments. According to the formula, incorporated in many treaties, extradition shall not be granted if the offence, for which extradition is requested, is regarded by the requested State as an offence of a political nature.

It should be noted that the EU and worldwide approach to the concept of the "political crime" and the "political offence exception" has substantially changed during the last two decades. An important reason for this is the growing terrorist threat and general unwillingness of the nations to grant protection to terrorists. Moreover, EU countries have moved even further and have eliminated the notion of the political crime in the context of extradition inside the EU, reasoning that EU legislation already grants alleged offenders a high level of rights and warranties.

The concept of the "political offence exception" is linked to the protection of political refugees, i.e. those individuals who cannot return to their countries because of the fear of being prosecuted for the reasons of their political opinions. The mechanism of refugee protection was established by the Refugee Convention of 1951, which also provides a number of reasons, other than political opinion (such as religion, race, etc), for which an individual cannot return to his native country for fear of being prosecuted.

Having a number of conceptual differences and similarities, both the "political offence exception" and the "political refugee" concept, are aimed at providing legal defence to an individual who has either escaped from his/her country, or who does not want return to his/her homeland because of "political reasons", e.g. for involvement in political crimes, or the expression of political opinions.

The concept of "political prisoner" which comprises an element of human rights protection is one more "line of defence" for individuals, the prosecution of whom bears a political element. Political prisoner protection is an old and well-known concept, yet it once again represents a problem of definition. There several definitions of "political prisoner" approved by different schools of thoughts. The definition approved and used by Amnesty International grants a "political refugee" status to individuals, prosecuted by the motive of religion, race, etc. Another school of thought considers political refugees as those who represent a threat to state security and who are therefore prosecuted. Definitions based on these principles are used by the U.S. administration. The definition adopted by PACE represents a mixture of the "government security" and the "persecuted individual" tests. PACE uses a series of objective criteria developed by experts to define "political prisoners."

The approach used by PACE shows the inseparable ties between the "political prisoner" concept and political justice. Some academics consider "political prisoners" as victims of political justice - the discriminatory application of the machinery of criminal justice to specific individuals- because they are seen as a threat to the established regime.

The research on political prosecution through analysis of the related notions of: "political crime", "the political offence exception", "political refugee" and "political prisoner", demonstrates some conceptual similarities in the understanding of the political element in application to criminal law and criminal prosecution. This element can be

understood as the reason underlying the individual's prosecution, and having direct or indirect connections with politics. This political reason is different from the formal reasons given for the individual's prosecution.

The selective and politically motivated treatment of Yukos, Khodorkovsky and his allies is recognised by different public and political forces, notably in the report of the PACE special reporter on the Khodorkovsky-Yukos case, and the resolution of the U.S. Senate on the case. There are a number of lesser known resolutions and statements, supporting the presence of significant procedural violations and political motivations in the Khodorkovsky-Yukos case. However the problem of political motivated prosecution in the Khodorkovsky-Yukos case has not been fully legally addressed yet. There are three main groups of legal decisions that mention the political motivation element in the case: the extradition decisions, brought by the UK and Lithuanian courts, prohibiting extradition of several Yukos-related individuals; the decision of the Swiss Supreme court, rejecting the cooperation between Russia and Switzerland in the Yukos case, and the decision in the U.S. Yukos bankruptcy case, containing several lines criticising the actions of the Russian government. The only decision on the Yukos-related case, brought so far by the European Court of Human Rights, is the decision on the preliminary detention of Khodorkovsky's friend Platon Lebedev, which only confirms several violations of the articles 5 of the Convention and says nothing about political motivation. Other ECHR decisions, which are certain to address the issues of political motivation in the case are expected in several years:

> The Strasbourg court has yet to address the central issues of fairness in the Yukos case, which triggered international criticism of the Kremlin for using the judicial system to muzzle political opponents and nationalize what had been the country's largest oil company.[980]

The current Russian regime strongly opposes any notion of political motivation in the case and uses every opportunity to prove that Yukos and Khodorkovsky story is solely about organised crime. Yet both Khodorkovsky's supporters and opponents claim that he had significant political ambitions. Supporters use this arguement to prove that Khodorkovsky has been prosecuted for his political activities. Opponents insist that he

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980 A Osborne, 'A Win for Former Yukos Hand' (2007) 26 October Wall St J <http://online.wsj.com/article/SB119332356639171445.html>accessed 26 October 2007.

represented and still represents a serious threat for the existing regime of "stability" as a potential organiser of an oligarchy coup. Khodorkovsky himself denies any political ambitions. Even a brief analysis of alleged Khodorkovsky's crimes shows that they have no political element and cannot be regarded as political. Thus, the significant political element in the case can be illustrated by the instrumental use of the Russian judicial system against Yukos and Khordorkovsky.

Western democracies have taken the political position based on the political character of the Yukos case and their courts tend to reject extradition and cooperation requests on the case. However, his recognition as political prisoner is made difficult by a multitude of factors such as: the complexity of the case, its high-profile political rationale, the controversial character of Khodorkovsky as a representative of "oligarchy" class and his conciliatory position in the first trial. The Khodorkovsky–Yukos case also raises the controversial problem of using general fraud and money laundering charges for the purpose of political prosecution.[981] Amnesty International, having rejected the first request for such recognition, now is reconsidering the case, but the results are not yet forthcoming.

Together with the problem of political motivation, the Yukos case raises the problem of the Rule of Law in transitional economies. The turbulent Russian transition of the 1990s serves as a perfect example of how inconsistent judicial practice and political consideration completely eroded the application of the law. Business in the 1990s in Russia was governed by so-called "principles" - unwritten rules of interaction between business and the state - rather than laws.[982] Everybody who wanted to gain any success in business was compelled to obey these "principles", violating the laws or creatively complying with the "letter of law" and not its spirit, and this effectively led to a state of affairs when "all fortunes in Russia have been accumulated in the most illegal manner".[983] Bearing significant "historical" criminal risks, the former oligarchs could either continue playing the same game of "willful" blindness with the government or sell (or simply lose) their

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[981] Widely used in Russia nowadays. See eg Harding, 'From Russia with $3 Billion. Another Putin Opponent May Have Fled to London'; RIA Novosti, 'Berezovsky Faces New Fraud Charges in Aeroflot Case' (2007) 14 April RIA Novosti <http://en.rian.ru/russia/20070413/63616284.html>accessed 14 December 2007.

[982] See eg Barnes, 'Russia's New Business Groups and State Power'; Doeh, 'Oil, Law and Politics in Russia' 207.

[983] Well known Russian proverb, coined by Ostap Bender. See <http://en.wikipedia.org/wiki/Ostap_Bender>

businesses. Khodorkovsky, who wanted to break this "circle of conspiracy" by cleaning up his business and structuring it in the recognised international manner, was punished as the State did not need, and does not need transparent, clean and thus potentially disobedient businesses. Even western major corporations have to play according to the "principles" pretending that they obey the laws.[984] Thus, the Yukos case and various subsequent cases have effectively demonstrated that the problem of the transitional rule of law in Russia, and this can only be solved by the passage of time.

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[984] See eg T Macalister and T Parfitt, '$20bn Gas Project Seized by Russia' (2006) 12 December Guardian <http://www.guardian.co.uk/world/2006/dec/12/business.oil>accessed 12 March 2008; Royal Dutch Shell, 'Sustainability Report 2006' (2006) <http://sustainabilityreport.shell.com/ workinginchallenginglocations/ sakhalin.html>accessed 10 March 2008.

Chapter 4.

The Yukos' Trading Scheme and the Yukos Tax Case.

4.1. Introduction.

The previous chapters demonstrate the unprecedented complexity of the Yukos affair, which includes dozens of different criminal cases. Regardless of the multidimensional character of the case, it is internationally recognised that its backbone is the notorious corporate tax evasion case, later supplemented by charges of money laundering that have been brought against the core shareholders and key managers of the Company.[985]

The aim of this chapter is threefold. Firstly, it aims to give a comprehensive description of the Yukos tax optimisation strategies and outline the main principles of the Yukos cash-flow management policies and operational (trading) schemes. Although, according to the Russian Criminal Code, all tax crimes are exempt from the list of the predicate offences for money laundering,[986] episodes of alleged tax evasion and money laundering in the Yukos case cannot be analysed separately as they are economically, politically and legally interrelated. As can be seen from the money laundering charges brought against the core shareholders and top managers of the company,[987] the prosecutors treated the oil and oil-product transactions between parties within the Yukos corporate group, conducted with violations of the arms' length principle, as acts of embezzlement.[988]

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[985] See eg Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance* (2004); Theede, 'Speech Delivered at the CIS Oil & Gas Conference'.

[986] See CC RF art 174 and 174.1.

[987] See *The Summary of the Chargers*.

[988] See eg Amsterdam and Peroff, 'White Paper'; M Elder, 'Khodorkovsky and Lebedev Charged' *MosTimes* (Moscow 6 February 2007) 117 March 2007; International Defence Legal Team, 'New Charges Brought against Mikhail Khodorkovsky and Platon Lebedev' (2007) 1 <http://www.mbktrial.com/about/mbk_04_01_2004.cfm>accessed 5 March 2007.

By doing so, they creatively replace the offences of alleged tax evasion with far more stringent money laundering charges, achieving political goals.

According to the prosecutors, further "laundering" operations were also funnelled through the same operational and tax optimisation scheme. As a result, the Yukos tax and money laundering case demonstrates a perfect example of the nexus between tax evasion and money laundering.[989]

Secondly, this chapter analyses the allegations made against the Company, during the course of the special audit that was initially conducted in 2003 on the 2000 accounts and later repeated in respect of the other years.[990] The allegations made by the Ministry of Tax and Levies were later confirmed by all the judicial instances, including the Supreme Arbitration Court,[991] and are seen as a result of the application of Russian and International anti-avoidance doctrines, never previously applied in the Russian judicial system.[992] Several structural elements of the corporate tax case that are corporate in nature according to Russian law, can be also regarded as essential constituents of the criminal Yukos money laundering case, and can be understood only in conjunction with one another.

Thirdly, the chapter attempts to describe the main Russian and international statutory interpretations and judicial doctrines on tax avoidance and evasion, and an attempt will be made to compare them to those used by the Russian courts in the Yukos tax case.

This analysis potentially sheds light on the nature of the Yukos operational (trading) schemes and their role in the subsequent embezzlement and money laundering case.

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[989] See L Sumin, 'Femida Na Rasput'e [Themis at the Crossroads]' (2007) 21 June Novye Izvestiya [New Izvestiya] <http://www.newizv.ru/news/2007-06-21/71358/>accessed 25 June 2007.

[990] Yukos, 'Tax Slides Update' (2005) <http://www.yukos.com/mp_upload/images/Ts_Feb_2005.pdf> accessed 1 April 2007.

[991] See Ernst & Young, 'The Constitutional Court Confirms the Statute of Limitations for Fines' (2005) May RussTax Brief 1-2 <www.tax.eycis.com>accessed 27 April 2007; V Egorov, 'Yukos: Kak Bylo Delo [Yukos: Just the Facts]' (2007) 1 Tvoi Nalogovyi Advokat [Your Tax Advocate].

[992] See eg S Pepelyaev, M Ivlieva and I Khamenushko, *Opinion Regarding Compliance with Legislation of Inspection Report No. 08-1/1 of December 29, 2003 Issued by the Tax Ministry of Russia* (2004) <www.yukos.com/taxes/final.pdf>accessed 15 January 2007; Clateman, 'Yukos Part VI: Tax Claims Revisited'.

4.2. Terminology: the Yukos Tax Case.

The core term used in this chapter is "the Yukos tax case". This term is more political in nature than it is legal, as it describes a multidimensional complex of economic, political and legal events that have resulted in draconian tax claims against Yukos and its subsequent liquidation. The Yukos tax case in the context of this thesis has the following basic characteristics.

Tax claims against Yukos cover the period from 2000-2004. The first claim was considered in 2004 after an extraordinary tax audit conducted on the 2000 accounts. This claim established a number of precedents for the Yukos tax case as a whole and flagged a new era for Russian "non bona fide" taxpayers.[993]

The tax claims mostly pertain to the entities comprising the Yukos Corporate Group, the financial results of which were reflected in the Yukos consolidated accounts, including so-called "shell" companies (SPVs).[994] In the Yukos tax case two distinct types of claims should be noted:

Firstly, the claims judicially ascribed to the Yukos Oil Company in accordance with the decisions of the Arbitration Court of Moscow, which comprise the majority of the Company's tax indebtedness. These claims represent the main pillar of the tax case, and led to the bankruptcy and liquidation of the company.[995]

Secondly, the claims brought against different Yukos subsidiaries, which mostly concern their transfer pricing operations. These tax debts were not apportioned to Yukos,

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[993] Ministry for Taxes and Levies, Resolution # 14-3-05/1609-1 to Hold the Taxpayer Fiscally Liable for a Tax Offence' (2004) 121 <http://www.yukos.com/taxes/YUKOStaxResolution_full.pdf>accessed 20 July 2006; Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance.*

[994] A special purpose vehicle (SPV) or special purpose entity (SPE) : a legal entity created to carry out a specific or limited purpose. See in general eg D Gololobov and J Tanega, 'Sham Spes: Part 1' (2006) 17 (11) ICCLR 304-17, 311-312.See also Appendix 4.

[995] The Moscow Times, 'Court Upholds $3.4bln Yukos Tax Claim'; Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance.*

but should be considered as part of the Yukos tax case in that they have influenced the financial position of the Yukos Group and have contributed to the bankruptcy of Yukos.[996]

Overall the claims amounted to approximately $ 27 bn. although it depends on the number of claims included in the official list.[997]

The tax claims, listed above, should be distinguished from the claims filed against the Company in the course of its bankruptcy procedure, which total approximately $ 32 bn.[998]

4.3. Literature Review.

The sources on the Yukos tax case can be divided into two main groups. The first group aims to analyse the Yukos tax case as a separate phenomenon, which has opened the gates for new aggressive anti-avoidance strategies in Russia, and has provided a platform for the fight against tax avoidance. These sources focus on the characteristics of the Yukos tax optimisation strategies and the results of the infamous case and the lessons to be learned from it. The tendency to focus on these areas in the academic literature on the Yukos tax case can be illustrated by the publications by Artem Rodionov, a Russian tax law expert. His book "Tax schemes, for which Khodorkovsky has been detained" is actually the first publication that provides a detailed review of the tax episode in the Khodorkovsky - Yukos case.[999] The article "A Look at Khodorkovsky and Lebedev's Taxes",[1000] written by the same author, describe the tax optimisation schemes, used by Yukos, the position of the Ministry of Tax and Levies and the court findings. They also

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[996] See eg Kommersant, 'The Third Case of Pavel Anisimov'.

[997] See Appendix 15.

[998] T Osborne, *Written Statement Addressed to the Participants of the Bankruptcy Court Hearing* (2006); AE Kramer, 'Bankruptcy Auction Closes Book on Yukos' (2007) 11 May International Herald Tribune <http://www.iht.com/articles/2007/05/11/business/yukos.php>accessed 16 May 2007.

[999] Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison*.

[1000] ibid.

provide extensive recommendations for tax practitioners regarding risk avoidance techniques.[1001]

The real value of Rodionov's book is its plain and accessible analysis of the Yukos tax schemes. It is invaluable as a source of primary data and commentary on the Yukos case, against a background of tenuous media publications on the case and a lack of any reliable information.

The second group includes sources analysing the problem of tax avoidance and tax evasion in Russia as a continuous integrated process. These sources view the Yukos case and the Yukos-born doctrines, in the context of Russian and international efforts aimed at tax avoidance and, as an opposing tendency, the protection of taxpayers' rights. Several books, demonstrating an academic approach, have been published by the lawyers of Russia's largest tax law firm "Pepelyaev, Goltsblat & Partners"[1002], which took part in the Yukos tax case as leading tax experts. This series of books includes "The Legal Problems of the Tax Administration of Major Taxpayers", written by Sergei Pepelyaev and Andrei Goltsblat, and two books written by other partners – "Tax Risks and the Tendencies of Tax Law" by Denis Scekin[1003] and "The Doctrine of Unfairness in Tax Law" by Sergei Savseris.[1004]

All the publications analyse the problems pertaining to Russian tax law and tax administration highlighted by the Yukos case. For example, Pepeliaev in his book points out: 'In the future, we shall probably accept the experience of the western countries concerning disclosure and preliminary approval of business operational schemes and transfer pricing agreements, as they are used in the States.'[1005]

[1001] ibid 1.

[1002] See <http://www.pgplaw.ru>.

[1003] D Scekin, *Nalogovye Riski I Tendentsii Nalogovogo Prava [Tax Risks and the Tendencies in Tax Law]* (Statut, Moscow 2007).

[1004] S Savseris, *Kategoriya Nedobrosovestnosti v Nalogovom Prave [The Doctrine of "Unfairness" in Tax Law]* (Statut, Moscow 2007).

[1005] S Pepelyaev (ed), *Pravovye Problemy Nalogovogo Administrirovaniya Krupneishikh Nalogoplatel'scikov [Legal Problems of Major Taxpayers' Tax Administration]* (Wolters Kluwer, Moscow 2006)

4.4. Tax Avoidance and Evasion: International Aspects.

4.4.1. Principles of Tax Planning.

Academic sources and professional commentaries provide several core principles, concerning the problem of tax avoidance and evasion, which are regarded as conventional for taxation and tax optimisation in particular.[1006] Below, two of them that are particularly important for this research are briefly reviewed.

4.4.1.1. Right to Tax Optimisation.

The right to tax optimisation is deemed to be recognized and unquestionable, providing the background for all tax optimisation strategies. [1007] The substance of this rule can be illustrated by a quotation from the Supreme Court of the United States: 'The legal right of a taxpayer to decrease the amount of what otherwise would be the amount of his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.'[1008]

It is also illustrated by an even more famous quotation used to describe the "freedom to pay reasonable taxes": 'No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business, or to his property, so as to enable the Inland Revenue to put the largest possible shovel into his stores."[1009]

Thus, the right of a taxpayer to "attract upon himself the least amount of taxes" is conventional, although it is subject to different interpretations and depends on a taxpayer's opportunities, which vary widely.[1010]

[1006] See eg SC Ruchelman, 'United States' (2004) 8 May Economic Substance Around the World 79-94, 79-80 <http://www.ruchelaw.com/pdfs/EconomicSubstanceAroundWorkd.pdf>accessed 18 June 2005.

[1007] MB Angell, 'Tax Evasion and Tax Avoidance' (1938) 38 Colum L Rev 80-97 83.

[1008] *Gregory v Helvering* 293 US 465, 469 (1935).

[1009] *Ayrshire Pullman Motor Service v IRC* (1929) 14 TC 754.

[1010] See A Mumford, *Taxing Culture* (Ashagate, Dartmouth 2002) 144.

4.4.1.2. Group Tax Planning.

The group tax planning principle has actually never been recognized as a rule of universal application, but its significance cannot be overestimated, especially for corporate group tax planning. Moreover, creative and aggressive application of this rule has distinctly echoed through the Yukos case.[1011] This rule can be deemed as a composite reflection of the case law doctrines applied to corporate groups, and it fixes a subordinate character of an individual company tax position to the group tax planning purpose.

> When, as in the present case, there are a number of associated companies, is the relevant purpose that of the individual company viewed in isolation or the purpose of the group as a whole? Is the whole scheme to be looked at or only that part of it in which the taxpayer companies are a direct participant? I have no doubt that in such a case regard has to be had both to the overall fiscal purpose of the group and the impact of its implementation on the group.[1012]

Thus, the tax schemes and tax benefits should be considered in the context of a corporate group tax optimisation plan, if such a plan exists.

4.4.2. Tax Evasion: Definitional Aspects.

The term "tax evasion" does not represent such a complicated problem of definition as "tax avoidance".[1013] There is general agreement about what is tax evasion although there are grey areas at the fringes.[1014] Tax evasion is a term that is succinctly defined by the OECD,[1015] which noted that it involves: '... illegal arrangements through or by means of

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[1011] See eg *The Summary of the Chargers.*

[1012] *Overseas Containers (Finance) Ltd v Stroker* [1989] STC 364, 370.

[1013] C Evans, 'Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions' (2007) 19 March UNSWLRS <http://www.austlii.edu.au/au/journals/UNSWLRS/2007/12.html#fn10>accessed 30 June 2007.

[1014] M McGowan, 'United Kingdom' (2004) 8 May Economic Substance Around the World 62 <http://www.ruchelaw.com/pdfs/EconomicSubstanceAroundWorkd.pdf>accessed 28 April 2005.

[1015] Evans, 'Barriers to Avoidance: Recent Legislative and Judicial Developments in Common Law Jurisdictions'.

which liability to tax is hidden or ignored ...[such that]... the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities'.[1016]

The distinction between tax evasion and tax avoidance is well recognized.[1017] It is the difference between working outside the law and working within the law (though against its spirit).[1018]

> .... the ingenuity and complexity of some schemes greatly strain the philosophical boundaries between evasion and avoidance. The efforts of many distinguished academics have not succeeded entirely in solving the problem. Despite the fineness of the distinction, there is a clearly identifiable dichotomy of public opinion towards them. Evasion is regarded as improper, dishonest and reprehensible. Avoidance, on the other hand, is generally considered to be a sign of great acumen, perspicacity and skill.[1019]

Analysing the opinions of commentators on the characteristics of tax evasion, we cannot avoid quoting the position of Lord Templeman that tax evasion "involves concealment of the facts and as a criminal offence looks almost conventional".[1020] Other theoreticians echoed him either by pointing out that the fundamental distinction between tax avoidance and tax evasion is mirrored in the concept of a sham[1021] or by stating that:

> ...the expression tax evasion should be deleted from the vocabulary as it is a euphemism which covers its true name, which is tax fraud. Tax evasion requires falsehood of some kind. Basically it requires either non-disclosure, or fabrication of a story which differs from the facts. No respectable tax adviser can be party to fraud or concealment.[1022]

Fraud in this context is conventionally understood as actual, intentional wrongdoing, with the specific purpose of evading tax. It is not established by negligence.[1023] It is not liability to tax that is being escaped from (which is a hallmark of tax avoidance) but

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[1016] OECD, *International Tax Terms for the Participants in the OECD Programme of Cooperation with Non-OECD Economies* (OECD, Paris).

[1017] See eg Angell, 'Tax Evasion and Tax Avoidance' 80-81; RWV Dickerson, 'Avoidance and Evasion: The Position of the Tax Practitioner' (1959-1963) 1 U Brit Colum L Rev 19-22, 19-20.

[1018] R Woellner and others, *Australian Taxation Law* (16th edn, CCH, Sydney 2006) 1544-45.

[1019] A Thompson, 'Some Thoughts on Tax Avoidance' (1978) 128 NLJ 629, 629.

[1020] L Templeman, 'Taxation and Tax Avoidance' in S Adrian (ed), *Tax Avoidance and the Law: Sham, Fraud and Mitigation?* (Key Haven Publications PLC, London 1997) 1-9, 1.

[1021] R Venabels, 'Tax Avoidance- a Practiotioner's Viewpoint' ibid (Key Haven Publications) 25-77, 26.

[1022] J Dilger, 'Tax Avoidance from the Practitioner's Perspective' ibid (Key Haven Publications PLC) 11-24, 12.

[1023] JH Murphy, 'Criminal Income Tax Evasion' (1953-1954) 48 Nw U L Rev 317-41, 319.

payment of tax due.[1024] Characterizing the doctrinal positions on tax evasion Dickerson's words are to be quoted: "Evasion of taxes is generally understood to refer to the actions of those who willfully disregard the words of a taxing statute in order to reduce the amount they have to pay".[1025]

Courts hearing tax evasion cases often define a willful act as "a voluntary, intentional violation of a known legal duty."[1026] Traditionally, a defendant can "willfully" violate the law regardless of the certainty or uncertainty of its interpretation.[1027]

The U.S. Supreme Court has illustrated it with the following words: [14]

> Affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or conceal.[1028]

The above brief analysis of theoretical framework and case law shows that deliberate actions (e.g. non-submission of a tax declaration or other mandatory papers, deliberate and large-scale misreporting of data in the declaration) are conventionally regarded as tax evasion.[1029] In many jurisdictions tax evasion is an object of criminal law[1030] and criminal rules and procedures are applied to tax evaders.[1031]

[1024] M Palmer, 'Treading the Fine Line: Tax Mitigation, Avoidance and Evasion' (2000) 8 ITCP 3-10, 3.

[1025] Dickerson, 'Avoidance and Evasion: The Position of the Tax Practitioner' 19.

[1026] *United States v Bishop* 412 US 346, 360 (1973).

[1027] J Stein, 'Criminal Liability for Willful Evasion of an Uncertain Tax' (1981) 81 Colum L Rev 1348-64, 1356.

[1028] *Spies v United States* 317 US 492, 499 (1942).

[1029] Interfax Information Services, 'Tax Planning and Gray Techniques of Tax Evasion - Assessment of Threat' (2004) Interfax Information Services 4 <http://global.factiva.com >accessed 25 May 2004.

[1030] See J Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle' (2004) 4 BTR 347-48, 347-48.

[1031] See Murphy, 'Criminal Income Tax Evasion'; R Leitman and others, 'Tax Evasion' (1995-1996) 33 Am Crim L Rev 1017-52; P Alldridge and A Mumford, 'Tax Evasion and the Proceeds of Crime Act 2002 ' (2005) 25 (3) Leagal Stud 353-73, 360-61.

4.4.3. Judicial Anti-Avoidance Doctrines.

The courts have developed several doctrines over the years to deny certain tax motivated transactions their intended tax benefits. These doctrines are not entirely identifiable, and their application to a given set of facts is often blurred by the courts and the tax authorities.[1032] They generally allow the recharacterisation of transactions based on their economic substance.[1033]

It is difficult to generate "nutshell" definitions of these doctrines because courts have interpreted and applied them interdependently, and have at times melded them into single doctrines.[1034] At their very foundation these doctrines are understood as indefinite, subject to precedential and interpretational flexibility and therefore difficult to apply with accuracy and consistency.[1035]

4.4.4. Doctrines v. Rules.

The cornerstone of any system of taxation is the recognition of bona fide behavior as a general principle, which means that all transactions should have a genuine economic or commercial purpose rather than a purpose of tax avoidance.[1036] Every legal system has evolved concepts and methods for disregarding transactions which are not what they

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[1032] AB Casarona, 'Regulating Corporate Tax Shelters: Seeking Certainty in a Complex World' (2000-2001) 50 Cathoic U L Rev 111-42, 119; Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' (2002) Joint Committee on Taxation Publications № JCX-19-02 7 <http://www.house.gov/jct/x-19-02.pdf>accessed 15 April 2007.

[1033] The Tax Law Review Committee, *Tax Avoidance* (IFS Commentaries 1997) 27<http://www.ifs.org.uk /tlrc/publications.php?publication_id=1908>accessed 18 May 2007.

[1034] DB McGinty, 'Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions after Black & Decker, Coltec, and Hercules' (2005-2006) 36 Cumb L Rev 1-62, 28.

[1035] J Bankman, 'The Economic Substance Doctrine' (2000-2001) 74 S Cal L Rev 5-30, 13, 29.

[1036] See eg S Douma and F Engelen, 'Halifax Plc v Customs and Excise Commissioners: The ECJ Applies the Abuse of Rights Doctrine in VAT Cases' (2006) 4 BTR 429-40, 431.

seem.[1037] Anti-tax avoidance, evasion doctrines and rules deal specifically with this problem.

In the fight against tax avoidance and evasion the tax authorities and courts have taken one of two approaches:

- The introduction of anti-avoidance rules into the local legislation (dealt with by legislature e.g. parliament)
- The development of an extensive set of court precedents aiming at the same purpose[1038]

Equally, different countries tend to adopt either one of two approaches. In the first approach, tax courts take an active role in combating tax avoidance by developing tax-specific concepts; in the second approach the tax avoidance issues are dealt with by legislature in the first place, and only then by courts.[1039]

Courts in most legal systems play a major role in fighting tax avoidance.[1040] For more than fifty years courts have interpreted and applied tax law with the aid of various "common law" doctrines, such as substance over form, step transaction, business purpose, sham transaction, and economic substance.[1041]These doctrines are closely related to one another, and no single doctrine has done all the work.[1042] Quite often doctrines are used together with anti-avoidance rules, and are approved for different taxes.[1043]

Several countries, such as Australia, Canada and others have adopted the definition of tax avoidance as a legislative provision, presenting them as a key part of general anti-avoidance rules (GAAR), evidently seeing it as a better way in the anti-avoidance fight in

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[1037] HF Fuller, 'Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation' (1962-1963) 37 Tul L Rev 355-98, 367.

[1038] J Maximovskaya, *Overview of the Bona Fide Concept and Anti-Avoidance Legislation in Other Countries* (International Tax Services 2006) 3<www.aebrus.ru/files/File/EventFiles/Taxation_Committee_Events/20050531/TaxMaximovskaya.ppt>accessed 20 May 2007.

[1039] ibid 4.

[1040] A Likhovski, 'The Duke and the Lady: Helvering v. Gregory and the History of Tax Avoidance Adjudication' (2003-2004) 25 Cardozo L Rev 953-1018, 955.

[1041] Bankman, 'The Economic Substance Doctrine' 5.

[1042] ibid 6.

[1043] RS Nock, 'Tax Avoidance' in S Adrian (ed), *Tax Avoidance and the Law: Sham, Fraud and Mitigation?* (Key Haven Publications PLC, London 1997) 79-308, 149.

comparison with the "old" common law doctrines.[1044] It is difficult to say whether the introduction of GAARs have greatly supplemented certainty between authorities and taxpayers, but it raises important questions about GAAR's relationship with the existing judicial approach to tax avoidance as expressed, for example, in the UK in *Ramsay* and subsequent cases.[1045]

The role of doctrines is tremendous. Unlike most tax norms, anti-avoidance doctrines are meant to prevent abuse of the tax code.[1046] Kaplow points out that this means that they would often have to be designed as standards, because rigid rules are easier to circumvent.[1047] He also stressed that an additional consideration favoring the use of standards when dealing with tax avoidance is that tax avoidance doctrines are meant to regulate behavior, which varies greatly since tax avoiders often can choose among a large number of legal ways to circumvent a particular tax norm. Determining the appropriate content of an anti-avoidance rule which would cover all contingencies *ex ante* would be expensive and some of the expense would be wasted since it will not occur in practice.[1048]Weisbach, commenting or rules and standards, said:

> ...lawmakers and regulators have shifted the tax system toward standards, primarily by adopting what are known as "anti-abuse rules." A typical anti-abuse rule allows the government to override the literal words of a statute or regulation. Instead, the government may require a "reasonable" tax result if the taxpayer enters into or structures a transaction with a principal purpose of reducing tax liabilities in a manner contrary to the purposes of the statute or regulation, even if the transaction otherwise literally complies with the rules.[1049]

According to Weisbach the end result should be a system that is based on rules (which are more efficient) but also governed by overriding anti-abuse standards[1050] which

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[1044] For the list of counties which use GAAR see ibid 113-49; O Ralph, 'Gaar: Empty Threat or Deal Stopper' (1998) 9 Int'l Tax Rev 13-16, 15.

[1045] The Tax Law Review Committee, *Tax Avoidance* 36.

[1046] Likhovski, 'The Duke and the Lady: Helvering v. Gregory and the History of Tax Avoidance Adjudication' 967.

[1047] L Kaplow, 'Rules Versus Standards: An Economic Analysis' (1992-1993) 42 Duke L J 557-629, 618.

[1048] ibid 564.

[1049] DA Weisbach, 'Formalism in the Tax Law' (1999) 66 U Chi L Rev 860-906, 860.

[1050] See also J Freedman, 'Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament' (2007) 123 LQR 53-90, 90.

provide the "fuzziness" needed to prevent tax abuse; i.e. a mixture of rules designed for common transactions accompanied by anti-avoidance standards to be used for unusual transactions.[1051]

The overview of development of the key Anglo-American anti-avoidance doctrines, given in Appendix 16, demonstrates that their genesis has been long, contradictory and inconsistent.[1052] The doctrines are still under the eye of different courts and even their substantial aspects can be subject to further revision.

4.4.5. Key Judicial Anti-Avoidance Doctrines: Basic Characteristics.

4.4.5.1. Sham Transaction Doctrine.

Sham transactions are those in which the economic activity that is purported to give rise to the desired tax benefits does not actually occur. The transactions have been referred to as "facades" or "fictions" and, in their most egregious form might be characterized as fraudulent.[1053] The sham doctrine does not focus on economic substance, but on the real legal transaction between the parties.[1054]

> In one of the UK cases the sham doctrine is described as applying to:[1055]
>
> ...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.[1056]

[1051] DA Weisbach, 'Ten Truths About Tax Shelters' (2001-2002) 55 Tax L Rev 215-54, 248.

[1052] See eg Freedman, 'Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament' 90.

[1053] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 8.

[1054] McGowan, 'United Kingdom' 63.

[1055] ibid.

[1056] *Snook v London & West Riding Investments Ltd* [1967] 2 QB 786, 802.

Sometimes a description of a transaction as a "sham", accompanied by mention of a tax-avoidance motive, suggests that "sham" means nothing more to the writer than "a transaction entered into to reduce tax liability."[1057]

In the U.S. the courts often apply the two-prong test for sham transactions established in *Rice's Toyota World*:

> ...a transaction will be treated as a sham if the court finds [(1)] "that the taxpayer was motivated by no business purposes other than obtaining tax benefits in entering the transaction, and [(2)] that the transaction has no economic substance because no reasonable possibility of profit exists.[1058]

Close to the "sham" transaction doctrine is the concept of "abuse of law" or "abuse of rights".[1059] The meaning of "abuse" in this context seems to be not that the taxpayer commits an illegal or unlawful act in exercising the right, but that the taxpayer does not exercise the right "validly".[1060] This concept is more common in civil law countries.[1061] The idea that a "right" can be "abused" is a strange one, both logically and conceptually, to a common law audience.[1062] Under the abuse of law doctrine, transactions entered into by a taxpayer to reduce his tax liability can be either disregarded for tax purposes, or substituted with another transaction which would not have had the fiscal effect intended by the taxpayer.[1063] The application of this principle to VAT was established in the case of *Halifax (Case C-255/02)*.[1064] The Court concluded in *Halifax* that:

> For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions ... and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary

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[1057] A Gunn, 'Tax Avoidance' (1977-1978) 76 Mich L Rev 733-77, 737.

[1058] See eg *Black & Decker v United States* 340 F Supp 2d 621, 623-24 (D Md 2004).

[1059] T Sanders, 'Netherlands Anti-Avoidance Relies on Abuse of Law' (1989-1990) 1 Int'l Tax Rev 40-42, 40-41.

[1060] McGowan, 'United Kingdom' 64.

[1061] But the U.S. has developed a similar doctrine, substantially separate from its Civil Law analogue. JM Perillo, 'Abuse of Rights: A Pervasive Legal Concept' (1995-1996) 27 Pac L J 37-98, 38.

[1062] IA Saunders, 'Recent Trends in United Kingdom Anti-Avoidance Law' (1993) 25 Case W Res J Int'l L 23-54, 23; McGowan, 'United Kingdom' 64.

[1063] Sanders, 'Netherlands Anti-Avoidance Relies on Abuse of Law' 41; E Féna-Lagueny and F Rontani, 'Abuse of Law' (2005) (774) Tax J 17.

[1064] Féna-Lagueny and Rontani, 'Abuse of Law'; MD Glaser, 'Implementing the Abuse of Law Principle' (2007) 128 De Voil ITI 9.

> to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.[1065]

Thus, application of the "abuse of law" doctrine is conventionally based on the two "pillars": Intention to avoid taxation and contradiction to the purpose of the law.

4.4.5.2. Economic Substance Doctrine.

The economic substance doctrine and its predecessors have been around for many years.[1066] The economic substance doctrine, as it has evolved to date, may be summarised as providing that an arrangement will be recognized for tax purposes only if it "appreciably" affects the taxpayer's beneficial interest such that it can be said "with reason ... to have purpose, substance, or utility apart from [its] anticipated tax consequences."[1067] One commentator formulates the theoretical substance of the doctrine in the following way: 'This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay, notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.'[1068]

The courts generally deny claimed tax benefits, if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations, regardless that the purported activity did actually occur.[1069]

The courts usually consider two factors in order to determine if the transaction has the requisite substance. First, they look to the "objective" economic substance of the transaction and asks "whether the transaction ha[d] any practical economic effects other

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[1065] Glaser, 'Implementing the Abuse of Law Principle'.

[1066] J Bankman, 'Modeling the Tax Shelter World' (2001-2002) 55 Tax L Rev 455-64, 458.

[1067] RT Smith, 'Business Purpose: The Assault Upon the Citadel' (1999-2000) 53 Tax Law 1-34, 1 quoting *Goldstein v Commissioner* 364 F 2d 734, 740 (2d Cir 1966).

[1068] per Lord Tomlin *IRC v Duke of Westminster* [1936] AC 1, 20.

[1069] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 12; McGinty, 'Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions after Black & Decker, Coltec, and Hercules' 29.

than the creation [e.g.] of tax losses" (e.g., whether it produced a profit).[1070] Second, the courts consider the "subjective" business purpose, looking for evidence of the taxpayer's motivation in entering into the transaction.[1071] Regarding the second prong, in *Rice's Toyota World,* it was held that a "transaction has no economic substance [where] no reasonable possibility of profit exists."[1072] In *Black & Decker* it was also stressed that this prong concerns "the objective reasonableness of the transaction."[1073] Further it was clarified that, "[a] corporation and its transactions are objectively reasonable, despite any tax-avoidance motive, so long as the corporation engages in bona fide economically-based business transactions."[1074] Thus, economic substance exists based on the results and effect of a transaction, not on the intention of the parties.[1075]

The judicially recognized primary limitation on the economic substance doctrine is that the doctrine cannot apply where a sensible reading of text, legislative intent, and purpose suggest it should not apply.[1076]

4.4.5.3. Business Purpose Doctrine.

Another doctrine that overlaps with the sham transaction and economic substance doctrines is the business purpose doctrine. The business purpose doctrine holds that taxes can be reduced only if there is a real business.[1077] The business purpose doctrine,

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[1070] See eg *ACM Partnership v Commissioner* 157 F 3d 231, 248 (3d Cir 1998) (citing *Jacobson v Commissioner* 915 F 2d 832, 837 (2d Cir 1990).

[1071] AM Walsh, 'Formally Legal, Probably Wrong: Corporate Tax Shelters, Practical Reason and the New Textualism' (2000-2001) 53 Stan L Rev 1541-80, 1555.

[1072] 752 F 2d 89, 91-92 (4th Cir 1985).

[1073] McGinty, 'Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions after Black & Decker, Coltec, and Hercules' 35.

[1074] 340 F Supp 2d 623-24 (citing *Frank Lyon Co. v United States* 435 US 561, 583-584 (1978)).

[1075] McGinty, 'Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions after Black & Decker, Coltec, and Hercules' 36.

[1076] GWJ Miller, 'Corporate Tax Shelters and Economic Substance: An Analysis of the Problem and Its Common Law Solution' (2002-2003) 34 Tex Tech L Rev 1015-70, 1057.

[1077] Weisbach, 'Ten Truths About Tax Shelters' 237.

generally, is the subjective leg of the judicial doctrines, denying tax benefits based on the taxpayer's non-tax motives for entering into a transaction.[1078]

The so called "business purpose test" originated in England in three decisions, those of *Furniss (Inspector of Taxes) v Dawson*,[1079] *IRC v Burmah Oil Co Ltd v IRC*[1080] and *Ramsay (WT) Ltd v IRC*.[1081] In *Halsbury Laws of England* this test is summarised as follows:

> There is no rule of law against the making of genuine and lawful arrangements by which the incidence of tax otherwise eligible is lessened or avoided. However, where a taxpayer enters into a preordained series of transactions consisting of two or more steps and those steps are inserted for no commercial business purpose apart from the avoidance of a liability to tax, the court will determine the tax consequences of the series by looking at the end result and ignoring the intervening steps.[1082]

In its common application, the courts use business purpose (in combination with economic substance, as discussed above) as part of a two-prong test for determining whether a transaction should be disregarded for tax purposes: (1) The taxpayer was motivated by no business purpose other than obtaining tax benefits in entering the transaction, and (2) The transaction lacks economic substance.[1083]

4.4.5.4. Substance over Form Doctrine.

The concept of the substance over form doctrine is that the tax results of an arrangement are better determined based on the underlying substance rather than an

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[1078] McGinty, 'Economic Substance, Business Purpose, and Tax Avoidance in Section 351 Contingent Liability Transactions after Black & Decker, Coltec, and Hercules' 29.

[1079] [1984] 1 All ER 530.

[1080] (1981) 1 All ER 865 (HL).

[1081] [1981] STC 174. See L Olivier, 'Tax Avoidance and Common Law Principles' (1996) 1996 J S Afr L 378-83, 381. Also note that Ramsay principle has been overruled by the subsequent decisions (eg *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51). See also S Anstey, 'Restricting Ramsay?' (2001) 13 December Taxation; P Ridd, 'Tax Avoidance - Legislative Intent. Can You See What It Is?' (2007) 876 Tax J 18-22.

[1082] --, *Halsbury's Laws of England* (4th edn, Simon Hetherington, London 2000) vol XXIII § 25.

[1083] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 26 quoting *Rice's Toyota World* 752 F 2d 91.

evaluation of the mere formal steps by which the arrangement was undertaken.[1084] In general form it was stated in *Kilburn* v *Estate Kilburn*[1085] as follows: "Courts of law will not be deceived by the form of a transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance."[1086]

Under this doctrine, two transactions that achieve the same underlying result should not be taxed differently simply because they are achieved through different legal steps.[1087] The Supreme Court has found that a "given result at the end of a straight path is not made a different result because reached by following a devious path."[1088]

In *National Alfalfa Dehydrating & Mill & Co.*, the Supreme Court ruled as follows:

> This Court has observed repeatedly that, while a taxpayer is free to organise his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, [citations omitted], and may not enjoy the benefit of some other route he might have chosen to follow but did not.[1089]

Tax laws are very formalistic and, therefore, it is often difficult for taxpayers and the court to determine whether application of the doctrine is appropriate.[1090]

4.4.5.5. Step Transaction Doctrine.

An extension of the substance over form doctrine is the step transaction doctrine. The basic premise of the step transaction doctrine is that an integrated transaction cannot be broken into independent steps in determining tax consequences.[1091] The step transaction

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[1084] ibid 26-27.

[1085] 1931 AD 501, 507.

[1086] Olivier, 'Tax Avoidance and Common Law Principles' 382.

[1087] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 27.

[1088] *Minnesota Tea Co v Helvering* 302 US 609, 613 (1938).

[1089] *Commissioner v National Alfalfa Dehydrating & Mill Co* 417 US 134, 149 (1974).

[1090] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 27.

[1091] Ruchelman, 'United States' 93.

doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result."[1092]

The courts have developed several methods of testing whether to invoke the step transaction doctrine.[1093] The end result test is most frequently used. Under this test, separate business transactions can be collapsed when it is determined that they were intended to be component parts of a single transaction, designed for the purpose of reaching the ultimate result.[1094]

In determining whether to invoke the step transaction doctrine, the courts have looked to two primary factors: (1) the intent of the taxpayer, and (2) the temporal proximity of the separate steps.[1095] The courts are permitted the application of the step transaction doctrine if its application would create steps that never actually occurred. [1096]

4.4.6. Statutory Interpretations: General Anti-Avoidance Rules (GAAR).

The tax law relating to business transactions is complex and ambiguous. [1097] This is fully applicable to a General Anti-Avoidance Rules (GAAR), which are criticised for creating further uncertainty in the sphere of tax law and tax administration, instead of putting the results of several centuries of application of the common law doctrines in

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[1092] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 27.

[1093] ibid.

[1094] Ruchelman, 'United States' 93.

[1095] Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 28.

[1096] ibid.

[1097] DP Hariton, 'Sorting out the Tangle of Economic Substance' (1998-1999) 52 Bull Sec Tax'n 235-74, 236; Casarona, 'Regulating Corporate Tax Shelters: Seeking Certainty in a Complex World' 113.

proper order. [1098] The existence of GAARs also raises the problem of rules and standards in the tax law, which does not have a unanimous solution.[1099]

When discussing GAAR, we should note that GAAR differs from other forms of statutory judicial anti-avoidance rules in several important respects. A general anti-avoidance provision is legislation that applies across all taxes or particular categories of tax, and applies to all forms of relevant transaction, not being limited to particular types of avoidance arrangement.[1100] The purpose of GAAR is to deter or counteract tax avoidance where a person carries out a transaction that has tax avoidance as its sole, or main purpose, or as one of its main purposes.[1101] Legislation may restrict or impose adverse taxation consequences upon certain types of transaction.[1102] Statutory anti-avoidance rules can take two forms: those where a tax avoidance motive is required and those where *no* such motive or purpose is needed.[1103] This difference in approach is fundamental to the result of a transaction and it is important to recognize that a statutory provision may be anti-avoidance, despite the fact that those words do not appear.[1104]

As it is seen from Appendix 17, GAARs have been adopted in at least ten countries and the models of GAARs vary. While GAARs feature in the tax systems of countries as diverse as Sweden, Hong Kong, and Germany, the focus of this research is on common law jurisdictions— the United Kingdom, Canada and Australia —which share a common law legal tradition with the United States.[1105]

Even taking into consideration the diversity of GAAR jurisdictions, Cooper proposed a theoretical model that provides a general understanding as to what features a general anti-avoidance rule should contain. The first and most obvious requirement is a provision that

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[1098] See D Crerar, 'Interpretations of Gaar: Before and Beyond Mcnichol and Rmm' (1997-1998) 23 Queen's LJ 231-58, 257.

[1099] See eg DA Weisbach, 'The Failure of Disclosure as an Approach to Shelters' (2001) 54 SMU L Rev 73-82, 79.

[1100] Nock, 'Tax Avoidance' 113-14.

[1101] P Nias, 'UK Unwraps GAAR Proposals' (1999) 10 Int'l Tax Rev 44-45, 44.

[1102] Nock, 'Tax Avoidance' 153.

[1103] ibid 153-54.

[1104] ibid 154.

[1105] See GS Cooper, 'International Experience with General Anti-Avoidance Rules' (2001) 54 SMU L Rev 83-130, 84.

defines the trigger for activating the GAAR i.e. a definition of "tax avoidance".[1106] A second element to the design of the GAAR should be a definition of the tax requirement, which is avoided in order to give rise to the unintended benefit.[1107] According to Cooper, another important feature of a standard GAAR is the provision permitting the revenue authority to reverse the tax outcome that has occurred, and substitute one of the possible tax outcomes that might have occurred.[1108]

From the content of Appendix 18, which is based on Cooper's model, is clear that introduction of GAARs has not significantly influenced the tests and principles in the anti-avoidance fight that have been produced in the evolution of the judicial doctrines in the relevant jurisdictions. There is no doubt that the concept of a GAAR more suitable for the legal systems of civil law countries than anti-avoidance rules fixed in judicial precedents.

4.5. The Yukos Tax Case and the Basics of the Russian Tax Law.

4.5.1. Russian Civil Anti – Avoidance Doctrines before the Yukos Tax Case.

It is recognized that before the Yukos case the means to fight large-scale tax avoidance and evasion in Russia were organisationally and legally limited.[1109] The formalistic approach, similar to one declared in the landmark *Duke of Westminster*[1110] case, was fully accepted by the tax authorities and the courts.[1111] It was one of the reasons why

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[1106] ibid 98.

[1107] ibid 102.

[1108] ibid.

[1109] See eg E Busse, 'The Embeddedness of Tax Evasion in Russia' in AV Ledeneva and M Kurkchiyan (eds), *Economic Crime in Russia* (Kluwer Law International, London 2000) 129-44, 133-36.

[1110] [1936] AC 1, 19 TC 490.

[1111] See eg A Ryabov and D Melnik, 'Russia's New Transfer Pricing Rules' (1999) 18 Tax Notes Int'l 1487-88, 1487; V Zaripov, 'Legal Instruments for Tax Planning in Russia' (2006) 26 May The Moscow Times. com <http://www.pgplaw.ru/live/publications.asp/two_id/top/id/11661>accessed 10 December 2007.

the tax optimisation schemes became so popular in Russia.[1112] In the absence of any definition of tax evasion in the Russian tax legislation, the Russian Constitutional Court simply served to define tax evasion, in general terms, as the illegal and intentional nonpayment of taxes. [1113] At the same time, the Court ruled that tax planning is legally permissible and that a taxpayer may not be penalized for electing advantageous forms of business from a tax perspective, creating opportunities for further development of tax avoidance schemes.[1114]

However, it would not be correct to say that the Russian legislation and case law did not have any doctrines to fight tax avoidance and evasion at all.[1115] Under the Russian Tax Code, the tax authorities were authorized to recharacterise the nature of transactions for tax purposes, treat them as sham, and challenge their validity.[1116] Tax authorities were entitled to impute additional taxes in cases of recharacterisation of transactions (though only through court proceedings).[1117] Nevertheless, the Russian Tax Code and the Russian tax authority regulations failed to provide any anti-avoidance rules, neither did they expressly require taxpayers to have a business purpose or demonstrate economic substance to be eligible for tax benefits. [1118] As in many civil-law countries without specific legislative rules, anti avoidance principles in Russia, until recently, were developed by courts based on several civil-law concepts.[1119] At the beginning of the Yukos case, the business purpose

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[1112] See eg C Patterson, *Legal Due Diligence of Mining Projects in Russia* (Canadian Mining Investment in Russia and Central Asia 2005) 15<http://www.nrcan.gc.ca/mms/invest/2005/rus/pdf/patterson.pdf>accessed 20 February 2008.

[1113] See Res of CC RF № 9-P.

[1114] See ibid.

[1115] The term "tax avoidance and evasion" is used in the dissertation for violations of the Tax Code that result both in tax (administrative) liabilty of the corporation and criminal liability of its managers, as happened in the Yukos case. According to the Russian laws, corporations cannot be criminally liable and, thus, in terms of the international law, can only be formally penalized for tax avoidance. Their managers can be prosecuted for tax evasion in accordance with art 198 of CC RF.

[1116] See The Law on Tax Authorities art 7.11. See also Civil Code art 169 and 170.

[1117] Tax Code art 45.1.3.

[1118] See A Seidov, 'Dealing with Judicial Antiavoidance Doctrines in Russia and the U.S.' (2007) 1 November Lexology <http://www.lexology.com/library/detail.aspx?g=0bc37dad-f901-4ea3-8ff5-fd7faf9e987c> accessed 10 December 2007.

[1119] See Appendix 19.

concept had not been sufficiently developed to cover sophisticated cases, similar to those in the U.S. or other continental system jurisdictions.[1120]

The weaknesses of the Civil Anti-Avoidance doctrines were based on the absence of legal statutory or judicial instruments for defining tax avoidance and evasion transaction. For example, in order to trigger the application of the Public Order Concept (Art 169 of the Civil Code) it was necessary to establish that a certain transaction was designed for tax avoidance and evasion purposes, but in the absence of the relevant tests, article 169 and other doctrines had quite limited, mostly politically driven application.[1121]

4.5.2. Russian Tax "Evasion": the Definitional Aspect.

As previously mentioned, Russian legislation and case law do not contain definitions of "avoidance" and "evasion" as such, so the usage of both terms will be based on their international and conventional understanding.[1122] Moreover, the Russian legislation labels all operations aimed at minimizing tax payments, which failed and resulted in penalties, as "evasion".[1123]

Russian commentators, who aim to solve the problem of definition and gain clarity, suggest certain formalistic criteria, which comply with the "spirit" of the international principles. According to these criteria, tax avoidance as an essential element includes full informational disclosure to the tax authorities, and in the case of failure, will result in the payment of taxes, interest and penalties.

[1120] See Seidov, 'Dealing with Judicial Antiavoidance Doctrines in Russia and the U.S.'.

[1121] See Ernst & Young, 'Court Orders Seizure of Assets Due to Tax Evasion' (2007) September RussTax Brief 1-2, 2.

[1122] See I Solov'ev, 'Uklonenie Ot Uplaty Nalogov I Optimizatsiya Nalogooblozheniya [Tax Evasion and Tax Optimisation]' (2001) Garant.RU <http://www.garant.ru/nav.php?pid= 286&ssid=89&mv=1>accessed 20 July 2007; T Gusev, 'Predely Osuscestvleniya Nalogovogo Planirovaniya S Uchetom Mezhdunarodnogo Opyta [International Experience: The Limitations of Tax Planning]' (2006) Garant.RU <http://www.garant.ru>accessed 20 July 2007.

[1123] See *Yukos v Russia* App № 14902/04 ECHR Russia's Mem (30 October 2006); *Yukos v Russia* App № 14902/04 ECHR Russia's Mem (15 April 2005). See also Appendix 20.

Tax evasion, which is based on intentional illegal acts and aimed at evading taxes due, will result in criminal sanctions against the responsible managers of the company (most frequently under Article 199 of CC RF), and additional penalties that do not exclude responsibility to pay the unpaid taxes, interest, etc.[1124]

A legal entity can only be penalized for corporate tax avoidance as it cannot be criminally liable according to Russian law, and if company managers organised tax evasion schemes, they will be personally sanctioned for tax evasion. A mixture of both elements is commonly and "politically" recognized as criminal tax evasion. This approach is used by the Russian Federation in its documents sent to ECHR.[1125]

4.5.3. The System of Sanctions for Tax Avoidance and Evasion in Russia.

Corporate tax avoidance and evasion operations according to the Russian Criminal and Tax Codes may result in tax sanctions against corporations, and may also result in administrative and criminal sanctions for the managers responsible. The presence of such a complex and overlapping system of sanctions may be confusing for international lawyers and thus needs certain clarification, given in Appendix 20.

The Yukos tax case has ultimately resulted in: (1) the forced collection of the principal sum of the tax claims, actually pertaining to the activities of the Yukos corporate group, but ascribed to, and collected from, the Yukos Oil Company as a legal entity;[1126] (2) the forced collection of the accrued interest; (3) the forced collection of special double tax

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[1124] See eg T Sergeeva, *Metody I Skhemy Optimizatsii Nalogooblozheniya: Prakticheskoe Posobie [Methods and Schemes of Tax Optimisation: Practical Issues]* (Ekzamen, Moscow 2005); A Elinskii, 'Opyt Velikobritanii I SSHA Po Razgranicheniyu Zakonnoi I Nezakonnoi Minimizatsii Nalogov I Ego Znachenie Dlya Sovershenstvovaniya Rossiiskogo Zakonodatel'stva [The UK and U.S. Experience Regarding Differentiation between Tax Avoidance and Tax Evasion and Its Importance for Russian Legislation]' (2006) 10 Zhurnal Rossiiskogo Prava [Journal of Russian Law] 140-43.

[1125] See *ECHR Russia's Mem (30 October 2006)*; *ECHR Russia's Mem (15 April 2005)*.

[1126] Yukos, 'Tax Slides Update'.

penalties (tax fines for repeated non-payment of taxes) from Yukos as a legal entity;[1127] (4) the forced collection of the principal sum of the tax claims and penalties from Yukos' subsidiaries; (5) criminal charges, brought against several Yukos top managers;[1128] and, (6) criminal charges, brought against several Yukos' subsidiary managers.[1129]

4.5.4. The Yukos' Operational (Trading) Scheme in the Context of Russia in the 1990s.

Aggressive tax optimisation strategies were an essential characteristic of Russia in the 90s.[1130] The line between optimisation, avoidance and evasion was completely blurred, which made the application of transfer-pricing schemes, which were based on a complete disregard of the "substance over form" principle, indispensable practice for all big corporate groups.[1131] Those who were not involved in semi-legal tax competition were doomed to lose:[1132]

> Under President Yeltsin, high tax rates and low levels of tax enforcement encouraged Russian firms to shelter income aggressively. Multiple taxes from different levels of government meant that tax obligations could even exceed profits. Company executives were not shy about how this tax burden affected their behavior. As Yukos Oil CEO Khodorkovsky argued, "As long as the tax regime is unjust, I will try to find a way around it."[1133]

[1127] ibid.

[1128] Krutilin, 'Criminal Alphabet of Yukos'.

[1129] ibid.

[1130] See eg Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*; Vitkina and Rodionov, *Tax Evaders of Putin's Epoch*.

[1131] See Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*; The Economist Intelligence Unit Ltd, 'Russia Risk: Tax Policy Risk' (2007) 22 January The Economist Intelligence Unit Ltd 4 <http://global.factiva.com/aa/default.aspx?napc=S&fcpil=en&_XFORMSTATE=AAN.>accessed 22 January 2007.

[1132] V Radaev, 'Informal Institution Arrangements and Tax Evasion in the Russian Economy' (2001) 13-15 September Higher School of Economics Working Papers 12 <www.jobfunctions.bnet.com /whitepaper.aspx ?docid=134430 >accessed 20 September 2005.

[1133] MA Desai, A Dyck and L Zingales, 'Theft and Taxes' (2004) September NBER Working Paper No 10978 16 <http://www.nber.org/papers/10978>accessed 22 March 2007.

Possibly, it is due to Khodorkovsky's determination to gain ultimate success that Yukos's schemes in particular are now under the international legal microscope.[1134]

4.5.4.1. The Yukos' Operational/Tax Optimisation Scheme in a Nutshell.

According to the officially published court decisions and official reports, the Yukos tax scheme functioned as follows. One of Yukos's production subsidiaries (Yganskneftegas, Samaraneftegas or Tomskneft) sold crude oil at prices determined by a public tender[1135] to companies established in the Russian regions, which granted operational companies tax concessions.[1136] The operational companies resold the oil to domestic and foreign buyers at market prices or processed the oil at one of the Yukos' refining companies.[1137] In most cases the operational companies, delegated bookkeeping and other internal corporate matters to a special accounting company affiliated to Yukos.[1138] Most business and other transactions were conducted by the operational companies with other entities of the Yukos corporate group.[1139] Export operations were structured through Yukos as a commissioner, which had an access to export pipeline capacities. Yukos also arranged for payment, transport, processing and shipment of the oil.[1140] The commission that Yukos and its affiliates received for these services was nominal (0.01– 0.5%).[1141]

[1134] See eg *Yukos Oil Company v Russia* App No 14902/04 ECHR (14 December 2004).

[1135] Initially the Company used prices published in special reference books.

[1136] See Ministry for Taxes and Levies, 'Yukos Resolution' 2-3; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 57-58.

[1137] Ministry for Taxes and Levies, 'Yukos Resolution' 2-3.

[1138] *Postanovlenie Federal'nogo Arbitrazhnogo Suda Moskovskogo Okruga po zayavleniyu Mezregionalnoi Nalogovoi Inspektsii № 1 protiv Kompanii Yukos [Decision of the Federal Arbitration Court of Moscow Region on the case Interregional Tax Inspection N1 v Yukos] [KA-A40/3222-05]* (Federal Arbitration Court of Moscow Region 30 June 2005) <garant.ru>accessed 23 May 2008; Ministry for Taxes and Levies, 'Yukos Resolution' 2-3.

[1139] Ministry for Taxes and Levies, 'Yukos Resolution' 2-3; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 57-59.

[1140] See *Interregional Tax Inspection N1 v Yukos [KA-A40/3222-05].*

[1141] Ministry for Taxes and Levies, 'Yukos Resolution' 2.

Since the operational companies enjoyed concessions on profits, tax, as well as a host of revenue taxes, (such as road use tax, housing stock, social benefits tax and property tax), the corporate group, which created and controlled the operational companies, made considerable tax savings by using the scheme.[1142]

As follows from the above narrative, the Yukos tax optimisation scheme was primarily based on the two main techniques, as were other Russian production companies' tax optimisation schemes, including schemes employed by the oil and gas sector. These two techniques were: (1) the use of operational companies registered in low tax zones;[1143] and, (2) transfer pricing operations.[1144]

The particularities of both techniques used in Russia still remain unclear for international researchers.[1145] The legal uncertainties pertaining to the application of both constituent parts of the tax optimisation schemes played a critical role in the Yukos case.

4.5.4.2. Russian Tax Havens: Legal Status and Problems.

The tax disputes involving Yukos have focused attention on the government's policy concerning tax havens, particularly on ZATOs. Such tax policies have implications far beyond Yukos and the other taxpayers.[1146]

Russia has for over a decade been experimenting with various forms of internal tax havens, in some cases giving regional governments the right to exempt taxpayers in those regions from a broad range of federal taxes.[1147] The original policy objective for these

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[1142] Clateman, 'Yukos Part VI: Tax Claims Revisited' 2-3.

[1143] See eg ibid 6-8; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 57-58.

[1144] See eg Clateman, 'Yukos Part VI: Tax Claims Revisited' 6-8; S Budilin, 'Dobrosovestnyi Ili Nedobrosovestnyi? Konstitutsionnye Osnovy Nalogovogo Planirovaniya: Novye Tendentsii [Fair or Unfair? Constitutional Grounds of Tax Planning – the New Tendencies]' (2006) 11 Rossiiskaya Yustitsiya [Russian Justice] 33 – 35.

[1145] For the only example see Clateman, 'Yukos Part VI: Tax Claims Revisited'.

[1146] Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia* 3.

[1147] International Tax and Investment Center, OE Forecasting and SSD L.L.P., *Taxes on Profits of Multinational Companies and Implications for Russian* (2004) 10.

havens was to encourage regional economic development and to allow a measured amount of regional autonomy. The hope was that reduced tax burdens in selected regions would stimulate investment there, and would help to boost the long-term prosperity of all Russia. Unfortunately, the hoped-for boom in investment in these regions did not materialise, and instead these regions became instruments for reducing tax payments.[1148] Experts point out that tax avoidance and tax evasion practices within business groups were based on strategies of concealment of illegal activities and political bargaining for tax avoidance with local authorities and tax inspections.[1149]

The application of questionable tax schemes, based on the regional tax breaks was directly acknowledged by the Ministry of Finance: '...it appears that several companies actively use special tax evasion schemes, by using front companies registered in domestic and foreign offshore zones, and by manipulating prices.'[1150]

Until the early 2000s these tax optimisation strategies were considered as acceptable or "legal" in nature by legal experts, given then current level of anti tax avoidance/evasion doctrines and techniques and the attitude of the authorities to the legislation.[1151]

There were several distinct types of tax benefit zones in Russia used in the Yukos schemes.[1152]Analysis shows that regional governments effectively used to sell the regional concessions. Their distinct goal was to provide their "clients" with a tax avoidance instruments for a fraction of tax payments that should have been paid according to the law.

[1148] ibid.

[1149] D Rogachev 'Zato on Lovko Ukhodil Ot Nalogov [He Smartly Avoided Taxes]' (2004) <http://www.compromat.ru/main/hodorkovskiy/zato.htm>accessed 25 June 2007.

[1150] Whalen and Chazan, 'Russia Considers Probe into Oil Industry's Taxes – Official Accuses Companies of Evading Payments' A24.

[1151] Mironov, 'Economics of Spacemen: Tax Evasion and Firm Performance. Evidence from Russian Banking Transaction Data' 3.

[1152] See Budilin, 'Fair or Unfair? Constitutional Grounds of Tax Planning – the New Tendencies'; N Medvedeva, I Ragozina and N Milenina, *Aktual'nye Voprosy Nalogooblozheniya, Nalogovogo I Byudzhetnogo Prava [Important Issues of Taxation, Tax and Budgetary Law]* (Nalogi i Finansovoe Pravo [Tax and Finance Law], Moscow 2007).

4.5.4.3. Transfer Pricing in Russia and the Yukos Case.

Taking into consideration the tremendously complicated and confusing situation with the regulation of trading operations of holding companies in the Russian Federation since their creation early 1990s and until 2003, several principal issues need to be addressed.

4.5.4.3.1. Transfer Pricing and Minority Shareholders Problem.

As discussed in the chapter on Yukos's history and structure, Russian holding companies were incorporated as vertical corporate groups, in which a head holding company quite commonly owned 50%+1 of the ordinary voting shares.[1153] Therefore, there were a large number of minority shareholders in the subsidiaries who quite rightly demanded dividends from the production companies where they held stock.[1154] It strongly contradicted the idea of "virtually integrated holding companies" which had to be profitable as consolidated corporate groups.[1155]

It should be noted that Russian corporate law demands the same "arms-length" approach to the transactions of companies as Western and international corporate laws do.[1156] A special procedure of approving the related parties and major transactions must be applied to all the transactions inside the corporate groups.[1157]

Until 2006, there were no mechanisms for the compulsory buyout of minority stock. That put newly established corporate groups in an ambiguous position: on one hand they did not want to pay shareholder-blackmailers who tried to enforce their rights, and on the

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[1153] Black, Kraakman and Tarassova, 'Russian Privitization and Corporate Governance: What Went Wrong' 1750-52; I Shitkina, *Kholdingovye Kompanii [Holding Companies: Legal and Corporate Governance Issues]* (Walters Kluwer, Moscow 2006) 214-21.

[1154] See Gololobov and Bakhmina, 'The Three Stages in the Development of Oil Industry Holding Companies'; Iji, 'Corporate Control and Governance Practices in Russia' 9-12.

[1155] See Gololobov, *Company v. Shareholder* 20-21.

[1156] See Appendix 22.

[1157] The Law on Joint Stock Companies art 78-79, 81-84.

other hand they had no legal means for the effective compulsory consolidation of the minority stock at the level of the head company.[1158] In this situation, the management of big Russian production companies had to walk a tightrope between pressures exerted by minority shareholders and the demands of tax inspections and international auditors. Companies were also facing tough competition. This was at a time when those who did not optimise their taxes could not survive. Eventually, all the oil majors applied different transfer pricing schemes:

> To get a sense of the magnitude of the manipulation in transfer pricing, analyst reports indicate that Sibneft's production subsidiary was selling oil at just $2.20/ barrel, considerably below the average export price of $13.50, and the average domestic price of $7.20/ barrel[1159]

Khodorkovsky's unwillingness to pay the state more than it "had to be paid" resulted in the Yukos' adherence to transfer pricing.[1160]

4.5.4.3.2. The "Russian" Fair Market Price.

The Russian Tax Code codified the arm's length principle as the basis for determining corporate income.[1161] Nevertheless, a lack of judicial practice, the general weakness in tax administration and the Russian Federation's problematic economic system gave birth to a confusing system of willful statutory blindness. In this climate big corporations paid taxes on the basis of a special agreement with the Ministry of Tax and Levies, not on the basis of the tax code. Thus, the Russian government closed its eyes to the universal application of "transfer pricing" schemes.[1162]

[1158] See S Savchuk and R Kadikov, *Dobrovol'nyi I Prinuditel'nyi Vykup Aktsii: Prakticheskie Aspekty [Voluntary and Compulsory Buy-out of Shares: Practical Aspects]* (INKOR, Moscow 2007).

[1159] See Korchagina, 'Sibneft's Owners Nation's Worst-Kept Secret'; Sibneft Oil Company, *Sibneft Bond Offering Prospectus* (2002) F-8.

[1160] See eg L Komisar, 'Western Critics: Khodorkovsky Stole Yukos Fair and Square' (2007) 28 March Johnson's Russia List <http://www.cdi.org/russia/johnson/2007-75-23.cfm>accessed 3 May 2007.

[1161] See also N Havard, 'Comparative Analysis of Tax Incentives Provided by the United States, the United Kingdom, and Russia to Domestic and Foreign Businesses' (2003-2004) 67 Alb L Rev 1159-83, 1167.

[1162] D Treisman, 'Russia's Taxing Problem' (1998) 112 Foreign Policy 55-66, 55-64; Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*, 2-5.

Due to the peculiarities of the Russian oil trading system, the application of the "fair market price" rule faced significant problems. As the export capacity of the Russian oil companies was restricted by the physical pumping capacity of the export pipeline that belonged to the state-controlled company "Transneft", they were allowed to sell approximately one third of the produced crude to overseas consumers.[1163] The rest of the oil had to be sold on the internal market or refined and sold as products.[1164] Therefore, there was the "world" fair market price, fixed by the international rating agencies for overseas sales, and the "internal" fair market price for domestic sales.[1165] The internal market price did not actually exist as there was no public exchange for oil contracts, and the majority of the oil was refined. This phenomenon could easily be explained by political factors: the internal price of oil was deemed a core macroeconomic factor that determined internal prices. If it had not been statutory indirectly controlled, the country would have faced a tremendous price-rise shock. Former first vice Prime Minister Egor Gaidar, defending Khodorkovsky and Yukos, stated the following:

> According to an assessment by the Russian Ministry of Energy, in the year 1999 more than 90% of the oil sold by Russian companies was sold via transfer-pricing...
> The Russian authorities have tried to incorporate this ['Outstretched Hand'] principle into the body of the Tax Code. This has failed...
> The 'parties to the transaction' - the parent-company Yukos and its subsidiaries - did exactly this: They agreed on 'the price of the product, works or services'. Was this a good or a bad thing? That's another matter. But it was legal under the existing law, and the government did not interfere in it.[1166]

[1163] See the Main Conditions.

[1164] R Corzine and J Thornhill, 'Oil Price Collapse Threatens Russian Economy' *The Financial Times* (London 19 March 1998) 2; C Mortished, 'Crude Oil Falls as Russia Lifts Export Curbs' *The Times* (London 18 May 2002) 52.

[1165] In case of Yukos, it exceeded five times the transfer price of their affiliated refineries. T Shiobara, 'Oversights in Russia's Corporate Governance: The Case of the Oil and Gas Industry' in S Tabata (ed), *Dependent on Oil and Gas: Russia's Integration into the World Economy* (Slavic Research Center, 2006) 85-115, 96.

[1166] E Gaidar, 'Nikto Do Sikh Por Ne Proanaliziroval Na Chem Stroyatsya Obvineniya Po Delu Mikhaila Khodorkovskogo I Platona Lebedeva [Nobody Analysed the New Chargers Brought against Khodorkovsky and Lebedev]' (2007) 4 The New Times <http://newtimes.ru/magazine/2007/issue004/doc-1527.html> accessed 14 June 2008.

Criticizing the arguementation of the prosecution he also pointed out: "The fact that prices for oil and gas in Russia differ from world-prices is well-known…to most Russian school-children. So it's not surprising that the courts also know about it…"[1167]

Therefore, the artificial absence of an internal market price should be understood as state policy, which suppressed the internal oil market and encouraged the application of transfer-pricing schemes.

The above arguements describe the situation that took place in Russia between the early 90s and the beginning of the Yukos case. They provide a proper basis for understanding the reasons why Yukos, like many other production companies, aggressively used transfer-pricing operations incorporated in its tax and cash flow optimisation schemes.

4.6. The Tax Avoidance and Evasion Allegations against Yukos.

According to the position of the Russian Federation, the results of the tax audits demonstrated that between 2000 and 2004 the Yukos Oil Company had been adhering to tax evasion schemes resulting in its failure to pay taxes.[1168] The findings of the tax agencies regarding the failure of the company to pay taxes were upheld by the courts.[1169] Initially, the allegations of tax evasion were described in detail in Resolution № 14-3-05/1609-1[1170] to hold the taxpayer fiscally liable for a tax offence.[1171] They can be summarised as follows:

[1167] ibid.

[1168] See for the position of the Russian Federation *ECHR Russia's Mem (30 October 2006)*; *ECHR Russia's Mem (15 April 2005).*

[1169] *ECHR Russia's Mem (30 October 2006)* 4.

[1170] The Resolution was brought on the basis of the Act of Extraordinary Tax Audit, conducted in respect of the year 2000 accounts by the Inter-Regional Inspection of the FTS of Russia, related to the largest taxpayers № 1 (Tax Code art 87-89).

[1171] See Ministry for Taxes and Levies, 'Yukos Resolution'.

4.6.1. Organised Tax Evasion Scheme.

The tax authorities alleged that the Yukos production subsidiaries sold crude oil at below-market prices to shell companies affiliated with Yukos that were established in the regions within Russia, which had granted such companies the relevant tax concessions. The shell companies resold the oil to domestic and foreign buyers at market prices.[1172] In the Resolution the tax inspectors pointed out:

> ...the "owners" (shell companies) concluded commission agreements to buy commodity crude oil with the Yukos Oil Company. The Yukos Oil Company, in its turn, upon the instructions of the "owners" registered in tax preferential territories, bought oil from Yukos's producing subsidiaries or from shell companies. In these deals the Yukos Oil Company purchased oil at undercut prices to lower the tax basis of the producers.[1173]

The tax audit showed that due to the use of the mentioned illegal tax evasion scheme, the Yukos Oil Company itself had not shown the receipts from the sales of products.[1174]

4.6.2. Control of the Organised Tax Evasion Scheme.

The key arguement of the tax inspection for challenging the Yukos' schemes, was that the Yukos Oil Company, which was the ultimate parent of the group, and the entity against which additional taxes had been assessed, completely controlled the operations and the finances of the shell companies. The Company exercised control via the placement of directors, powers of attorney and via different agreements with the companies under which Yukos organised the purchase, sale, transport, processing and export of oil.[1175]

[1172] See eg Clateman, 'Yukos Part VI: Tax Claims Revisited' 2; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 58-61; Egorov, 'Yukos: Just the Facts'.

[1173] Ministry for Taxes and Levies, 'Yukos Resolution' 1-2.

[1174] ibid 1.

[1175] See eg Clateman, 'Yukos Part VI: Tax Claims Revisited' 2; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 58-61.

Based on the above evidence, the tax inspectors came to the conclusion that the network of seemingly independent companies had been fully controlled by Yukos. The elements of substance over form, business purpose and economic substance doctrines can be distinctly seen in the arguement of the tax authorities.

4.6.3. Illegal Tax Concessions.

The second key arguement of the tax authorities was that the Yukos-controlled shell companies had illegally obtained tax benefits in the regions where they had been located.

According to the Resolution, the specific taxation order was established by the relevant laws of the regions where Yukos' shell companies had been registered in order to: "create favorable conditions for investments in the economy of those regions, to improve their social and economic potential, to develop their securities market and create new vacancies".[1176]

The main arguement of the Ministry of Tax and Levies was that the "owners" registered in the territory of the regions, which provided the tax concessions, carried out no actual activities in their territories, attracted no capital and added no improvements to the social and economic potential of the region. On the contrary, their non-payment of taxes caused substantial damage to the local budgets, as well as to the federal budget.[1177]

Thus, these organisations used the tax preferences without any intention to improve the economy of the relevant regions, but in order to help the Yukos Oil Company to evade taxes on its production, processing and sales operations of oil and products, and consequently acted against the law.[1178] The elements of substance over form, business purpose, economic substance and other doctrines can be clearly perceived here as well.

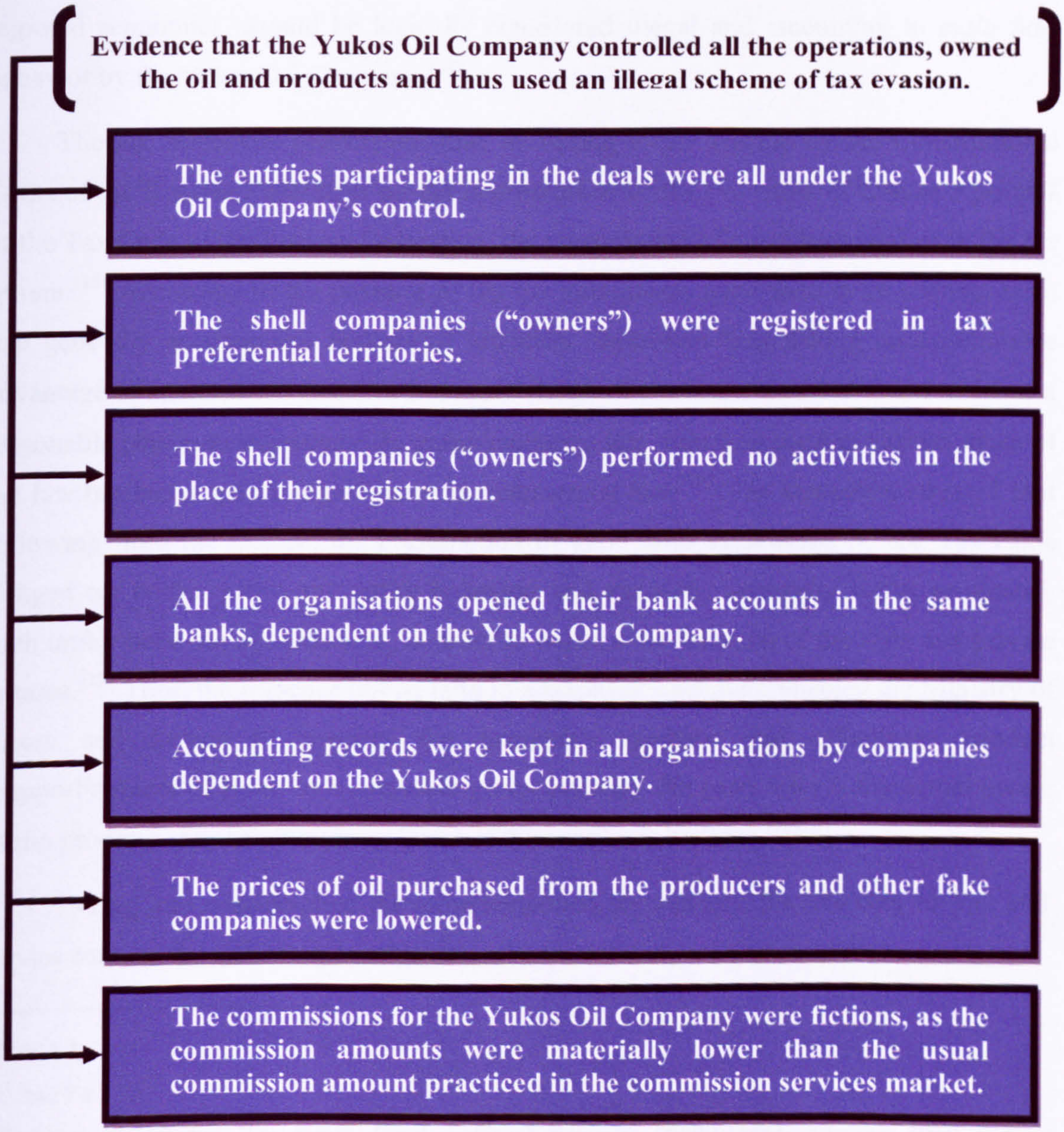
[1176] ibid 3-8.

[1177] See ibid; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 60-61, 77-79.

[1178] Ministry for Taxes and Levies, 'Yukos Resolution' 4.

Figure 16 represents the main arguements, used by the tax authorities, to prove that Yukos Oil Company managed and controlled the shell companies which participated in the tax avoidance scheme.

Figure 16. "Evidence of Control in the Yukos Tax Optimisation Scheme."



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[1179] Ministry for Taxes and Levies, 'Yukos Resolution' 2-3.

4.6.4. Dishonest Tax Conduct.

The final formula used by the Ministry of Tax and Levies, was that the Yukos Oil Company's tax evasion, committed by means of registering shell companies in tax preferential territories, with the single aim of tax non-payment by fake organisations performing no actual activities in these territories, and making no investments in the regional economies, should be logically considered illegal and amounting to *mala fide* behavior by the Yukos Oil Company.[1180]

The tax inspectors pointed out that, according to the Decree by the Constitutional Court of the Russian Federation on the interpretation of the provision of Clause 3 point 7 of the Tax Code of the Russian Federation, the presumption of good faith applies in the tax sphere.[1181] According to the position of the tax authorities, good faith is an abstract term that generally encompasses honesty of intention, abstention from taking unconscionable advantage of another, and freedom from knowledge of circumstances that ought to cause a reasonable person to investigate. In many countries this term was used in various areas of the law but had a special significance in commercial law.[1182] The inspectors stressed that following from the Decree, the presumption of good faith established by the Tax Code obliged tax bodies prove any unfair behavior, and carry out necessary audits to identify such unfair behavior by taxpayers, in order to balance the interests of the state and private entities.[1183] Thus, the presence of bad faith in a taxpayer's behavior enabled the Ministry of Taxes and Levies to reassess the taxpayer's position and effectively conduct reapportionment of profit in a corporate group (identify the party who is the actual owner of the property and the ultimate recipient of the economic benefit).[1184]

Taking into consideration the aforementioned arguements, the Ministry of Tax and Levies came to the following conclusion:

[1180] ibid 7.

[1181] ibid 7-8.

[1182] Ernst & Young, 'Taxpayers' Good Faith Questioned' (2006) May RussTax Brief 3-4, 3 <http://www.ey.com/global/download.nsf/Russia_E/RTBMay06/$file/RTB_May06.pdf>accessed 27 April 2007.

[1183] Ministry for Taxes and Levies, 'Yukos Resolution' 7-8.

[1184] ibid 116-17.

Firstly, in this case the Ministry had rights for reassessment (recharacterization). In order to strike a balance between public and private interests, the tax authorities may conduct inspections in order to identify the actual owner of property sold, and to ascertain the owner's bad faith, which manifested itself in using a tax evasion scheme. In doing so the tax authorities identify the party who is the actual owner of the property based on the actual relationship arising between parties to the transactions, irrespective of who is called the owner of the property in the documents submitted in the course of a tax audit.[1185]

Secondly, the Yukos Oil Company had been the actual and ultimate owner of oil and products. The Yukos Oil Company actually had the rights of possession, use and disposal in relation to oil and oil products and, in relation to them performed all actions, including alienation, transfer for processing, etc., through shell companies dependent on Yukos. That Yukos did this at its own volition is proved by the evidence described in the Resolution.[1186]

Thirdly, the ultimate tax liabilities of the Yukos Oil Company concerning particular taxes in the light of the extraordinary audit appeared as follows, according to the Ministry of Taxes and Levies.

In respect of VAT and other taxes, the inspectors stated that the Yukos Oil Company, the actual owner of the oil and oil products, when selling them had incurred various liabilities: a value-added tax liability, a motorway user tax liability, a POL sales tax liability and a housing stock and social amenities maintenance tax liability, none of which had been paid within the prescribed time-limits.[1187]

The Ministry of Taxes and Levies also pointed out that an economic benefit derived by an entity in monetary form, or in kind, gave rise to a profit tax liability, as prescribed by the Profit Tax Law, irrespective of whether this benefit was obtained by means of transferring funds directly to the accounts of the taxpayer, or to the accounts of other

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[1185] ibid 116.

[1186] ibid.

[1187] ibid.

parties. Therefore, the company via the shell companies dependent on it, was the ultimate recipient of the economic benefit, and was subject to the profit tax.[1188]

The tax inspectors stressed that property tax liability should be incurred by an entity who was obliged to reflect fixed assets, intangible assets, stocks and costs on its balance sheet. Since the field tax audit ascertained that the Yukos Oil Company had this obligation, this taxpayer also incurred a property tax liability.[1189]

Finally, the Ministry of Taxes and Levies came to the conclusion that as the Yukos Oil Company intentionally took measures to evade taxes. It also concluded that as its executives, understanding the illegal nature of these activities, wished or intentionally allowed the harmful results thereof, the company is subject to extra (double) sanctions. This is established by Article 122 point 3 of the Tax Code of the Russian Federation, for non-payment or underpayment of taxes as a result of intentional illegal activity (inactivity) in the form of penalty to an amount of 40% of the sums unpaid.[1190] The above arguements of the Ministry of Tax and Levies clearly confirm the indirect application of framework elements derived from the substance over form, business purpose and other doctrines, which supported the application of the Russian Civil Anti-Avoidance doctrines.

According to the Resolution, the Yukos Oil Company had to pay approximately $ 3.4 bn., which just flagged the beginning of the Yukos tax case.

4.7. The Yukos Position.

The position of Yukos regarding the Tax audit procedure and its results stated in the appendix to the Resolution may be summarised in the following main arguements:

[1188] ibid 116-17.

[1189] ibid 117.

[1190] See Tax Code art 110 (4).

4.7.1. The Legal Meaning of Interdependence of Shell Companies.

The grounds for attaching the proceeds and tax liabilities of the shell companies to the Yukos Oil Company concern the interdependence between these companies and Yukos. Russian tax laws do not enable the tax authorities to demand that the taxes due from one company be paid by another company. In Russian legislation, interdependence of entities does not have the legal meaning that is attached to it in the Inspection Report. The company in its official comments pointed out:

> In current Russian legislation the status of interdependent entities has strictly definite legal implications for tax purposes. It means that if there is a fact of interdependence of entities, the tax authorities become entitled.... to adjust ... for tax purposes the results of the transactions between these companies. [1191]

The Company's position regarding the interdependence arguement was based on the statutory rules, which quite clearly provided that there were no other legal consequences of recognizing legal entities to be interdependent, except for those, stated in article 40 of the Tax Code providing the tax authorities with the right of adjustment.[1192]

4.7.2. The Definition of a "Shell" Company.

The position of the Company regarding existence of "shell companies" was based on the perception that current tax legislation did not contain the notion of a "shell" company. The company emphasized that: '... in order to conclude that these entities are fake companies, the tax inspectors should either challenge their state registration as legal entities or prove that these companies are not registered as legal entities at all, or are registered with material violations.' [1193]

[1191] Ministry for Taxes and Levies, 'Yukos Resolution' 11.

[1192] See Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 66; K Nepesov, *Nalogovye Aspekty Transfertnogo Tsenoobrazovaniya [Tax Aspects of Transfer Pricing]* (Walters Kluwer, Moscow 2007) 2.1.2.

[1193] Ministry for Taxes and Levies, 'Yukos Resolution' 11.

The Company and its consultants clearly stated that the terms, "shell" or "front" companies, in the meaning implied by the Ministry of Tax and Levies, were unknown in Russian legislation and from a legal standpoint, all companies were properly registered and formally complied with all the characteristics of legal entities.[1194]

4.7.3. The Company Cannot Pay Taxes for Third Parties.

The Company's lawyers pointed out that by coercing the Company to pay taxes for the allegedly affiliated group of "shell" companies, the Ministry actually violated the tax law. The opinion of the Company's tax adviser said: 'The statement saying that Yukos is obliged to pay taxes for other companies runs counter to art. 45 of the Tax Code of the Russian Federation, which provides that all taxpayers are obliged to meet their tax liabilities independently.'[1195]

The Company also added that the tax inspectors actually changed the status of the taxpayer, treating it as if it were obliged to pay the additionally charged amount for third parties.[1196]

It should be noted that the prohibition to pay taxes for any third party is one of the cornerstones of the Russian tax law, although it may look rather obscure to international lawyers. However, the Constitutional Court in its decision clarified that this prohibition had been stipulated by the law to provide proper identification of the funds transferred to the budget, and to prevent unnecessary interference of third parties in the process of taxation.[1197] It does not prevent companies from using duly authorized intermediaries.[1198]

[1194] Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report.*

[1195] ibid.

[1196] Ministry for Taxes and Levies, 'Yukos Resolution' 112.

[1197] See Res of CC RF № 41-O.

[1198] See eg T Matveicheva, 'Vozmozhnost' Perechisleniya Nalogov v Byudzhet Tret'imi Litsami Za Nalogoplatel'scika [On Whether Can Taxes Be Paid by Third Parties?]' (2004) 3 Vash Nalogovyi Advokat [You Tax Advocate].

4.7.4. Regional Tax Concessions.

The Yukos position, regarding illegal administration of the tax concessions, was based on the assertion that the tax inspectors simply *alleged* that the said companies had not conducted activities on the territory of the relevant administrative and territorial formations, because the companies had not owned or leased any fixed assets for storing oil, and no oil had really been transported to the relevant regions.[1199] The Company's advisers reacted: 'We are not aware of any case in court practices where taxes reassessed upwards would be levied, not on the company that used the allowances, but on another entity.'[1200]

The Company, in its Statement of Objections,[1201] also pointed out that the so-called "shell" companies' activities lay in the commercial intermediary services performed in these territories, irrespective of where the oil products were located, these companies' activities did not consist of selling oil or oil products on the territory of the relevant administrative and territorial formations. The law did not impose an obligation on companies to conduct commercial intermediary activities at the place where the trade item is located.[1202]

The company also mentioned in its Statement of Objections that the unlawful use of the tax concessions by third parties should not serve as a reason for bringing any allegations against the Yukos Oil Company, since the latter did not perform any actions (omissions) in connection with the use of the said concessions.[1203]

[1199] Ministry for Taxes and Levies, 'Yukos Resolution' 113.

[1200] Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report.*

[1201] Cited as an Appendix to the Resolution.

[1202] Ministry for Taxes and Levies, 'Yukos Resolution' 113.

[1203] ibid 114.

4.7.5. Expiration of the Statute of Limitation Period.

The Yukos Oil Company stated that the limitation period for imposing liability for a tax offence had expired.[1204] Article 113 of the Tax Code of the Russian Federation clearly provided that no one may be held liable for a tax offence, if three years had expired (statute of limitation period) from the date on which the offence was committed or from the day following the end date of the tax period in which this offence was committed.[1205]

There were several other supplementary arguements summarised in the Yukos objections, submitted to the Ministry of Tax and Levies, such as procedural violations, breach of confidentiality rules and arithmetical mistakes.[1206]

The character of Yukos's objections showed that its consultants used contra-arguementation based on the formal and literal approach to the statutory provisions, completely denying application of any elements of the foreign doctrines, effectively used by the Ministry of Tax and Levies.

4.8. The Court's Rulings on the Yukos Tax Case.

Quite a number of decisions have been brought concerning the Yukos Tax Case. The court decisions pertain to different years, as the extraordinary audit was conducted subsequently in respect of the years 2000-2004. However, all the findings were based on the same principles, established in the decision brought for the year 2000. Moreover, the decisions of the subsequent Appeal and Cassation simply confirmed the findings of the First Instance, so the decisions of the Appeal and Cassation may be regarded as putting several findings of the First Instance into a more "polished" legal form. The Decision of the Supreme Arbitration Court and the Decision of the Constitutional Court, concerned only selected aspects of law pertaining to the named decisions.

[1204] The amount of fine calculated in the Inspection Report is RUR 18,887,192,996.

[1205] Ministry for Taxes and Levies, 'Yukos Resolution' 114.

[1206] ibid.

4.8.1. Findings of the Courts.

The findings of the Moscow Arbitration Court, which considered the Yukos application to declare unlawful Resolution of the Ministry of the Russian Federation for Taxes and Levies dated 14.04.2004 No. 14-3-05/1609-1, served to confirm the allegations brought by the Ministry.[1207]

Firstly, the Court fully confirmed the existence of the scheme under which the Yukos Oil Company controlled operations with oil and oil products, through participation in transactions, acting either as the broker or by engaging other entities, affiliated with the Yukos Oil Company for participation in transactions, as brokers.[1208]

The Court also established that the Yukos Oil Company was the ultimate owner of oil and oil products. Purchase, transfer of oil for refining and sales of oil and oil products were actually performed by the Yukos Oil Company as the owner. This was witnessed by the direct participation of the Yukos Oil Company in all operations, and by the actual movement of oil and oil products from producing entities to refineries or to tank farms under control of Yukos, as attested by the goods shipping documents.[1209]

Figures 17 summarises in a graphic form the court's arguementation concerning the Yukos' control of the shell companies which participated in the tax evasion scheme.

[1207] See the Decision in Appendix 23.

[1208] *Reshenie Arbitrazhnogo Suda g Moskva po zayavleniyu Mezregional'noi Nalogovoi Inspektsii № 1 protiv Kompanii Yukos [Decision of the Moscow Arbitration Court on the case Interregional Tax Inspection N1 v Yukos]* [A40-61058/04-141-1510] (Moscow Arbitration Court 26 May 2004), 11.

[1209] ibid 12.

Figure 17. "The Arguements Used by the Court for Proving the Presence of the Yukos' Control of the Scheme."

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Taking into consideration these factors, the Court came to the conclusion that the Yukos Oil Company should pay the property tax, profit tax, VAT and other taxes for all the "shell" companies in accordance with the Ministry's position.

The court did not accept the arguement of the Yukos Oil Company that tax authorities had no right to collect taxes on sums of earnings received by the third parties. The Court stated that the Decision of Russian Federation Constitutional Court No. 138-O of 25.07.2001 confirms the right of tax authorities to present to the courts claims, which provide for the receipt of taxes in the budget, upon the established bad faith of the taxpayer. The Court then pointed out that the bad faith of the taxpayer, i.e. the Yukos Oil

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[1210] ibid.

Company, and the fact that it effectively owned the earnings from operations with oil and products, is supported by the case materials.[1211]

The Court also stated that Yukos Oil Company was incorrect to argue that the status of interdependent persons had legal meaning only for application of the transfer pricing rules (i.e. application of the fair market price instead of the price used originally by the parties and, thus, reapportionment of the taxable income). The Court stressed that interdependence of persons in this case is a circumstance by which the taxation authority substantiated the bad faith of the taxpayer.[1212]

The Court established that application of tax benefits by entities affiliated with the Yukos Oil Company, and the participation in any tax evasion scheme created by it, is unlawful.[1213] Supplementing this finding, the Court pointed out that pursuant to Article 56 of Tax Code, tax benefits are recognized as preferences, stipulated by the taxes and duties legislation, for certain categories of taxpayers as compared to other taxpayers, including the possibility of not paying the tax or paying it in lower amounts.[1214]

The Court emphasized that, following the presumption of good faith of taxpayers, tax benefits may be regarded as legitimately granted only if the amount of provided benefits virtually matches the sum of investments made by the investing entity into the economy of a relevant region. This principle complies with the purpose of tax benefits as a stimulus for investing in particular regions. As the level of benefits declared for taxes by the aforementioned entity and the sums of investments it made were obviously non-commensurate, the application of benefits was completely unlawful.[1215] The Court added that the application of tax benefits by the relevant entities had not been aimed at improving the economies of the regions, but had been pursued by the Yukos Oil Company in order to evade paying taxes on operations of production, refining and sales of oil and oil products and, consequently, must be seen as unlawful.[1216] In respect of the ZATO territories the

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[1211] ibid 13-14.

[1212] ibid 19.

[1213] ibid 14.

[1214] ibid.

[1215] ibid 16.

[1216] ibid 15.

Court stated that investment contributions made by the taxpayers did not influence the development of their regions' economic systems. As the "shell" companies did not actually carry any activity in the ZATOs –they were not actually present in their territories, and there were no material resources and production facilities requisite for the procurement and storage of oil in the territory – the application of tax benefits by the mentioned entities contradicted the law.[1217] The court, in bringing the decision on the substance of the tax claims brought against Yukos thereby blessed the creative indirect application of the foreign anti-avoidance doctrines in combination with the old Russian ones.

The Court then brought the most controversial and unexpected decision. In respect of the expiration of the limitation period for the imposition of fines, it stated that the presumption of good faith of taxpayers operates in the sphere of tax relations, as provided by the meaning of the provision contained in Article 3 of Tax Code. Reasoning from this presumption, the norms of tax legislation that confer rights, or guarantees, to bona fide taxpayers cannot be extended to mala fide taxpayers. Since, in the course of the extraordinary tax audit, the facts of Yukos Oil Company's bad faith conduct and abstraction of the tax authorities auditing activities had been established, the court came to the conclusion that the limitation period of calling Yukos Oil Company for tax liability had not expired.[1218]

The Court also declined the Yukos' allegations of procedural violations made by the Ministry of Tax and Levies in the course of the extraordinary tax audit.[1219] Finally, the Court almost fully upheld the claim of the Ministry of Tax, collecting from Yukos taxes to the amount of 47,989,073,311 RUR, fines to the amount of 32,190,430,314 RUR and penalties to the amount of 19,195,606,923 RUR for the income of the budget.[1220]

By the decision of the appellate instance of the Moscow Arbitration Court of 29 June 2004[1221] and by the subsequent decision of the Federal Arbitration Court of the Moscow

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[1217] ibid 16-18.

[1218] ibid 19-20.

[1219] See Yukos, *Violations Committed by the Arbitration Court of Moscow* (2004).

[1220] *Interregional Tax Inspection NI v Yukos [A40-61058/04-141-1510]* 22.

[1221] See ibid; The Moscow Times, 'Court Upholds $3.4bln Yukos Tax Claim'.

Circuit of 17 September 2004, the decision of the first instance (trial court) was upheld, except for some insignificant changes.

4.8.2. The Findings of the Supreme Arbitration Court and Constitutional Court of the Russian Federation.

The Yukos Oil Company addressed the Supreme Arbitration Court of the Russian Federation with supervisory appeals on the reconsideration of the decision of the trial court, the judgement of the appellate instance, and the judgement of the Federal Arbitration Court in the order of supervision.[1222] The Yukos Oil Company also appealed to the Constitutional Court of the Russian Federation. The Company claimed that its constitutional rights had been violated in relation to the imposition of sanctions for a tax violation in 2000, and they asked the Court to review the consistency of articles 3 (paragraph 7) and 113 of the Tax Code, with the relevant articles of the Constitution. This also meant a review of the courts' position as to the expiration of the statute of limitation period and the Civil Anti-Avoidance doctrine, which declined legal protection for mala fide taxpayers.[1223]

Initially, the Presidium of the Supreme Arbitration Court of the Russian Federation adjourned consideration of the Company's appeal until it had obtained the position of the Constitutional Court.[1224]

The Constitutional Court refused to accept the appeal for consideration on the basis that Article 113 is not unconstitutional and the correctness of the application of the law is a matter for the arbitration courts, not the Constitutional Court.[1225] Amongst other things, the Court pointed out that granting relief to the taxpayer, in a case of an obstruction of a tax

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[1222] See Presscenter, 'Timeline of Events'.

[1223] See I Kuznets, 'Kommentarii K Postanovleniyu Konstitutsionnogo Suda RF № 9 P [Commentaries to the Decision of the Constitutional Court of the Russian Federation № 9 P]' (2005) 4 Vash Nalogovyi Advokat [You Tax Advocate].

[1224] See Presscenter, 'Timeline of Events'.

[1225] See Res of CC RF № 9-P (II).

audit committed by the taxpayer, which had resulted in expiration of the limitation period for imposition of tax penalties, would amount to a violation of the principle of equality, and would be unfair to other taxpayers. According to the Constitutional Court's position, courts considering the case of a particular taxpayer shall distinguish bone fide and mala fide taxpayers and should not allow mala fide taxpayers to avoid sanctions exclusively because of expiration of the limitation period.[1226]

The Supreme Arbitration Court, after renewing the hearing of the Yukos case and taking into consideration the findings of the Constitutional Court, declined the arguements of the Yukos' supervisory appeal in full, declaring that:

> The Constitutional Court pointed out....that in case of obstruction of measures of tax control and tax audit by a taxpayer, a relevant court may establish that the reasons of expiration of the limitation period shall be regarded as good reasons, and impose sanctions for the violations identified in the course of the tax audit...
>
> In the Yukos cases presence of such good reasons was established by the Arbitration Court of Moscow.[1227]

Other cases related to the Yukos case have never reached the level of the Supreme Arbitration or Constitutional Court. Once established, the complex "Yukos precedent" was applied to other tax cases[1228] pertaining to subsequent years. This situation left Yukos without any viable options for successful litigation in Russia. In the findings pertaining to subsequent Yukos-related cases, which can be seen as precedent of "selective" application, the Yukos case established two important case law precedents at the highest level of Russian case law.

Firstly, transactions accounted for by a taxpayer in non-compliance with their actual economic substance can be re-classified by the court for taxation purposes based on their

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[1226] See for comments Budilin, 'Fair or Unfair? Constitutional Grounds of Tax Planning – the New Tendencies'; Ernst & Young, 'Taxpayers' Good Faith Questioned'; A Zolotarev, 'Razgranichenie Pravomernoi Praktiki Nalogovoi Optimizatsii I Ukloneniya Ot Nalogooblozheniya [Legitimate Tax Optimisation and Tax Avoidance]' (2006) 2 Tvoi Nalogovyi Advokat [Your Tax Advocate].

[1227] See *FTS v Yukos* № 8665/04

[1228] See Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance*; Yukos, 'Tax Slides Update'.

actual economic substance.[1229] Secondly, the fact of violations of tax liabilities by a taxpayer's counterparties does not in itself constitute evidence of a taxpayer obtaining an invalid tax benefit. Nevertheless, a tax benefit may be deemed invalid if the tax authorities prove that the taxpayer acted without due care and circumspection and should have been aware of the violations committed by its counterparty.[1230]

4.8.3. The Position of the Western Courts and the European Court of Human Rights.

Some aspects of the Yukos tax case have been reviewed by several Western courts. The former Yukos management and the minority shareholders coalitions have tended to use arguements concerning procedural violation and the forceful sale of Yganskneftegas in the suits being filed with the international courts.[1231]

The tax evasion scheme applied by the Yukos Oil Company was the cause for its minority shareholders to file lawsuits against the company's directors with the U.S. court. One of such lawsuit that was related to gross violation of the Russian tax legislation by the company, and which was filed with the United States District Court, Southern District of New York, was found partially admissible, but later reconsidered and rejected. The plaintiffs alleged that Yukos and its officers failed to disclose material facts concerning Yukos's alleged tax evasion scheme, such as:

> First ... Yukos touted the Company's operational success and reported increasingly positive financial results that overstated profits and understated tax liability.
>
> Second, Yukos represented that its financial results were in conformity with U.S. GAAP and other established reporting standards.
>
> Third, Yukos represented that it reduced its effective tax rate because certain of its subsidiaries took advantage of lower regional taxes.

[1229] Res of SAC № 53. For comments see Y Lermontov, 'Rezolutsiya № 53 Plenuma VAS [Resolution № 53 of the Plenum of SAC]' (2007) 3-4 Audit i Nalogooblozhenie [Audit and Taxation] <www.garant.ru>accessed 10 December 2007.

[1230] ibid.

[1231] See eg <http://www.yukosshareholdercoalition.com>.

Finally ...Yukos represented that it dealt at arms-length with related parties.[1232]

The suit filed with the U.S. court, in its legal substance represented a securities fraud action. It alleged that Yukos, its external auditor and certain of its executives and controlling shareholders had knowingly concealed the risk that the Russian Federation would take action against Yukos, by failing to disclose that Yukos had employed an illegal tax evasion scheme since 2000.[1233] The important aspect of this case was that the U.S. court scrutinized the problem of the legitimacy of the Yukos tax schemes by analyzing the transfer pricing ("Article 40") and illegal tax benefits allegations.

The findings of the U.S. court, being based on the limited amount of data,[1234] directly contradicted the position of the Russian judicial instances.[1235] However, it should be noted that the main decisions in the Yukos tax case were not submitted for the Court's observation in this case, and the Russian State was not a party to it. This gave the Company only a partial victory.

On 27 April 2004, when all the domestic remedies had been exhausted, the Company lodged an application with the ECHR, basing its position on the violations of Article 1 of Protocol No 1 to the European Convention on Human Rights and Article 13 of the Convention. It claimed violation of the peaceful enjoyment of possessions and the right to an effective domestic remedy.[1236] The grounds for the Application are the result of the Applicant's complaints about the bogus tax re-assessments and their draconian enforcement. Grounds for the Application also resulted from the controversial auction of YNG, and its consequential acquisition by the State owned and controlled Rosneft.[1237]

The admissibility of the application has not been determined as of January 1st 2008.[1238] As the application and the ECHR procedure are more concerned with the procedural violation, rather than the substance of the tax evasion allegation brought against

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[1232] *Re Yukos Oil Co Sec Litig* Not Reported in F Supp 2d 2006 WL 3026024 (SDNY 2006) 24.

[1233] See ibid.

[1234] As the Russian government was not a party to the proceeding and did make any submissions.

[1235] See Appendix 24.

[1236] See on the Court's reaction to the application *ECHR Russia's Mem (30 October 2006)*; *ECHR Russia's Mem (15 April 2005)*; *Yukos v Russia* App № 14902/04 ECHR Protective App (23 April 2004).

[1237] *Yukos v Russia* App № 14902/04 ECHR Comm to the Rebgun's Letter (23 April 2007) 6.

[1238] ibid 2.

the Yukos Oil Company and its managers, for the purpose of this research it is more important to highlight the general "politicized" treatment of the Yukos tax case by the Russian authorities. The summarised approach of the Russian Government to the Yukos tax case is quite clearly expressed in the Additional Memorandum of the Russian Federation of October 30th 2006. Russia strongly refuted declined Yukos' allegations of procedural and other violations by stating:

> The tax evasion scheme, abetted by factitious "dummy companies" set up and controlled by the company, was the main focus of the courts' evaluation. The scheme was held to be illegal by the courts. It was held that the preferential lax assessment procedure, applied by the applicant company, was contrary to the Tax Code…and that actions of the company did contain elements of mala fide.[1239]

Thus, the Russian Federation continued to pursue a hard-line strategy in the Yukos case, including its tax-driven aspect, even in highest international judicial instances.

4.9. The Main Legal Implications of the Yukos Tax Case.

4.9.1. Anti - Avoidance Doctrines in the Yukos Tax Case.

The claims comprising "the Yukos tax case" should be seen as based on the application of Russian Civil Anti-Avoidance doctrines, as formally stated in the official court decisions, and on the international anti-avoidance concepts, analysed in the first part of this chapter.

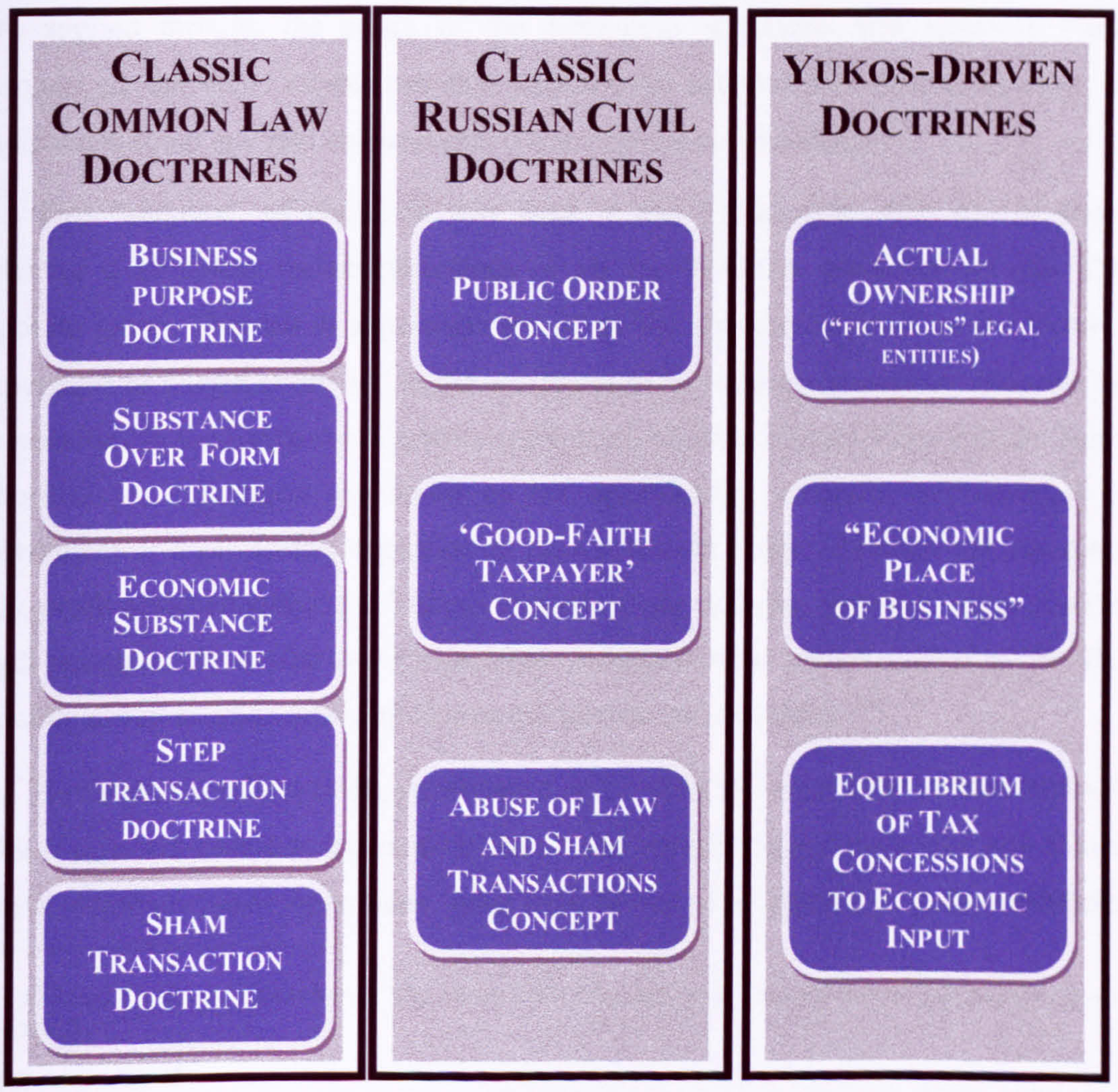
Although the characteristics of these doctrines and methods of their application differed significantly from the similar ones used internationally or in Anglo-American jurisdiction,[1240] the substantial elements of such doctrines were virtually identical. They were also applied not in their undiluted form as they are normally applied in Anglo-American jurisdictions, but in close interaction with the Russian Anti-Avoidance doctrines.

[1239] *ECHR Russia's Mem (30 October 2006)* 10.

[1240] See Seidov, 'Dealing with Judicial Antiavoidance Doctrines in Russia and the U.S.'.

As the Russian Anti-Avoidance doctrines were poorly developed and their application was of a limited nature before the Yukos case,[1241] the international doctrines effectively supplemented and extended their application, promoting their further development in Russia. Figure 18 below represents the main international, Russian civil and Yukos – driven doctrines, used directly or indirectly in the Yukos-related tax cases.

Figure 18. "International, Russian Civil and Yukos – Driven Doctrines."



[1241] See R Vakhitov, 'Recent Developments Regarding Judicial Anti-Avoidance in Russia' (2005) 45 (4) ET 163-66; Seidov, 'Dealing with Judicial Antiavoidance Doctrines in Russia and the U.S.'.

Some practitioners have opined that the mixed creative application of the international and Russian doctrine, may have even given rise to specific Yukos-driven doctrines.[1242] However, these doctrines so evidently originate from the international ones, that they can only be regarded as "secondary" doctrines lacking independence from the main ones.[1243]

Although applied indirectly and creatively, the core anti-avoidance doctrines are to be considered as the actual pillars of the Yukos tax case.[1244] For example, both the civil doctrine of "bad faith" and the presumably Yukos-driven "Actual Ownership" doctrine were applied through the prism of the Economic Substance and Business Purpose doctrines, as the court established that transactions between the shell companies were conducted without any real business purpose except for tax avoidance.[1245]

This "mixture" of doctrines was used in the Yukos case with the propose of achieving a complete recharacterization of all the business operations of the Yukos corporate group. This led to apportionment of all the operational profit to the Yukos Oil Corporation as a legal entity and to the ascription of all assumingly unpaid corporate taxes and penalties to the Company. Creative application of these doctrines enabled the Russian authorities to; (1) negate the result of tax optimisation schemes, implemented with involvement of legal entities registered in the tax benefit zones; (2) make the adjustments of the profit obtained within the Yukos corporate group with the assumed violation of arms length principle; (3) ascribe to the Yukos Oil Company all the income earned by the Yukos corporate group in 2000-2004 and charge the interest and penalties.[1246]

However, regardless to the significance of the doctrinal aspect, the cornerstone issues of the Yukos tax case are that neither classic anti avoidance doctrines, nor any Russian-specific doctrines based upon them, have ever before been applied in such combinations

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[1242] See Maximovskaya, *Overview of the Bona Fide Concept and Anti-Avoidance Legislation in Other Countries* 8.

[1243] See Appendix 25.

[1244] See Appendix 26.

[1245] See *Interregional Tax Inspection N1 v Yukos [A40-61058/04-141-1510].*

[1246] Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report*; Egorov, 'Yukos: Just the Facts'.

and so stringently in Russian judicial practice.[1247] It highlights the likelihood of a political thrust to the case, previously reviewed in detail.

In general, the impact of the Yukos tax case can be assessed as critically changing the very substance of the judicial approach to the tax avoidance/evasion fight in Russia by employing recognized international and western anti-avoidance doctrines.[1248]

4.9.2. The Yukos Tax Case and the Contemporary Russian Case Law.

One of the significant aspects of the Yukos tax case is the lack of similar cases in contemporary Russian case law. This issue was raised by the ECHR in its communications with the Russian Government, as this matter represented a particular interest from the standpoint of selectivity in the Yukos case. The Russian authorities did their best to prove that the Yukos case was not unique in Russia, but their list of precedents looks rather limited and only serves to confirm the opposite point.[1249]

Analysis conducted independently by Russian tax practitioners shows that none of these cases is comparable with the Yukos Case in its precedential nature, general size and impact on the taxpayer company.[1250] Even the notorious Rusneft case, considered to be the closest to the Yukos tax case in the line of the Post-Yukos cases is hardly comparable with the latter in respect of the size, severity and creativity.[1251] However, it should be noted that

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[1247] Clateman, 'Further Legal Observations on the Yukos Affair'; Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report.*

[1248] See eg BBC News, 'Putin Calls for End to Tax Terror' (2005) 25 April BBC News <http://news.bbc.co.uk/2/hi/business/4481685.stm>accessed 7 December 2007; V Milov, 'Pravovye Itogi [Legal Results]' (2007) 31 October Vedomosti <http://www.robertamsterdam.com/2007/10/vladimir_milov_the_legal_resul.htm>accessed 3 November 2007.

[1249] *ECHR Russia's Mem (30 October 2006)* 32.

[1250] For the information of these cases see Vitkina and Rodionov, *Tax Evaders of Putin's Epoch.*

[1251] See eg Reznik, 'Gutseriyev's Personal Case'; N Sergeev, 'Police Undertakes Mikhail Gutseriyev' (2007) 15 May Kommersant Online <http://www.kommersant.com/p765407/Russneft/>accessed 20 May 2007.

professionals stress the positive outcome of the Yukos case as a lesson for other taxpayers and claim it has had a positive impact on tax discipline in Russia.[1252]

The second question regarding the genesis of Russian case law is the impact of the Yukos case on its further development.

In October 2006, the Supreme Arbitration Court, under significant pressure from taxpayers and from a Government that wanted to put "the rules of the game" in proper order, prepared and issued the general clarifications of the problem of validity of tax benefits (unjustified tax benefits).[1253] This clarification, being obligatory for the lower courts, represents something in-between a Ramsay type approach and a GAAR (general anti-avoidance rule).[1254] The Resolution substantially revised the term "bad faith taxpayer", which the Constitutional Court introduced into court practice in 2001.[1255] The Supreme Arbitration Court proposed that the concept of the valid receipt of tax benefits must be used instead.[1256] The Resolution sets up the several basic principles.[1257] Taxpayers are presumed to be acting in good faith and actions resulting in the receipt of tax benefits are presumed economically sound.[1258] A tax benefit is defined as: the reduction of the amount of tax liabilities as a result of reducing the tax base, obtaining a tax deduction or tax concession, applying a lower tax rate, and obtaining the right to a tax refund (deduction).[1259] A tax benefit may be deemed invalid in cases of accounting for taxation

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[1252] See eg C Mortished, 'BP Venture Pays $1bn in Back Taxes as Russia Gets Tougher' *The Times* (London 11 November 2006) 56; Kommersant.com, 'Yukos Bankruptcy Sorts out Russia's Budget Problems' (2007) 12 July Kommersant Online <http://www.kommersant.com/p781872/Budget_Spending_Revenue_YUKOS > accessed 14 July 2007.

[1253] M Filinov and I Lemetyuynen, 'Russia: New in 2007' (2007) February Int'l Tax Rev <http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=23343&SID=673790&TYPE=20>accessed 2 July 2007.

[1254] See E Mosin, 'Doktrina Obosnovannoi Nalogovoi Vygody [The Doctrine of Valid Tax Benefit]' (2007) 5 Tvoi Nalogovyi Advokat [Your Tax Advocate].

[1255] Salans, 'Letter from Russia' (2006) October Tax Alerts 4, 1 <http://www.salans.com/FileServer.aspx?oID=1594&lID=0>accessed 31 October 2007.

[1256] ibid 1-2.

[1257] D Gololobov, 'The Yukos Tax Case or Ramsay Adventures in Russia' (2008) 7 (1) Fla St U Bus L Rev 165-253, 213-15.

[1258] Res of SAC № 53 para 1.

[1259] ibid. For comments see E Arora, *Neobosnovannaya Nalogovaya Vygoda [Ungrounded Tax Benefit]* (IndeksMedia, Moscow 2007); Lermontov, 'Resolution № 53 of the Plenum of SAC'.

purposes, for transactions that do not correspond to their actual economic substance, or do not stem from reasonable economic or other reasons (business objectives).[1260]

In 2008 the Supreme Arbitration Court in its decision on a different case, reversed the practice of imposing double "extra" fines for the repeated violation of the tax law, applied by the courts in the Yukos case. It would have brought the company back approximately $ 3.5 bn.[1261] It should also be noted, that in its clarification the Supreme Arbitration Court has fully excluded the application of the Public Order Concept (Art 169 of the Civil Code) to tax disputes, but this problem may become a case for the Constitutional Court.[1262]

Important changes to the precedents, established by the Yukos case, additionally confirm the problem with the state of the Rule of Law in Russia. In the Yukos tax case the deviation from the principles was so significant and the court had to bend the law to such a degree, that it actually flagged the begining of several years of "tax terror" in Russia, when the taxpayers had no judicial protection.[1263] The Yukos tax case, in the eyes of the public, exemplifies the selective utilisation of the judicial system, namely the Arbitration courts, for the purpose of prosecuting political opponents by the effective confiscation of their business in favor of a new political elite.[1264] This arguementation has been extensively used in the ECHR application on the Yukos corporate tax case and, therefore, is sure to get further assessment at an international level.[1265]

[1260] Res of SAC № 53 para 3-4. For comments see Arora, *Ungrounded Tax Benefit*; R Lewis, M Maximov and N Lobova, 'Russia: Guidance on Legitimacy of Tax Optimisation Arrangements Provided by Supreme Arbitration Court Ruling' (2007) January Euro TS 28-29; Mosin, 'The Doctrine of Valid Tax Benefit'.

[1261] Kommersant.com, 'Yukos Paid 90bn in Excess to Budget' (2008) 4 April 2008 Kommersant Online <http://www.kommersant.com/p-12299/Yukos_excess_fine/>accessed 4 April 2008.

[1262] Res of SAC № 22 para 6.

[1263] BBC News, 'Putin Calls for End to Tax Terror'.

[1264] See Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"' 2-6.

[1265] See *Yukos v Russia* (App no 14902/04) ECHR Protective App (23 April 2004).

4.9.3. The Criminal Aspect of the Yukos Tax Case.

The criminal aspect of the Yukos tax case is vague. Formally, the Yukos Oil Company was not held criminally liable for commission of criminal offences, in the meaning of the provisions of the criminal legislation of the Russian Federation. This is because, according to Article 19 of the CC RF, only a physical person may be subject to criminal liability.[1266] In 2004, the General Prosecutor Office, taking into consideration that the "deeds of the directors of Yukos Oil Company to evade taxes were of deliberate nature" brought criminal charges against the general director of the company that provided accounting services to the Yukos Group, Irina Golub (Chief Accountant).[1267] The charges were formulated as, "evasion to pay corporate taxes and (or) contributions committed by a group of persons acting in conspiracy on an especially large scale (Article 199 § 2 (a) and (b) of CC RF)."[1268] The General Prosecutor's Office believed that Golub and unidentified persons used shell companies to avoid paying taxes on Yukos subsidiaries. Therefore the charges are legally based on the allegations made in the corporate tax case.[1269] The company officially commented on the charges, stressing that they did not take into account the company's operational schemes:

> The ongoing investigation by the Russian prosecutor ... completely ignore the very clear fact that the YUKOS Oil Company is a vertically integrated corporation. Further, the allegations do not consider even the most basic principles of consolidation accounting. [1270]

[1266] CC RF art 19. For comments see Duyunov and others, *Commentaries on the Criminal Code of the Russian Federation*; A Guev, *Kommentarii K Ugolovnomu Kodeksu Rossiiskoi Federatsii Dlya Predprinimatelei [Commentaries on the Criminal Code of the Russian Federation for Entrepreneurs]* (Ekzamen, Moscow 2006).

[1267] ECHR *Russia's Mem (30 October 2006)* 10.

[1268] ibid.

[1269] See D Butrin and D Skorobogat' ko, 'Yukos Tolkayut v Dolgovuyu Yamu [Yukos Is Pushed to Debtor's Prison]' (2004) 3 August Kommersant Online <http://www.kommersant.ru/ doc.aspx?docsid=502602> accessed 30 June 2007

[1270] Yukos, 'Statement: Yukos Refutes Continuing Unfounded Russian Government and Administration Allegations'.

Since that time, no developments of the case have been made public by the prosecutors or the defendant.[1271] However, the term "evasion", extensively used by the Russian authorities in the official documentation filed with the ECHR, demonstrates that it is the position of the Russian Federation to consider the Yukos' operational schemes as organised corporate tax avoidance and evasion. This has resulted in negative pecuniary consequences for the company (including its subsequent liquidation) and criminal charges against particular responsible managers.[1272] This position is also confirmed by the criminal case against the managers of the subsidiaries.[1273]

4.10. Conclusion.

The Yukos Oil Company organised and used a trading and tax optimisation scheme, which can be regarded as a typical scheme for Russian vertically integrated companies between 1995-2003.[1274] All these schemes, including the Yukos scheme were based on transfer-pricing sales of oil, gas and other raw materials to special purpose vehicles that were registered in tax benefit or tax-free zones. This was where the profit from the tax optimised operations was accumulated and was later, either transferred abroad through dividends or distributed to the head company of a corporate group, which as a public joint stock company, paid dividends to its shareholders.[1275]

The core element of the tax schemes from 1995-2003, was tax concessions that could be legally granted to companies who complied with the local laws on tax benefit, and were approved on the basis of the relevant provisions of the Russian Tax Code, or the Law on

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[1271] S Mashkin, 'The Khodorkovsky Family to Lease Cottage' (2006) 31 July Kommersant Online <http://www.kommersant.ru/doc.aspx?docsid=693919>accessed 30 May 2007.

[1272] See eg *ECHR Russia's Mem (30 October 2006)*; *ECHR Russia's Mem (15 April 2005)*.

[1273] See eg Cherkasova and Dorokhov, 'The Line of Sentences: The Yukos Cases Are Being Put on the Conveyor'.

[1274] See Iji, 'Corporate Control and Governance Practices in Russia' 14-25; Clateman, 'Yukos Part VI: Tax Claims Revisited'.

[1275] See Hoffman, *The Oligarchs: Wealth and Power in the New Russia*; Vitkina and Rodionov, *Tax Evaders of Putin's Epoch*.

Closed Administrative Zones.[1276] The primary goal of these concessions, given to them by a legislator, was to establish a system of incentives for the external investors (investors, located outside the relevant regions) to invest in the economy of the designated regions, where military enterprises had formerly been located.[1277] However, these regions had difficulty finding reliable investors, and so rapidly became tax concessions "shops" for big "oligarchic" production companies.[1278]The Government, upon finding huge loopholes in the Law, amended them too late. The damages sustained by the budget as a result of "statutory approved" tax avoidance were not countable in principle.[1279]

The situation with the application of the arm-length principle and transfer-pricing rules was even more ambiguous and complicated than that of the tax concessions. The enormous difference between the internal sales of oil and gas and their export price made application of those rules, which formally existed, politically unacceptable as it would have created an unbearable burden for the population.[1280] As a result almost all the Russian corporate groups were forcefully dragged into a game where everybody pretended to sell its product at the "market" price, whilst recognising that this price had nothing in common with the real market.

Although the major Russian oil and gas companies aggressively used tax optimisation schemes, they needed to raise capital, sell products to foreign customers and improve their business reputation in the eyes of the international business community.[1281]

[1276] See G Brock, 'The Zato Archipealago Revisited. Is the Federal Government Loosening Its Grip? A Research Note' (2000) 52 (7) Europe-Asia Stud 1349-60; Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia.*

[1277] See Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*; International Tax and Investment Center, Forecasting and L.L.P., *Taxes on Profits of Multinational Companies and Implications for Russian* 10.

[1278] See Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*; Rogachev, 'He Smartly Avoided Taxes'.

[1279] See Rogachev, 'He Smartly Avoided Taxes'.

[1280] See S Stroykova, 'Courts Extend Application of Russian Transfer Pricing Rules' (2006) March Int'l Tax Rev <http://www.internationaltaxreview.com/includes/magazine/PRINT.asp?SID=616738&IS...>accessed 30 April 2007; I Paliashvili, A Butenko and V Dmitriev, 'Transfer-Pricing Rules in Russian Legislation' (2007) <http://www.rulg.com/documents/Transfer_Pricing_Rules.htm>accessed 10 June 2007.

[1281] See eg CE Perotti and S Gelfer, 'Red Barons or Robber Barons? Governance and Financing in Russian Financial-Industrial Groups' (1999) 45 (9) Eur Econ Rev 1601-17; B Black, 'The Corporate Governance Behavior and Market Value of Russian Firms' (2001) 2 (2) Emerging Markets Review 89-108; Shiobara, 'Oversights in Russia's Corporate Governance: The Case of the Oil and Gas Industry'.

Therefore the companies retained numerous top level consulting, PR, legal and auditing firms, which assisted them in preparation and careful application of special strategies and techniques. It was this that allowed the majors to conceal the questionable nature of the optimisation schemes from the international business community. Through creative drafting of their financial reports and via other similar means, Yukos persuaded the international business community that the applied strategies were perfectly acceptable in countries with transition economies. [1282]

In the course of the Yukos affair, recognising that fraudulent privatisation and other charges of similar legal nature were unable to generate significant financial claims, and were thus insufficient to ruin the Khodorkovsky Empire, the authorities decided to launch a multi-level tax evasion case against the Yukos Oil Company, the major source of Khodorkovsky's financial power.[1283] In order to boost the amount of tax claims to a level enabling the authorities to commence a bankruptcy procedure, sell the company's assets and liquidate it, the Government had to apply a completely new approach to auditing the Company. This approach, which was based on the creative application of the "old" Russian Civil Anti-Avoidance Doctrines, and several foreign anti-avoidance doctrines, is known to international and Commonwealth case law.[1284] Amongst the Russian doctrines, aggressively and creatively applied in the Yukos tax case, were such concepts as the "bad faith" taxpayer and the abuse of law, amongst others. However the Russian doctrines were applied exclusively in conjunction with, and through the prism of, established international judicial concepts such as business purpose, economic substance and substance over form.[1285] For example, "Equilibrium of Tax Concessions to Economic Input" doctrine was applied, which being a reflection of "substance over form", "business purpose" and "economic substance" doctrines, allowed tax authorities and courts to challenge the

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[1282] See on the problem eg RS McIntyre, 'Tax Cheates and Their Enablers ' (2005) 12 April Economic Policy Institute Tax Enforcement Forum 2 <http://www.ctj.org/pdf/epishel.pdf>accessed 5 March 2007; O Pleshanova, PwC Discovered a Group Crime' (2007) 26 June Kommersant Online <http://www.kommersant.ru/doc.html?docId=777939>accessed 26 June 2007.

[1283] See *ECHR Protective App (23 April 2004)*; Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance*; Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"'.

[1284] See Clateman, 'Yukos Part VI: Tax Claims Revisited'; Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges'.

[1285] See eg Budilin, 'Fair or Unfair? Constitutional Grounds of Tax Planning – the New Tendencies'; Nepesov, *Tax Aspects of Transfer Pricing*; Savseris, *The Doctrine of "Unfairness" in Tax Law.*

disproportionate tax benefits, obtained by Yukos-related companies in the tax concessions zones.[1286]

The courts confirmed the position of the Ministry of Tax and Levies, that the Yukos trading and tax optimisation schemes had been created exclusively with the purpose of tax avoidance and evasion. Not only did the relevant transaction with crude and products have to be ignored, but a complete recharacterization of the commercial activities and ownership inside the Yukos Group had to be conducted.[1287] This recharacterisation led to the ascription of actual ownership of oil and products to the Yukos Oil Company and thus the imposition of unpaid taxes, interest and special penalties on the Company.[1288] Moreover, amongst other findings the court declared the SPVs that were registered in regions with tax breaks, to be "sham" companies, i.e. that they had no assets, no legal personality, conducted no independent business and were fully under Yukos' control, and hence affiliated with the company. As that was effectively concealed, all the transactions with those companies should be treated as sham and the Yukos scheme amounted to tax evasion.[1289] The problem surrounding the issue of tax avoidance and evasion in the Yukos case also stems from the absence of clear statutory, or judicial, definitions of tax avoidance and tax evasion, and the difference between them in Russia. This loophole helped the authorities to represent the case as blatant criminal tax evasion.[1290]

The right of a taxpayer to optimise its taxes and chose commercial schemes that allow him to pay less tax is internationally recognized.[1291] However, the duty of taxpayer to pay taxes generally in accordance with the economic substance of his commercial activities, and the right of tax authorities to disregard schemes and transactions aimed

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[1286] This docrine actually based on the same principles as thouse, pronounced in *R v Inland Revenue Commissioners Ex p Matrix Securities Ltd:* "Once a tax avoidance scheme has been identified, the scheme must be construed as a whole and the taxing statute must be applied to the results in fact achieved by the scheme...The claim to initial tax allowance of £38m. based on a pretended expenditure of £95m. must fail" [1994] 1 W LR 334, 346.

[1287] The Moscow Times, 'Court Upholds $3.4bln Yukos Tax Claim'.

[1288] See Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report*; Osborne, 'Testimony before the Senate Foreign Relations Committee "Democracy on the Retreat in Russia"'.

[1289] See Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance.*

[1290] Butrin and Skorobogat'ko, 'Yukos Is Pushed to Debtor's Prison'; Yukos, 'Statement: Yukos Refutes Continuing Unfounded Russian Government and Administration Allegations'.

[1291] See *Gregory v Helvering* 293 US 465 (1935); *Ayrshire Pullman Motor Service v IRC* (1929) 14 TC 754.

exclusively at avoidance of certain taxes is also conventional.[1292] These principles vary significantly, depending on the particular jurisdiction and characteristics of commercial activities of a particular taxpayer. The research conducted in this chapter shows that the framework elements of the doctrines applied by the Russian authorities in the Yukos case comply in their substance with similar doctrines of Anglo-American and Commonwealth jurisdictions. However, the existing concepts set up the principles, which allow authorities to disregard certain transactions and conduct the apportionment of the income, actually mean that income apportioned to one taxpayer and then taxed, should be deducted from the income of his counterpart to whom it has been previously mistakenly allocated.[1293]

In the Yukos tax case, this means that the income ascribed to Yukos, and the taxes then imposed, should be deducted from the income and taxes paid by the relevant production companies and SPVs. This would have led to the recharacterisation and recalculation of all the taxes inside the corporate group, and would not have led to the imposition of such severe taxes as has happened in reality.[1294] This assumption is confirmed by the recent Resolution of the Supreme Arbitration Court of the Russian Federation on the validity of tax benefits. This resolution describes the "economic substance", "substance v. form" and "business purpose doctrines" and provides that if certain tax benefits are declared invalid, the court should apply rules regulating the rights and duties of a taxpayer in accordance with the economic substance of a transaction.[1295]

Analysis of the judicial doctrines and general anti-avoidance rules adopted and used in Russian and Anglo-American jurisdiction, show that the conventional approach to tax evasion is based on the understanding of evasion operations as fraudulent (sham) intentional operations, aimed at evasion of taxes which are lawfully due.[1296] In the Yukos

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[1292] Angell, 'Tax Evasion and Tax Avoidance' 85; Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 26-27.

[1293] See eg HM Revenue and Customs, *A General Anti-Avoidance Rule for Direct Taxes: Consultative Document* (1998) 19<http://www.hmrc.gov.uk/consult/consult_1.htm>accessed 20 September 2007; Joint Committee on Taxation, 'Background and Present Law Relating to Tax Shelters' 4.

[1294] See Pepelyaev, Ivlieva and Khamenushko, *Opinion on the Yukos Inspection Report*; Lermontov, 'Resolution № 53 of the Plenum of SAC'.

[1295] See Res of SAC № 53; Zolotarev, 'Legitimate Tax Optimisation and Tax Avoidance'.

[1296] See eg GS Cooper, 'Analyzing Corporate Tax Evasion' (1994-1995) 50 Tax L Rev 33-152; A Watters and J Levy, 'Avoiding Evasion: Disclosure, Concealment and Fraud' (2003) 710 Tax J 10-12.

tax case, the key arguement used by the authorities was that registration and usage of the SPVs ("sham" companies) in different regions with tax breaks is turning tax avoidance into tax evasion.[1297] Nevertheless, the concept of "sham" entities used in the case has never before been applied in the context proposed by the prosecutors in Russia, and it is not generally in compliance with the position of the Supreme Arbitration Court, which was announced after the case was actually finished and the company went into liquidation.[1298] Also non- disclosure of affiliation in a situation, when the rules for such disclosure were unclear and were not complied with by other companies, could not itself mount to tax evasion, counting the fact that the company was subject to numerous audits that found no violations. The position of the U.S. court on Yukos' compliance with the concession rules should also be noted.[1299] All these factors, with the fact that anti-avoidance rules in western jurisdiction have developed gradually over a fifty-year period, brings to the agenda the question of the rule of law, selective treatment and political prosecution in the Yukos case.

Due to the political and economic conditions existing between 1995-2003, the Yukos Oil Company, like many other Russian production companies established a complicated corporate trading scheme, which, being based on transfer pricing sales and the usage of SPVs located in the regions with tax breaks, could be seen as specially designed for tax avoidance purpose. The scheme used the opportunities provided to Yukos by its corporate group structure and advanced technologies of corporate governance and international accounting.

Such tax optimisation schemes were implemented due to the numerous legislative loopholes and willful blindness of the Government. In a situation when political realities required the quick and effective liquidation of Yukos, the Government and courts used a number of established western judicial doctrines to ground tax claims against the Company, although application of such aggressive strategies were evidently selective and

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1297 *ECHR Russia's Mem (30 October 2006)* 10; Butrin and Skorobogat'ko, 'Yukos Is Pushed to Debtor's Prison'.

1298 Clateman, 'Yukos Part VI: Tax Claims Revisited' 10; Rodionov, *Tax Schemes That Lead Khodorkovsky to Prison* 58-68.

1299 See *Re Yukos Oil Co Sec Litig* 26.

politically motivated, which was confirmed by the subsequent clarifications of the high judicial instances.

The Yukos tax case raises again the problem of the Rule of Law in Russia, the state of which allows the new political elite to use the Russian judicial system to prosecute its political opponents and reach its economic goals. Tax cases are the most powerful instrument for ruining the business of those who do not want to dance to the Siloviki fiddle. The Yukos tax case has already become a benchmark case of state tax terror, so severe, that it had to be stopped personally by Putin. The subsequent judicial decisions, effectively changing the precedents established by the Yukos case, confirm the selectivity and the outrageous violation of the principles of the Rule of Law.

Chapter 5.

The Yukos Money Laundering Case.

5.1. Introduction.

The quintessence of the Yukos case is the money laundering case that was launched in February 2007 against Khodorkovsky and his allies.[1300] These charges are actually a new front in Russia's campaign against the nation's one-time richest man. The prosecutors said that Khodorkovsky and his friends had illegally acquired more than $25bn worth of oil from Yukos subsidiaries from 1998 to 2003, passing off crude as "well fluid"[1301] and then selling it on to consumers at prices three or four times higher. Several managers are also accused of laundering the proceeds.[1302]

The new proceedings can be seen as a sign that the state is keeping up pressure on Khodorkovsky after he was charged in October 2003 with fraud and tax evasion.[1303] Experts see that the money laundering and embezzlement charges give authorities a chance to portray the Yukos dismemberment as the Russian equivalent of the Enron case, rather than a state assault on a private firm.[1304]

[1300] MosNews, 'Khodorkovsky Charged with Money Laundering' (2007) 5 February Mosnews.com <http://www.mosnews.com/news/2007/02/05/khodorkovskycharged.shtml>accessed 29 April 2007.

[1301] See A Nikol'skii and I Reznik, 'Ukrali Vsyu Skvazhnuyu Zhidkost' [All Porous Liquid Is Stolen]' (2007) 12 February Vedomosti <http://www.vedomosti.ru/newspaper/ opinions.shtml? 2007/02/12/120533_2> accessed 20 July 2007.

[1302] C Belton, 'Khodorkovsky 'Laundered $23bn" (2007) 9 February FT.com <http://proquest.umi.com/ pqdweb?did=1213854061&sid=1&Fmt=3&clientId=44714&RQT=309&VName=PQD >accessed 18 July 2007.

[1303] The Moscow Times, 'Khodorkovsky Faces Laundering Charges' (2005) 17 January The Moscow Times.com 5 <http://www.themoscowtimes.com/stories/2005/01/17/045.html>accessed 18 July 2007.

[1304] C Schreck, 'Khodorkovsky Likely to Face Fresh Charges' (2006) 27 December ibid 1 <http://www.moscowtimes.ru/stories/2006/12/27/002.html>accessed 18 May 2007.

The significance of money laundering and embezzlement charges is in fact much broader than Khodorkovsky and his business partners being kept in jail for another ten of fifteen years.[1305] These charges give proper grounds for considering the whole Yukos corporate group as a complex "laundering" machine, generating tainted profit.[1306] A complex money laundering case launched against the top managers of the biggest Russian oil company, known for its adherence to advanced accounting and corporate standards, highlights the conflict between principles and rules which regulate corporate and business activities of corporate groups, and contemporary international anti-money laundering legislation.[1307]

The main goal of this chapter is to show a new dimension of international money laundering cases, stemming from the conflict of the activities of corporate (business) groups and contemporary anti- money laundering legislation, and also to demonstrate a nexus between tax avoidance and evasion schemes and money laundering, using the example of the Yukos embezzlement and money laundering case.

5.2. Literature Review.

There are only a few publications on the problem of money laundering in the Russian Federation as a phenomenon related to contemporary Russian capitalism. The majority of publications dealing with the money laundering problem in Russia either link this problem with the general problem of the Russian mafia worldwide,[1308] or simply mention several conventional facts such as the notorious Bank of New York scandal,[1309] which confirms

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[1305] See Amsterdam and Peroff, 'White Paper' 4-6.

[1306] A Karavaeva, 'Prokuratura Protiv Yukosa [Prosecutors against Yukos]' (2004) <http://www.scilla.ru/works/uprdem/yukos-ch.html>accessed 18 July 2007.

[1307] See comments in P Lebedev, 'Open Letter to Vedomosti Concerning Its Article on PwC ' (2007) <http://www.khodorkovsky.ru/speech/7013.html>accessed 9 July 2007.

[1308] See eg M Galeotti, *Mafiya: Organized Crime in Russia* (Special Report No 10 1996); J Bäckman, *Russian Organized Crime: Research Report Summaries 1996* (1997); LL Fituni, 'Russia: Organised Crime and Money Laundering ' (1998) 1 (4) JMLC 360-73.

[1309] See Economist, 'Crime without Punishment' (1999) (26 August) Economist.com <http://Economist.com/background/displaystory.cfm?story_id=234642>accessed 30 June 2007; PL Robinson

that corruption, money laundering and Russian oligarchy capitalism are synonyms in substance.[1310] It should be noted that due to the absence of any enforceable substantial anti-money laundering legislation until 2001,[1311] all the publications, either in Russian or other languages, were mostly of a socio-political character and described the money laundering problem as a socio-economic phenomenon.[1312]

The key publication on the relationship between Russian capitalism and money laundering is a report of the United Nations Office for Drug Control and Crime Prevention "Russian Capitalism and Money laundering", published in 2001.[1313] Although it is six years old, the general ideas expressed in the report are not outdated. The report highlights the basic principles of the money laundering fight in Russia, which will be in force for at least a couple of decades: "No accurate figures exist to indicate the overall level of money laundering in the Russian Federation because it involves activities which are hard to observe or detect."[1314] The report provides an explanation of the role of privatisation in the promotion of general lawlessness Russian Federation, by pointing out that privatisation as it evolved not only halted the trend towards fair, competitive and efficient markets, but also promoted inefficiency and wider acceptance of arbitrary rules. Privitization facilitated the capture of the Government at various levels by groups whose critical mission was to use the State to legalize their fraudulent acquisition of wealth and mask its origins.[1315] A key part of the report analyses the initial stage of the anti-money laundering fight in Russia and shows its perception by the population, which understands it as a powerful tool for redistribution of the property illegally obtained through privatisation tenders.[1316] The

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and ES Burger, 'The Regulatory Framework and Potential Implications of the Bank of New York Money-Laundering Scandal for Russia and the United States' (2007) Winter Russ Bus Watch <http://www.american.edu/traccc/resources/publications/burger01.html>accessed 21 July 2007.

[1310] See eg M Galeotti, 'The Mafiya and the New Russia' (1998) 44 (3) Aust J Polit 415-29.

[1311] For the statistical data see <http://www.kfm.ru/eng>.

[1312] See eg F Varese, 'Is Sicily the Future of Russia? Private Protection and the Rise of the Russian Mafia' (1994) 35 (2) Archives Européennes de Sociologie 224-58; SD Syfert, 'Captialism or Corruption - Corporate Structure, Western Investment and Commercial Crime in the Russian Federation' (1998-1999) 18 NYL Sch J Int'l & Comp L 357-406; A Cohen, 'Corruption, Western Economic Assistance, and the Future of the Russian Economy' (2000) 7 Brown J World Aff 157-66.

[1313] See United Nations, *Russian Capitalism and Money- Laundering* (United Nations Austria 2001).

[1314] ibid 1.

[1315] ibid 8.

[1316] ibid 18-22.

importance of the report lies in its attempt to explain the origin of the widespread money laundering problem in Russia, as stemming from social inequality, illegal redistribution of statutory property and illegal methods of governance.

There are two other comparatively recent publications important for this stage of the research. Both articles represent the somewhat limited number of international commentaries on the new Russian legislation. The first one is "New Russian Money Laundering Legislation" by Markus Schaer.[1317] It gives a brief overview of the new Russian legislation on money laundering and the situation with money laundering in Russia just before its enactment in 2002.[1318] The second article, "Breaking the Wash Cycle: New Money Laundering Laws in Russia" by Olga Sher, represents a much more comprehensive analysis, from political and criminological standpoints, of the situation which led to the adoptation of the new anti-money laundering laws in Russia.[1319] The article highlights a strange paradox: although Russia is definitely a complying country now,[1320] the money laundering legislation is being aggressively used as a regulator of the financial and economic system and is being used to suppress of opponents of the Government.

1317 See also O Mikhailova, 'New Russian Law on Combating Money Laundering' (2001) 16 (12) JIBL 302-04.

1318 M Schaer, 'New Russian Money Laundering Legislation' (2001) 29 Int'l Bus Law 369-73.

1319 O Sher, 'Breaking the Wash Cycle: New Money Laundering Laws in Russia' (2003) 22 NYL Sch J Int'l & Comp L 627-46.

1320 Financial Action Task Force, *Annual Report 2002-2003* (2003) 18<http://www.oecd.org/dataoecd/12/27/2789358.pdf>accessed 21 May 2008; HM Treasury, 'Statement on Equivalence' (2008) <http://www.hm-treasury.gov.uk/documents/financial_services/money/fin_crime_equivalence.cfm>accessed 24 May 2008.

5.3. The Money Laundering Legislation of the Russian Federation: a General Brief.

It is recognized that the period of transition from socialism to capitalism in the Russian Federation appeared to present limitless opportunities for international money laundering.[1321]

Money laundering in the Russian Federation is intertwined with the wide-ranging political, economic and social processes in the country. It has become one of the core characteristics of contemporary capitalism in the Russian Federation. [1322] It is accepted that, in Russia, it remains incredibly difficult to prosecute alleged criminals, due to the lack of appropriate legal frameworks to fight sophisticated financial crimes.[1323] However, the Yukos case demonstrates the opposing tendency, confirming that Russian anti-money laundering legislation is a valid legal instrument even for combating sophisticated, organised crimes.

The development of anti-money laundering legislation in Russia has come through a number of obstacles. For a while, the Russian Federation strongly opposed the idea of anti-money laundering legislation and President Yeltsin personally vetoed a project on anti-money laundering laws.[1324] Experts think that Russia's inability to detect and to prosecute money laundering activities was created intentionally, and permitted former members of the Soviet governmental apparatus to legitimize their embezzled funds.[1325]

In 1996, the Russian Federation enacted a new criminal code that criminalized money laundering.[1326] The Code was a product of both the need to address the changing social, political, and economic conditions of contemporary Russian society, and the need to

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[1321] United Nations, *Russian Capitalism and Money - Laundering* 1.

[1322] ibid 21.

[1323] ibid 7.

[1324] S Chung, 'Criminalizing Money Laundering as a Method and Means of Curbing Corruption, Organized Crime, and Capital Flight in Russia' (1999) 8 Pac Rim L & Pol'y J 617-50, 623-24.

[1325] ibid.

[1326] See Appendix 5.

confront the drastic increase in post-Soviet crime.[1327] Article 174 of the Russian Criminal Code, entitled "Legalization of Money (Money laundering) or of Any Other Assets Acquired Illegally," specifies punishment for financial transactions involving assets that have been acquired by illegal methods.[1328] Academics understand Article 174 only as a skeletal provision, purporting to criminalize money laundering activities. Stated in another way, "[the CC RF's] primary importance is as a theoretical normative statement... the new code announces the principles under which Russians one day hope to live."[1329]

On July 13, 2001, the Duma, proceeding with the fight against money laundering in Russia, passed an anti-money laundering bill.[1330] The law came into effect in February 2002 in parallel with a law that amended the Russian Criminal Code and other legislative acts.[1331] These laws actually established the general anti-money laundering framework in Russia.[1332] The core characteristics of this framework, pertaining to the definition of money laundering and key elements of offenders' liability, as follows:

[1327] See Burnham, 'The New Russian Criminal Code: A Window onto Democratic Russia'.

[1328] See CC RF art 174.

[1329] Chung, 'Criminalizing Money Laundering as a Method and Means of Curbing Corruption, Organized Crime, and Capital Flight in Russia' 629.

[1330] See the Law on ML. For comments see Financial Action Task Force, *Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures* (2000) 9<http://www.fatf-gafi.org/dataoecd/56/43/33921824.pdf>accessed 26 May 2007.

[1331] For practical implementation of the Law on ML were adopted the Amendments to CC RF.

[1332] The Act found its development in the decrees of the President, act of Government and regulations of the FIU. See O Zinmin and B Boltonskii, 'Sravnitel'no-Pravovoi Analiz Mezhdunarodnykh I Natsional'nykh Pravovykh Norm RF v Oblasti Bor'by S Legalizatsiei Dokhodov, Priobretennykh v Resul'tate Sovershenia Prestuplenii [A Comparative Analysis of the International and National Laws of the Russian Federation on the Fight with Laundering of Illegal Gains]' (2007) 4 Pravo i Ekonomika [Law and Business] 94-98.

5.4. Definition and General Provisions of the Substantive Law.

The current Russian legislation defines the offence of money laundering as:

> The legalization (laundering) of earnings received in an illegal way', means bringing a legal appearance to the possession, use or disposal of amounts of money or other property received as the result of committal of an offence[1333]
>
> Earnings received in an illegal way', means amounts of money or other property received as the result of committal of an offence.[1334]

The Criminal Code gives a definition of a substantive money laundering offence:

> The accomplishment of large-scale financial transactions and other deals in amounts of money, or other property, knowingly acquired by other persons in an illegal way (except the offences stipulated by Articles 193, 194, 198 and 199 of the existing Code),[1335] and bringing the appearance of legality to the possession, use and disposal of the said amounts of money or other property...[1336]

This definition is valid for both offences of money laundering, incorporated into the Russian Criminal Code: Article 174 (when the laundering operations are conducted by a person who has not been involved in the predicate offence) and Article 174.1 (when the laundering operations are conducted by the person who actually committed the predicate offence).[1337]

According to the Russian Criminal Code and the Law on Money Laundering, the offence of criminal money laundering does not require any negative consequences for any persons or for the economic system of the state in order to be considered as completed.[1338]

[1333] The Law on ML art 3.

[1334] ibid. Such definition generally corresponds to the international practice. See RE Bell, 'Abolishing the Concept Of "Predicate Offecnce"' (2002) 6 (2) JMLC 137-40.

[1335] Tax crimes exception. See Zinmin and Boltonskii, 'A Comparative Analysis of the International and the National Laws of the Russian Federation on the Fight with Laundering of Illegal Gains'.

[1336] CC RF art 174.

[1337] CC RF art 174 and 174.1. For the purpose of Article 174 CC RF an offender should not be, in any case, involved in commitment of the predicate offence. N Lopashenko, *Ekonomicheskie Prestupleniya [Economic Crimes (Author's Commentary)]* (Walters Kluwer, Moscow 2007) part on art 174.

[1338] See O Zinmin and D Grebnev, 'Problemnye Voprosy Kvalifikatsii Legalizatsii Denezhnykh Sredstv Ili Inogo Imuscestva, Priobretennogo Prestupnym Putem [Problematic Questions of Qualification of Money Laundering Offences]' (2007) 3 Rossiiskaya Yustitsiya [Russian Justice] 17 – 21.

One of the key problems in defining the responsibility of those involved in money laundering activities is defining the term "financial transactions and other deals". The law gives the general definition:

> Transactions in amounts of money or other property' as the actions of natural persons and legal entities involving amounts of money, or other property, irrespective or the form and method thereof, aimed at instituting, altering or terminating of civil rights and duties related thereto.[1339]

The Plenary Session of the Supreme Court has clarified that this term covers actions of persons aimed at instituting, altering or terminating the rights of such persons in respect of funds, securities and other assets.[1340] The same clarifications also say that even a single deal or act of disposition with the illegal funds would amount to money laundering.[1341]

The absence of the definition of the term "bringing a legal appearance", leaves a significant gap in the Russian anti-money laundering law and judicial practice. This has been only discussed at an academic level, and has already led to the confusion between acts of laundering (intentional acts of bringing a legal appearance to the illicit funds), and mere acts of selling stolen goods simply to obtain money.[1342]

5.4.1. Qualified (Grave) Money Laundering Offences.

It should be noted that the articles on money laundering offences contain provisions which qualify as grave offences, committed by a group of persons in a preliminary agreement; committed repeatedly by a person abusing his/her position, and as the most

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[1339] The Law on ML art 3.

[1340] Res of SC № 23. See also M Zhuravlev and E Zhuravleva, 'Otvetstvennost' Za Legalizatsiyu (Otmyvanie) Prestupnykh Dokhodov: Zakon I Sudebnaya Praktika [Sanctions for Money Laundering: The Law and Judicial Practice]' (2004) 3 Zhurnal Rossiiskogo Prava [Journal of Russian Law] 32-42.

[1341] ibid. Article 6 of the Law on ML contains a list of reportable transactions.

[1342] See eg M Lapunin, *Vtorichnaya Ugolovnaya Deyatel'nost' [Secondary Criminal Activity: Definition, Types, Issues of Qualification, Criminalization and Penalization]* (Walters Kluwer/Garant.RU, 2006) <www.garant.ru >accessed 20 July 2007; Zinmin and Grebnev, 'Problematic Questions of Qualification of Money Laundering Offences'. On the AML regime in Russia see also A Orlova, 'Russia's Anti-Money Laundering Regime: Law Enforcement Tool or Instrument of Domestic Control?' (2008) 11 (3) JMLC 210-33.

grave offence, acts of money laundering, committed by a organised group.[1343] In application to commercial organisations, two qualifying provisions are important: the abuse by a person of his/her position, which is conventionally applied to managers of companies,[1344] and the problem of organised groups and money laundering, which is not well researched, and thus creates problems in practical applications.

5.4.2. Predicate Offences.

The definition of laundering offences in the Russian Criminal Code remained rather broad since the notion of 'crime' under Russian law includes all criminal offences irrespective of their gravity.[1345] However, it reflects the international tendency to cover as many offences as possible with the definition "criminal activity".[1346] The previous definition did not make the offence dependant on the purpose of disguising the criminal origin of the money. However, the words 'through illegal means' were replaced by 'through criminal means', which meant that only criminal offences (offences defined by the Russian Criminal Code) may be regarded as giving origin to illicit funds.[1347]

5.4.3. Problem of Knowledge.

In application to money laundering offences, the Criminal Code contains the word 'knowingly', which also restricts the possible application of the articles 177-174.1.

[1343] See relevant CC RF art 174 and 174.1.

[1344] See Zhuravlev and Zhuravleva, 'Sanctions for Money Laundering: The Law and Judicial Practice'; Zinmin and Grebnev, 'Problematic Questions of Qualification of Money Laundering Offences'.

[1345] It further excluded offences defined by articles 193, 194, 198 and 199 of the CC RF, i.e. the failure to repatriate funds in accordance with exchange control regulations, avoidance of the payment of taxes and customs duties.

[1346] See Bell, 'Abolishing the Concept of "Predicate Offecnce"'; United Nation Office on Drug and Crime, *An Overview of the UN Conventions and the International Standards Concernig Anti-Money Laundering Legislation* (Global Programme Against Money Laundering 2004) 36-40.

[1347] Schaer, 'New Russian Money Laundering Legislation' 369-70.

Essentially, this means that the offence must have been committed intentionally, with negligence not being a sufficient excuse.[1348] The existing judicial clarifications provide that an offender must have actual knowledge of the illicit origin of funds and have an intention to commit an act of laundering.[1349] This clarification creates significant problems for investigation, as the clarification obliges any investigation to collect evidence confirming the fact that an offender not only suspected the illicit origin of funds, but had an actual knowledge about it, which definitely differs from the provisions. For example, UK legislation provides that an offender must simply suspect that property has been derived from criminal activities.[1350] However, in the case of money laundering in corporate groups or in a group of business allegedly controlled by a single criminal group, this useful provision of the Russian law will not help offenders.

5.4.4. General Reporting Requirements.

According to theoreticians, article 6 of the Law containing reporting provisions is comprehensive in nature and corresponds to the international standards. It covers almost all activities commonly associated with money laundering.[1351] As reporting is considered the weakest area in Russian money laundering legislation, most of the recent legislative efforts have concentrated on its improvement.[1352] In the context of this research it is important to note that the financial operations of Russian holding companies after 2001, were conducted

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[1348] Chung, 'Criminalizing Money Laundering as a Method and Means of Curbing Corruption, Organized Crime, and Capital Flight in Russia' 633.

[1349] The Res of SC № 23. See also Lopashenko, *Economic Crimes (Author's Commentary)* part on art 174.

[1350] Section 340(3) POCA. See also R Rhodes and S Palastrand, 'A Guide to Money Laundering Legislation' (2004) 8 (1) JMLC 9-18, 9-10.

[1351] ibid 634.

[1352] See KPMG, *KPMG's Global Anti-Money Laundering Survey 2007: Russia and the Commonwealth of Independent States* (2007); Zinmin and Boltonskii, 'A Comparative Analysis of the International and the National Laws of the Russian Federation on the Fight with Laundering of Illegal Gains'. On the legislative developments see <http://www.kfm.ru/law_ list_1.html?topic=6>.

after the enactment of the general reporting rules, so the authorized body should have been informed about any suspicious operations, had any of them taken place.[1353]

5.4.5. General Assessment and Political Realities.

In giving general assessment to the Russian anti-money laundering framework, practitioners have pointed out that the definition of the offence seems to meet minimum standards set by the Strasbourg Convention,[1354] and the recommendations of the OECD Financial Action Task Force on Money Laundering (FATF),[1355] and that Russia is moving towards a comprehensive anti-money laundering regime.[1356] The Russian legislation deviates from the international best standards in such aspects as: determination of the grounds for money laundering countermeasures and the substance of such measures; criminal sanctions for money laundering and application of confiscatory measures, including international cooperation; and special police measures.[1357]

However, as analysts have noted, in the Russian context, the question of defining the criminalization of money laundering has crystallized the moral issues at stake in implementing international recommendations in this field. The decision on whether or not to integrate forms of economic delinquency common within the Russian business community was liable to radically modify the objectives of anti-laundering and the definition of its targets.[1358] Favarel-Garrigues points out:

[1353] See The Federal Financial Monitoring Service, 'Novoe Kachestvo Rezul'tatov [The New Quality of Results]' (2006) <http://www.kfm.ru/press_20042006_767.html>accessed 20 July 2007; The Federal Financial Monitoring Service, 'Informatsionnoe Soobscenie [Press Statement]' (2007) <http://www.kfm.ru/news_22052007_277.html>accessed 20 July 2007.

[1354] Council of Europe, Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (8 November 1990) ETS No 141.

[1355] Schaer, 'New Russian Money Laundering Legislation' 370.

[1356] Sher, 'Breaking the Wash Cycle: New Money Laundering Laws in Russia' 646.

[1357] Zinmin and Boltonskii, 'A Comparative Analysis of the International and the National Laws of the Russian Federation on the Fight with Laundering of Illegal Gains'.

[1358] G Favarel-Garrigues, 'Domestic Reformulation of the Moral Issues at Stake in the Drive against Money Laundering: The Case of Russia' (2005) 57 (185) Int Soc Sci J 529-40, 537.

In analyzing the case of Russia, I wish to show that the implementation of international standards against money laundering does not necessarily imply a commitment to common values, or even to a common vision of the objectives of this campaign. The Russian example highlights, on the contrary, the latitude afforded to states to define the moral issues at stake in efforts to combat money laundering within their borders, in accordance with domestic concerns.[1359]

A number of factors support the hypothesis that the anti-laundering mechanism constitutes a valuable resource in the political management of the business community. Its instrumentalisation is wholly in line with government action based on the exploitation of the legal vulnerability of Russian economic and financial elites.[1360]

His assumption, that such a regulatory instrument as money laundering legislation could ultimately be used to crack down on certain personalities and, ultimately, be used to intimidate the business community by centralizing information on bank transactions and institutions,[1361] has been fully realised by the recent Russian criminal cases.[1362]

The message from this brief overview of contemporary Russian anti-money laundering legislation is that by the date of Mikhail Khodorkovsky's arrest and by the time the Yukos case commenced, the core provisions of Russian anti-money laundering legislation had already been enacted. The legislation had not been developed enough in several important aspects, but the main elements were in place and generally complied with the main international guidelines.[1363] The "backbone" provisions were in place and found the reflection in case law.[1364]

[1359] ibid 536.

[1360] ibid 538.

[1361] See ibid.

[1362] See Orlova, 'Russia's Anti-Money Laundering Regime: Law Enforcement Tool or Instrument of Domestic Control?', 225-26. See eg the Case of Bank Neftanoi - see Banki.RU, 'Linshits Accused of Money Laundering' (2006) <http://www.banki.ru/news/engnews/?ID=123940>accessed 23 April 2007; Lepina, 'Bank Neftyanoi Top-Managers Are Charged with Organised Crime'.

[1363] In October 2002, the FATF removed four countries, including Russia, from the NCCT list.

[1364] See the Res of SC № 23.

5.5. The Khodorkovsky/Yukos Embezzlement and Money Laundering Case: General Characteristics.

It is important to note that "The Yukos Embezzlement and Money Laundering Case" is based on the two main "pillars". The first is "organisational" (structural), morphing from "The First Khodorkovsky Case" and the accompanying cases, when Khodorkovsky and his allies were charged with the organisation and management of a network of shell companies, which were designed and used for corporate tax evasion and other crimes.[1365] The "organisational" element (creation of a special corporate structure for illicit purpose) was transmitted from the First Case to the Second Khodorkovsky/Yukos Embezzlement and Money Laundering Case, where the organisation and management of the shell companies' network comprises one of the fundamental episodes of organised embezzlement and money laundering.[1366]

The other "pillar" of the Second case is "financial" and deals with the trading operations, cash flow and taxation of Yukos as a corporate group. The claims of the Ministry of Tax and Levies, amounting to $ 27 bn., roughly match the sums, mentioned in the charges, brought in the Second case. Therefore, they are both evidently based on the assumption that the same funds were the object of tax avoidance and evasion operations and further laundering and legalization.[1367] Hence, the money laundering charges and corporate tax claims originate from the same source – the Yukos corporate group structure and company's operational tax optimisation scheme.

Figure 19 demonstrates the genesis of the Yukos embezzlement and money laundering case as stemming from the peculiarities of the Yukos corporate structure and its operational schemes.

[1365] See *Russian Federation v Khokorkovsky et al (Judgement)* 43-51. For comments see Saunders, Pappalardo and Logan, 'Analysis of the Criminal Charges'.

[1366] See *The Summary of the Chargers* and *Russian Federation v Khokorkovsky et al (Judgement)* 43-51.

[1367] See Yukos, *Incremental Tax Assessed on Yukos Vs. Yukos Financial Perfomance*; O Pleshanova, I Moiseev and N Grib, 'Pricewaterhousecoopers Blamed in Yukos Tax Affair' (2007) 21 March Kommersant Online <http://www.kommersant.com/p751697/Yukos,_PricewaterhouseCoopers,_taxes/>accessed 4 April 2007.

Figure 19. "Elements of the Yukos Embezzlement and Money Laundering Case."

One of the distinct characteristics of the Yukos/Khodorkovsky case is its intense publicity, unprecedented in Russia. The General Prosecutor's Office has itself published several important documents concerning "The First Case" including the Summary of the Judgement.[1368] When the investigation into "The Second Case" had been finished, the General Prosecutor's Office published the Summary of the Charges, brought against Khodorkovsky and Lebedev, on its official website.[1369]

The other important feature of the case is that the embezzlement and money laundering charges brought against Khodorkovsky and others in the Second Yukos case, showed the formation of a new concept in Russian criminal law – the "criminal corporate

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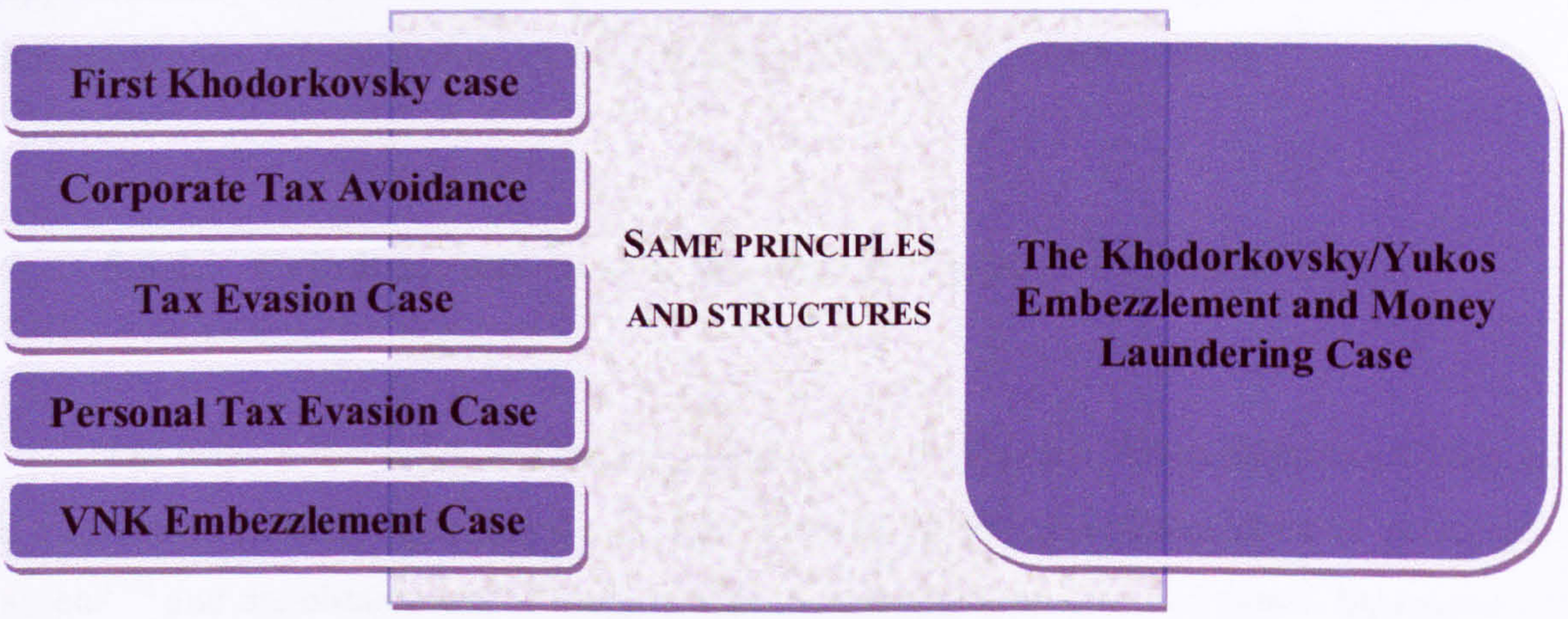
[1368] See *Bill of Indictment for Lebedev*; *Bill of Indictment for Khodorkovsky* ; General Prosecutors Office, 'One More Case against the Former Yukos Managment'.

[1369] See

Appendix 27.

group".[1370] This is a corporate group, created for the purposes of tax evasion and money laundering, managed by a group of individuals recognized as an organised criminal group.[1371] After bringing the charges against Khodorkovsky, the embezzlement and money laundering case became the "backbone" to the Yukos case, uniting other cases in a comprehensive and interrelated system.[1372]Figure 20 shows the interrelation between the Yukos–related cases as based on the same principles.

Figure 20. "Interrelation of the Yukos Cases."



The new charges against Khodorkovsky and his allies, completing the general picture of the Yukos case, highlight the distinct characteristics of the case.

[1370] See on the concept of "organised criminal group" section 2.3.2.2.

[1371] There is a similar tendency growing in the United States. See GE Lynch, 'Rico: The Crime of Being a Criminal Parts I and II' (1987) 87 Colum L Rev 661-764, 662.

[1372] See Amsterdam and Peroff, 'White Paper' 9-15; Gololobov, ' The Yukos' Five-Year Plan: A Deadlock Case'.

5.5.1. The Time Line.

The alleged organised criminal group headed by Khodorkovsky and his friend Lebedev (later – the head of the Menatep Group) was evidently formed as a group before 1994 when it was involved in the Apatit case. According to the Summary of the Charges, this organised criminal group had "also been engaged in criminal activities in the country's petroleum industry".[1373] Therefore the "Menatep-Rosprom-Yukos" group, due to its vast variety of interests (property, oil production, banking,) can be seen as a "diversified organised criminal group".[1374] Thus, the activities of the criminal group lasted from approximately 1993 until 2003 (probably even longer, as the management controlled by Khodorkovsky left the Company for London in October-November 2004).[1375]

5.5.2. Criminal Activities of the Group: General Characteristics.

The prosecutors represent the whole story of the Menatep-Yukos-Rosprom Group as a continuous process of criminal activities focused on the misappropriation of privatised assets[1376] and the obtainment of illegal profit from the misappropriated assets, by means of tax evasion and money laundering schemes.[1377] The investigation considers even formal actions undertaken in the course of business and corporate activity of the group as a part of the continuous criminal offence. For example, the corporate restructuring procedure which

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[1373] See *The Summary of the Charges*.

[1374] See --, 'The Criminal Analysis of the Actions Committed by the Yukos Group'; L Komisar, 'Criminal Complaint Filed against Khodorkovsky, Lebedev, and Golubovich in Switzerland' (2003) 28 November Russ J <http://thekomisarscoop.com/2006/08/21/criminal-complaint-filed-against-khodorkovsky-lebedev-and-golubovich-in-switzerland>accessed 20 May 2007; O Pleshanova, 'PwC Discovered a Group Crime' (2007) 26 June Kommersant Online <http://www.kommersant.ru/doc.html?docId=777939>accessed 26 June 2007.

[1375] AE Kramer, 'Yukos Managers Are Now Targets of Prosecutors' *N Y Times* (New York 17 August 2006) 9.

[1376] See *The Summary of the Charges*.

[1377] See --, 'Yukos Bosses to Face New Charges' *The Independent* (London 17 January 2007) 19; MosNews, 'Khodorkovsky Charged with Money Laundering'.

took place in 2000[1378] has been described in the Summary of the Charges as follows: 'In order to fulfill his criminal aspirations...and obtain the right to their strategic and operational direction, Khodorkovsky, together with the members of the organised group, created management companies controlled by them for OAO NK YUKOS...'[1379]

Even salaries and annual bonuses paid to the employees and managers have been announced as a form of bribery:

> Khodorkovsky and Lebedev bribed those shareholders who were not under their control and those members of the higher management who were likely to put up active resistance to their nefarious activities. The bribe took the form of the unlawful payment of a bonus from the bank accounts of foreign companies under the control of Khodorkovsky and Lebedev.[1380]

The assessment of the general activities of the Yukos Group as a continuous criminal offence is, according to the prosecutors, confirmed by the amount of funds allegedly laundered by the organised criminal group through Yukos.[1381] Therefore, according to the prosecutors, the Yukos corporate group were (a) created with a criminal goal; (b) on the basis of illegally privatised assets; (c) managed by criminals; (d) generate illicit funds.

5.5.3. Khodorkovsky's Position in the Corporate Group.

Khodorkovsky's position in the legal entities is named in the Summary of the Charges in one of the key aspects of the case. In the "First Khodorkovsky Case", his lawyers used the arguement that neither Khodorkovsky, nor Lebedev had controlled the corporate structure of the group of affiliated companies (the corporate group).[1382] The Summary does not name all the posts taken up by Khodorkovsky, but gives several

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[1378] M Khodorkovsky, 'The Third Alternative ' (2001) 3 YUKOS Rev 16-19, 16-19; Iji, 'Corporate Control and Governance Practices in Russia' 20-22.

[1379] *The Summary of the Charges*.

[1380] ibid.

[1381] See Yukos performance at M Khodorkovsky, 'Yukos' (2003) YUKOS Oil Company Web Site 1-26 <yukos.com/new_ir/pdf/April_03.pdf>accessed 10 June 2007; Yukos, 'Tax Slides Update'.

[1382] See Padva, 'Closing Arguements Given in the Meshchansky Court on April 6'.

examples of the control that Khodorkovsky and his allies exercised over the Corporate Group and the personnel.[1383]

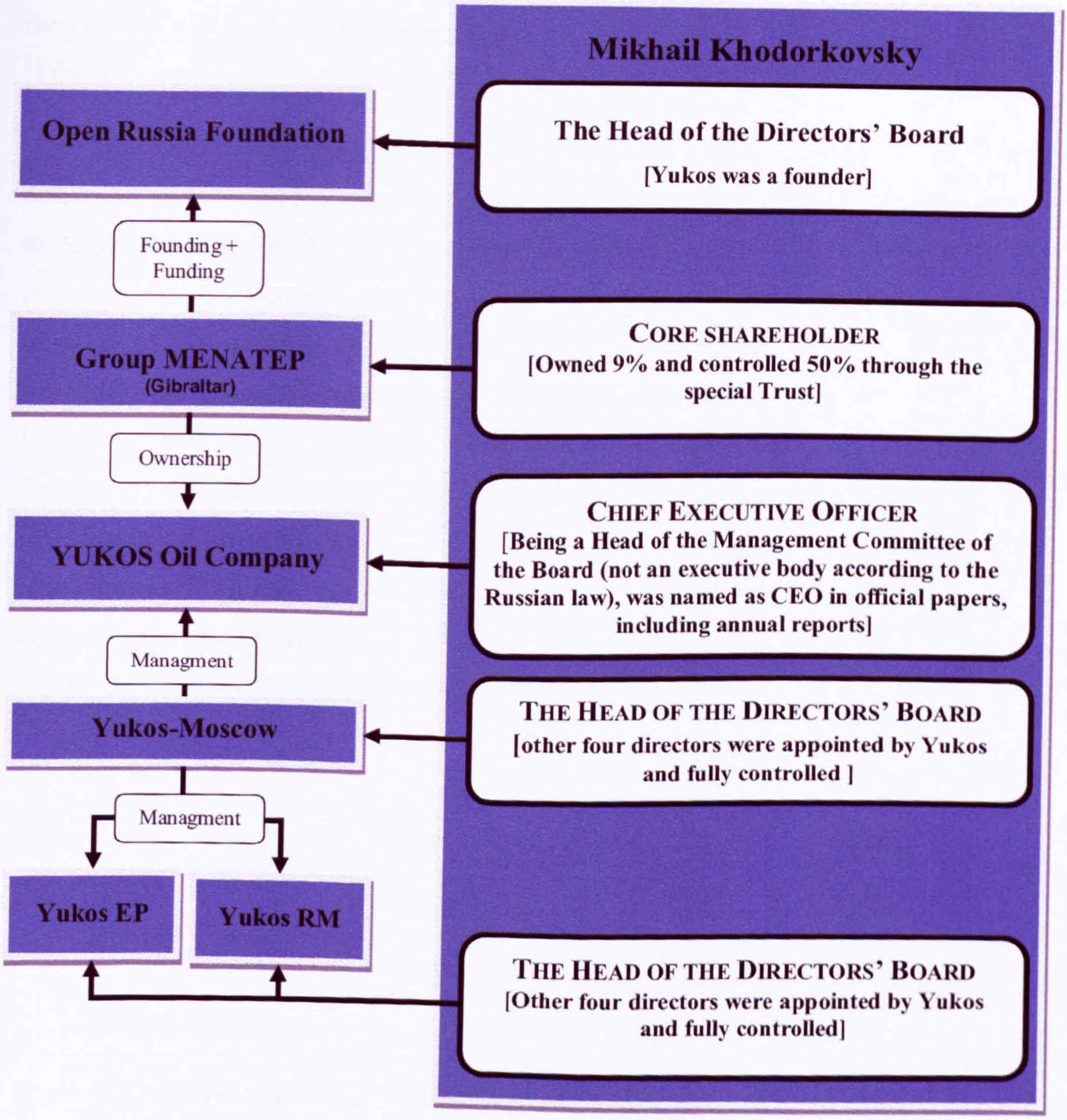
From the content of Figure 21 and Appendix 28 it becomes clear that the prosecutors have applied a concept similar to the UK concept of the "shadow director" [1384] or the U.S. concept of the "controlling person"[1385] to both Khodorkovsky and Lebedev. The diagram below shows that they have proper grounds to prove that Khodorkovsky had been the sole controlling individual, not only for the Yukos and Menatep Groups, but for the Open Russia Foundation as well. By emphasizing Khodorkovsky's controlling and managerial functions, the prosecutors want to show that all the cash flows, within the Yukos Corporate Group and outside it (dividends, paid to the Menatep Group; dividends paid by the Menatep Group to its shareholders and the funds distributed to the the Open Russia Foundation), were ultimately under control of the same person - Khodorkovsky- who understood their illicit origin perfectly. By introducing a concept similar to the "shadow director" or "controlling person", the prosecutors purport to demonstrate that Khodorkovsky and other members of the organised criminal group actions were intentionally aiming at the continuous laundering of "dirty" funds, and their accumulation abroad. Figure 21 represents all the offices held by Khodorkovsky in the Yukos Group and its related companies and foundations, which allowed him to be in control of operations, considered as embezzlement and money laundering.

[1383] See Appendix 28.

[1384] Shadow directors arise from a statutory concept created under the Companies Act (UK) in order to extend obligations of directors to persons who exercise the same kind of influence over the company as appointed directors would do. They are, in effect, not real directors and have no legal powers to act on the company's behalf. See S Plant and M Prior, 'Officers' and Directors' Liability in the Context of Insolvency' (2000) 28 Int'l Bus Law 303-12, 304. Shadow directors are persons in accordance with whose instructions the company's directors are accustomed to act; thus a shadow director might be a significant shareholder or creditor of the company. See CM Hague, 'Directors: De Jure, De Facto, or Shadow' (1998) 28 Hong Kong LJ 304-14, 307-08; C Bradley, 'Transatlantic Misunderstandings: Corporate Law and Societies' (1998-1999) 53 U Miami L Rev 269 -315, 294-94.

[1385] The American concept of "control-person liability" is much broader. Controlling shareholders of corporations in the United States may be subject to a duty of fair dealing similar to the duties imposed on directors and officers of the corporation, and breach of this duty will give rise to liability in the same way. Unlike the liability imposed on shadow directors in Britain, this liability will not arise only on insolvency of the corporation. See Bradley, 'Transatlantic Misunderstandings: Corporate Law and Societies' 293-94.

Figure 21. "Khodorkovsky's Positions in the Group and Outside."



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[1386] See Gololobov, 'The Yukos Money Laundering Case' 19.

Although Russian law doesn't directly recognize the concept of "shadow directorship" or the "controlling person" in the form as they are recognized by the UK and U.S. legislation and case law, Article 56 of the Civil Code and Article 3 of the Federal Law on Joint Stock Companies, provides that if a person is able to give orders to a company, they can be held liable for the damages incurred in a course of the company's bankruptcy, if the bankruptcy arose from such orders.[1387]

However, by describing Khodorkovsky's position inside and outside Yukos Group in detail and by stressing his actual managerial position, the investigation aimed to solve the threefold problem. Firstly, they tried to prove Khodorkovsky's actual position as a head manager and core owner of the Group before and after his formal resignation, for the purpose of the ongoing criminal investigation and the court hearing in Russia.[1388] Secondly, the prosecutors attempted to create proper grounds for the Yukos money laundering case in the light of current European anti-money laundering legislation, including confiscation, seizure and civil recovery provisions, which might help the investigators to seize the funds allegedly belonging to Menatep, Khodorkovsky and his allies abroad.[1389]Thirdly, the investigators wanted to create grounds for prospective civil actions against Khodorkovsky in the West and internationally, by additionally confirming his role as the ultimate controlling person in the Group.[1390]

[1387] See Civil Code, The Law on Joint Stock Companies.

[1388] See G Faulconbridge, 'Khodorkovsky Gives up Yukos' (2005) 13 January The Moscow Times.com 5 <http://www.themoscowtimes.com/stories/2005/01/13/041.html>accessed 20 July 2007; Presscenter, 'Custody Extended until October 2' (2007) <http://www.khodorkovsky.info/khodorkovsky_in_colony/135331.html>accessed 20 July 2007. For the legal implications see Res of SC № 51 pp 22-24.

[1389] See D Rebrov, 'Vremya, Rynok I Auktsion Vse Rasstavyat Po Mestam [Time, Market and Auctions Will Put Everything in Place]' (2007) 24 July Kommersant Online <http://www.kommersant.ru/doc.aspx?DocsID=789184>accessed 24 July 2007on the Yukos' funds abroad.

[1390] Amsterdam and Peroff, 'White Paper' 4.

5.6. The Core Episodes of the Khodorkovsky/Yukos Money Laundering Case.[1391]

The Summary of the Charges represents a "secondary" document, which only summarises the main points of the official charges in the form that the prosecution would like to represent them to the public.[1392] Yet the Khodorkovsky/Yukos case is extremely complicated from a legal perspective, spans over a ten-year history of several dozens of companies, and is interrelated with quite a number of other corporate, tax and criminal cases. For that reason the episodes covered in the money laundering case should be analysed in line with the corporate story of the Group and other related data. The Summary of the Charges focuses primarily on the most indicative parts of the alleged activities of the organised criminal group, omitting detailed discussion of several important points, such as the problem of a predicate offence in the case, which will be analysed in a separate paragraph.

5.6.1. The Creation of the On Shore Networks of Shell-Companies.

5.6.1.1. The First Stage

The arguements of the prosecutors generally reflect the findings of the Yukos tax case, especially on the "shell" companies' network, but have certain specifics concerning the characteristics of the "fraudulent scheme" due to the criminal character of the case.[1393]

[1391] *The Summary of Charges* also includes an episode on the illegal alienation of the subsidiaries shares belonging to VNK (see 2.13 " The "VNK" Case."). This episode does not concern the main Yukos operational schemes and does not represent the case that needs an in-depth analysis.

[1392] A full version of the official charges is available only for the defendants and their lawyers. See K Moskalenko, 'On the Case of M.B. Khodorkovsky' (2007) 8 February Robert Amsterdam Blog <http://www.robertamsterdam.com/MotionMoskalenkoGPO%20%23254619.pdf>accessed 20 July 2007.

[1393] The prosecutors see it not as a part of corporate tax optimisation strategy, but as a part of the plan of the organised criminal group.

They clearly see two stages in the development of the Yukos' shell-company network. The first stage, which lasted approximately from 1997 to 2000, is characterized by the use of shell companies[1394] registered in so-called "closed cities" or ZATOs: areas authorized to grant tax exemption to the companies producing something in their territory.[1395] The prosecutors use the following formula:

> Thus, between 1997 and 1998 in the closed community of ... [one of the ZATOs] the subordinates of Khodorkovsky... registered at their instigation the following commercial organisations:
>
> These organisations were essentially dummy legal entities, using the movement through them of petroleum, petroleum products, securities and cash as their raison d'être. On behalf of these dummy companies, which gave them the right of ownership of the extracted petroleum, Khodorkovsky, Lebedev and the other members of the organised group disposed of the petroleum as if it were their personal property.[1396]

Therefore, as clearly as the findings of the Yukos tax avoidance and evasion case, the Summary of the Charges demonstrates that the large-scale use of so-called "shell" or "dummy" companies was the key element of the alleged embezzlement, tax evasion and money laundering scheme created by Yukos.

It is important to note that before the Yukos case, the term "shell company" had had an extremely rare application in Russian criminal law.[1397] The definition of the "shell" or "front" company, given in the Judgement on Khodorkovsky case, is, actually, the first comprehensive definition that sets standards for Russian case law.[1398]

> The companies... had not actually possessed any functions or features of a legal entity, envisaged by articles 48 through 50 of the Civil Code of the Russian Federation, i.e.:

[1394] During this period the secretarial services to the Company were provided by Peter Bond and the holding and secretarial company Valmet Group Limited (Bermuda). See *The Summary of the Charges.*

[1395] The same as in the Yukos tax case.

[1396] *The Summary of the Charges.*

[1397] See I Degtyarev, 'Inostrannye Kholdingi Na Zascite Rossiiskikh Aktivov [Overseas Holding in the Guarding of Russian Assets]' (2005) 18 Ekonomika i Zhizn [Econ & Life].

[1398] It should be noted that the same position has been expressed in the Yukos-related tax cases. See *Interregional Tax Inspection N1 v Yukos [A40-61058/04-141-1510]; Reshenie Arbitrazhnogo Suda g Moskva po zayavleniyu Nalogovoi Inspektsii № 5 protiv Zakrytogo Aktsionernogo Obscestva Priceuoterkhauskupers [Decision of the Moscow Arbitration Court on the case Tax Inspection № 5 v ZAO 'PwC']* [N 40-77631/06-88-185] (The Arbitration Court of Moscow 20 March 2007)

- did not posses, manage or operate a separate property for processing, storage and sale of crude oil and oil products,
- were not able to achieve and exercise their rights of property on their own without the orders,
- were not able to perform their activity, the main objective of which was to receive profit, since their activity was unprofitable,
- meant for the purposes of evasion of taxes by the oil-production and oil-refining subsidiary enterprises of OAO 'NK 'YUKOS', engaged in sale of oil and oil products, and profit-making organisations affiliated to it.[1399]

Although the substance of the term "shell company", as it is understood by the Russian court, is close to that of international case law,[1400] the absence of any statutory or consistent judicial guidelines raises again the question of the application of the "Rule of Law" in the Russian Federation.[1401]

It should be noted that according to the Arbitration court decisions, the network of on-shore companies was created and used mainly for the purpose of tax evasion, as an illicit "profit-making" corporate activity.[1402] In parallel with obtaining illegal profit derived from the tax evasion operations, the network of "shell" companies was used for its "secondary purpose". This was the purpose of laundering illegal gains by putting the illicit funds in the corporate group internal "wash cycle", where allegedly the laundered funds were used many times for acquisition of crude, i.e. further avoidance and evasion operations.[1403]

This "dualistic" approach, based on the recognition of the illicit nature of the Yukos' offshore and onshore company network, has actually allowed the authorities "to kill two birds with one stone". The tax side of the story has lead to the liquidation of the company and forced sale of its assets; the money laundering aspect has led to new charges being brought against its owners and managers.

[1399] *Russian Federation v Khokorkovsky et al (Judgement)* 40.

[1400] AR Pavkov, 'Ghouls and Godsends - a Critique of Reverse Merger Policy' (2005-2006) 3 Berkeley Bus LJ 475-514, 501-03; D Gololobov and J Tanega, 'Sham Spes: Part 2' (2006) 17 (12) ICCLR 369-80, 378-80.

[1401] See Clateman, 'Yukos Part VI: Tax Claims Revisited'; Rodionov, 'A Look at Khodorkovsky and Lebedev's Taxes'.

[1402] See *Interregional Tax Inspection N1 v Yukos [A40-61058/04-141-1510].*

[1403] This scheme sets up a perfect example of nexus between money laundering and tax evasion.

5.6.1.2. The Second Stage.

The prosecutors point out that by 2001 Khodorkovsky, and the other members of the organised group, concentrated a huge amount of wealth in Russia and in foreign companies under their control. Because of the criminal nature of this accumulated capital and their intent to continue increasing that capital, the group of changed their system of misappropriating petroleum and laundering money. They organised a new system to move petroleum and products via companies, registered in the other regions that gave them tax breaks.[1404] For this purpose the executives of the companies, controlled by the organised group, drew up appropriate agency agreements, purchase and sale agreements, commissions and other documents needed for the purchase and sale between petroleum and products companies.[1405] The key principals of the system were, according to the prosecutors, "false" publicity gained through the scheme of forced changeability:

> With the aim of concealing the bogus nature of the said companies from the tax and other regulatory authorities, the plan worked out by Khodorkovsky and the other members of the organised group to misappropriate other people's wealth entrusted to them, made provision for the periodic renewal of the artificial systems of sales of petroleum and petroleum products, i.e. the regular replacement in these systems of just the dummy organisations – the petroleum traders – which were engaged in the resale of petroleum and petroleum products to other organisations, including newly founded ones.[1406]

The investigators insist that between 2001 and 2003 Khodorkovsky and the other members of the organised group misappropriated 202,214,394 tonnes of petroleum from the main Yukos production subsidiaries, with a total value of $ 27 bn.[1407]

[1404] Evenkia, Mordovia and some others. See Appendix 21.

[1405] *The Summary of the Charges.*

[1406] ibid.

[1407] ibid.

5.6.2. Using the Auditor's Opinion as a Shelter.

According to the prosecutors, while using the network of shell companies, Khodorkovsky and his allies, acting as managers of the corporate group, undertook several steps to conceal the illegal character of the operations:

> ....Khodorkovsky and the members of the organised group declared the balances of these dummy companies, which they nominally referred to as operational companies, side by side with the balances of their subsidiary petroleum-extracting and petroleum-processing plants when presenting their financial statements to the international auditors. By this deception they convinced everybody that the dummy companies were all within the sphere of influence of Yukos.[1408]

Prosecutors point out that, having received the false opinion from the auditors that no infringements had been involved in the sale of petroleum and products, the members of the organised group continued to use the major portion of the funds for their personal enrichment. Only a fraction was paid to the production companies engaged in petroleum extraction and processing, allowing the criminal scheme to run.[1409] However, the Summary of Charges contains no evidence that the funds, accumulated on the balance of the corporate group as a consolidated company, were used illegally or were in violation of the appropriate corporate procedures. The absence of any significant violations has been confirmed by the consolidated accounts audited by PwC since the beginning of 1997.[1410] Nevertheless, the charges are based on the assumption that the consolidated accounts of the Company are just a method of concealing the embezzled and laundered funds. That PwC's opinion was considered as a tool for such concealment was later confirmed by PwC itself when its Russian office withdrew the opinions.[1411]

[1408] ibid.

[1409] ibid.

[1410] See eg Yukos, *Consolidated Financial Statements, 31 December 2000* (2001); Yukos, *U.S. GAAP Consolidated Financial Statements 31 December 2002* (2003).

[1411] See C Belton, 'PwC Withdraws Yukos Audits' (2007) 24 June FT.com <http://www.msnbc.msn.com /id/19402423/print/1/displaymode/1098/>accessed 25 June 2007; GL White, 'Yukos Audits Withdrawn' (2007) 25 June Wall St J Online <http://online.wsj.com/article/SB118271730700546328.html?mod= rss_ whats_ news_europe>accessed 25 June 2007.

Significantly, the role of the international auditor (PwC) in the collapse of Yukos, and its alleged involvement in the Yukos schemes, had not been assessed in any way until the Russian Ministry of Tax and Levies, represented by one of its inspections (local agencies), filed an unprecedented application with the Moscow Arbitration Court, claiming PwC's actual knowledge, and its direct facilitation of, the Yukos fraudulent tax schemes.[1412] The Moscow court sided with accusations from Moscow city tax officials, who claimed that PwC had aided Yukos in perpetrating tax evasion by covering up the company's tax shelter schemes, and drawing up two different audit reports in over three years.[1413] Accordingly, the court found that the audit agreements between Yukos and PwC Audit for the years 2002-2004 were invalid because they constituted illegal and unethical deals according to the Civil Code of the Russian Federation. The court awarded the government 16.8 million rubles ($480,000) in restitution.[1414] PwC was also charged with "misleading Company shareholders", "wrongful acts resulting in substantial harm to society and the state" and providing a "knowingly false audit report".[1415] This case is the first and the only example of when a company such as PwC has been recognized as an accomplice and a facilitator of the Yukos schemes,[1416] although PwC had used the same formula to describe the tax risk for all its "big" clients in the Russian oil sector, which is clearly seen from Appendix 29.

However, PwC, due to assistance of its long-standing client Gazprom, finally started collaborating with the authorities and withdrew its opinions,[1417] issued for almost nine years, declaring significant non-disclosure and misrepresentations on the Yukos side.[1418] It did not represent a significant problem for PwC, as the legislation in the period of the "hot"

[1412] See E Judge and T Halpin, 'PwC Faces Court Action in Russia over Yukos Audits' (2006) 28 December Timesonline <http://business.timesonline.co.uk/tol/business/law/corporate/article1264576.ece?print=...> accessed 20 April 2007; Pleshanova, 'PwC Discovered a Group Crime'.

[1413] The court case revealed that the firm had compiled two sets of accounts — one for internal use and another for shareholders. *See Interregional Tax Inspection N1 v Yukos [A40-61058/04-141-1510].*

[1414] Pleshanova, Moiseev and Grib, 'PricewaterhouseCoopers Blamed in Yukos Tax Affair'.

[1415] Lebedev, 'Open Letter to Vedomosti Concerning Its Article on PwC '.

[1416] See Y Komarova, 'PwC Appeal Likely to Be Sustained at Top Level ' (2007) 28 April The Moscow News.com <http://english.mn.ru/english/issue.php?2007-14-20>accessed 29 April 2007.

[1417] T Adelaja, 'PwC Is Criticized for Pulling Yukos Audits' (2007) 26 June The Moscow Times.com <http://www.themoscowtimes.com/stories/2007/06/26/046.html>accessed 26 June 2007.

[1418] ZAO "PricewaterhouseCoopers", 'Otzyv Auditorskikh Zaklyuchenii [Letter of Withdrawal]' (2007) 26 June Kompromat.RU <http://www...ru/main/hodorkovskiy/ pwcotzyv2.htm>accessed 26 June 2007.

transition from 1995 to 2003 was quite vague and an auditor can always find serious omissions in client's representations.[1419] Now PwC has decided to play together with the prosecutors and its position based on the assumption of the Yukos' intentional misrepresentations will be aggressively used in pending trials, domestically and internationally.[1420]

The PwC story is far from at an end, as the notorious court's decision can be appealed up to the Supreme Arbitration Court, whose final ruling sets precedent on any occasion, and it will set the benchmark for auditors' liability in Russia.[1421]

5.6.3. The Creation of the Offshore Network of Shell (Dummy) Companies.

The Summary of Charges provides that, for the purpose of legalizing the misappropriated petroleum, Khodorkovsky acquired dummy ("shell") companies abroad. Through these dummy companies he created a network of foreign sales organisations for petroleum and products based on the following pattern: Yukos (or a dummy company registered in Russia in a preferential tax assessment zone) sold oil and products to a controlled foreign company registered in Switzerland, which resold them to a controlled foreign company registered offshore, which, in turn, resold them to an actual buyer at a petroleum-processing plant, in the form of a foreign company.[1422]

[1419] See eg Kommersant.com, 'Court Blasts PricewaterhouseCoopers' (2007) 2 April Kommersant Online <http://www.kommersant.com/p755086/PricewaterhouseCoopers_Audit_YUKOS/>accessed 5 April 2007; Pleshanova, 'PwC Discovered a Group Crime'.

[1420] See Presscenter, "'Now PwC Has Taken the Side of Oficials in the Yukos Trial'" (2006) <http://www.khodorkovsky.info/timeline/135412.html>accessed 12 July 2006; F Sterkin, 'PwC Pobedil v VAS [PWC Won in SAC]' (2007) 11 July Vedomosti <http://www.vedomosti.ru/newspaper/article .shtml?2007 /07/11/128995>accessed 12 July 2007.

[1421] See Komarova, 'PwC Appeal Likely to Be Sustained at Top Level'.

[1422] *The Summary of the Charges*, Komisar, 'Yukos Kingpin on Trial. Billionaite Mikhail Khodorkovsky Faces the Music in Moscow. Are the Charges Politically Motivated?'; M Teagarden, 'Yukos Defaults on Long-Term Contracts to Supply Oil' (2005) 20 January Bloomberg.com <http://www.energybulletin.net/ 4105.html>accessed 30 April 2007.

The objective of Khodorkovsky, Lebedev and the other members of the organised group, was to mislead the regulatory authorities and foreign businessmen by including in the network a foreign company, controlled by them and registered in Switzerland, which was enough to impart an image of reliability and trustworthiness to OAO NK YUKOS operations involving the export of petroleum and petroleum products.[1423]

In his defence statement Khodorkovsky replied:

> Any vertically integrated company, including the vertically integrated oil company Yukos, which was set up by presidential decree, combines the productive and financial activities of a number of enterprises that are inter-related, both technologically and in share-ownership.
>
> The accounting processes of all vertically integrated companies, including Yukos (treated as a single unit), take the form of consolidated accounts that enable one to see the various sources of income and expenditure, and the assets and liabilities of the company. (See, for example, accounts prepared by Gazprom, Rosneft, Gazpromneft and Yukos: Source, Federal Financial Markets Service.)[1424]

The fact that almost all major Russian companies used the same tax optimisation/operational schemes has never been a secret, and it has been addressed by several pieces of research that comment on Russian corporate governance problems.[1425] All Russian oil and gas corporations have off-shore company networks, which reside primarily in the same jurisdictions as Yukos.[1426]

It is only in the case of Yukos that the creation of several off-shore companies has been recognised as a constituent part of the criminal offence. The fact that information about the core off-shore companies, which were directly controlled by Yukos, had been publicly disclosed according to the regulations of the Federal Securities and Exchange Commission has not been given any consideration at all.[1427] Figure 22 describes the relationship of ownership and control in the Yukos offshore network before the attack on the Company.

[1423] *The Summary of the Charges.*

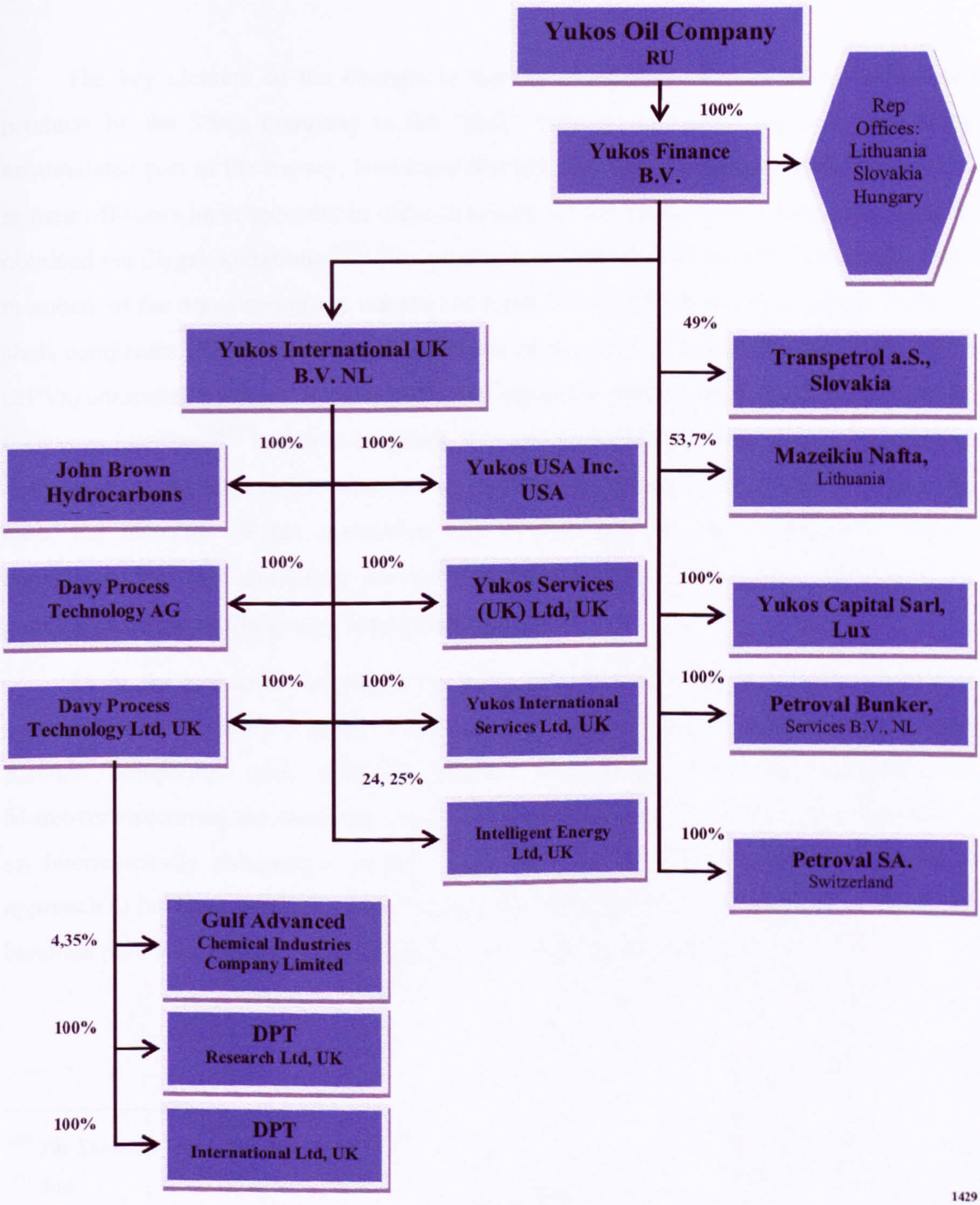
[1424] M Khodorkovsky, 'Statement by Mikhail Khodorkovsky' (2008) <http://www.khodorkovsky.info/khodorkovsky_in_colony/136452.html>accessed 1 July 2008.

[1425] See S Guriev and others, *Corporate Governance in Russian Industry* (NES-CEFIR-IET, Moscow 2003); Goriaev and Sonin, 'Is Political Risk Company - Specific? The Market Side of the Yukos Affair'.

[1426] See as an example the structure of Alfa Group at <http://www.alfagroup.ru/276/about.aspx>.

[1427] See <http://www.yukos.ru/files/10938/spisok_03_11_03.pdf>.

Figure 22. "Yukos' Offshore Network."[1428]



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[1428] Before the restructuring and collapse.

[1429] *Re Yukos Oil Company* Appeal Brief Par 1.11 Gispen's Decl No 06-B-10775 (RDD) (Bankr SDNY 26 May 2006) 6-7.

5.6.4. The Accumulation of Profit on the Foreign Accounts.

The key element of the charges is that by organising the sale of petroleum and products by the Swiss company to the "shell" offshore company, the organised group accumulated part of the money, laundered through the sale of misappropriated petroleum, in their off-shore bank accounts in order to reduce the tax burden on the Company's profits obtained via illegal operations.[1430] The prosecutors claim that Khodorkovsky and the other members of the organised group transferred funds from the bank accounts of the "trading" shell companies (SPVs) to the bank accounts of the other ("financial") shell companies (SPVs) controlled by them. Subsequently, the organised group manipulated these funds for their own interests.[1431] It should be noted, that although the Summary of the Charges says nothing about the tax evasion schemes as irrelevant in principle to the money laundering case, the elements of tax avoidance and evasion can be seen everywhere, which, considering the tax exemption provision in the CC RF, significantly undermines the genuine character of the money laundering charges.[1432]

As in the previous paragraphs on the problem of the Yukos' off-shore network, comments may be limited to the remark that it is quite evident that almost all leading Russian companies used offshore schemes and fund-accumulation techniques.[1433] Moreover structuring the corporate group cash flow through offshore treasury companies is an internationally recognized business practice.[1434] It is evident that the prosecutors' approach to business practice erodes the line between legal business operations and illegal business practices, putting political prosecution issues on the agenda.

[1430] *The Summary of the Charges.*

[1431] ibid.

[1432] Eg regarding shams companies registered in Russia in a zone of concessionary taxation.

[1433] Eg Sibneft schemes. See M Tul'skii, 'Pochemu Abramovich Perekachivaet Za Granitsu Po $1 Mlrd. v God [Why Roman Abramovich Is Transferring One Billion Dollars a Year Abroad]' (2004) <http://compromat.ru/main/abramovich/pokupki.htm>accessed 20 April 2007.

[1434] See G Green, 'Transfer Pricing Techniques for Group Treasury Companies' (2001) 12 Int'l Tax Rev 23-26, 23-26.

5.6.5. The Redistribution of the Illegal Profit through Shared Re-distribution and Dividends.

The final "masterstroke" of the prosecutors was the part of the Summary that stated that, Khodorkovsky had redistributed the share capital of the Menatep Group, under the guise of official dividend payments, amongst the several members of the organised group to conceal their "remuneration" for the crimes committed. The investigation claims that it *was done with the purpose* of making them partners and owners of shares in Yukos, and other companies on the accounts of *which the legalized funds* were kept.[1435]

Taken separately from other episodes, these allegations mean that any redistribution of shares in a holding company (a head company of a corporate group) could be taken as concealment of illegal operations inside the group.

5.6.6. The Laundering Operations: General Summary.

In the Summary of Charges, the prosecutors have separately enumerated several laundering operations, allegedly conducted by the members of the organised group through the corporate structure of the Company: (1) cancellation of the Menatep Bank's creditor indebtedness to foreign banks; (2) acquisition of Eurobonds, and; (3) the performance of various financial exchange operations.[1436] This was evidently done with the sole purpose of "illustrating" the wrongdoings of the criminal group. All the operations generally complied with the publicly known business activities of the Company and its core shareholder the Menatep Group. The bulk of these activities was disclosed in the audited, quarterly and annual, Company accounts.

In his statement on the problem of Yukos's financial operations, Khodorkovsky comments in the following way:

[1435] *The Summary of the Charges.*

[1436] See Appendix 30.

The consolidated profits of Yukos as a vertically integrated company are reflected in the consolidated accounts for 1998-2003, and are higher than average for the sector. These profits were spent on capital investment, the acquisition of assets, and the payment of dividends, in accordance with the decisions of the Yukos board of directors in 1999-2003.

The transactions described in the charge sheet as "legalisation" are single instances of a great number of ordinary transactions for the (temporary) placement of Yukos funds on the Russian and international financial markets by the company's finance department. The same term is applied to the rest of the company's usual financial and economic activities, which find reflection in the accounts of the individual legal entities and in Yukos's consolidated accounts (see relevant accounts).[1437]

The analysis of the Summary of the Charges provides surprising results. Excluding the Yukos tax avoidance and evasion case, which is legally not related to the embezzlement and money laundering case, the Summary of Charges does not name any corporate or operational activity of Yukos as a corporate group that would not generally comply with international business practice, and the practices of comparable Russian companies. The language of the Summary does not contain any corporate restructuring transactions or business operations that cannot be found in the accounts and reports of other Russian oil giants. This arguement is aggressively used by the defendants' lawyers for dissolving the case.[1438] Therefore the alleged illegality of the Yukos operational scheme, represented by the prosecutors as a money laundering cycle, is based on the violation of the arm's length principle in application to the acquisition of crude from the production's subsidiaries, allegedly qualifying to the predicate offence of embezzlement.

5.7. A Predicate Offence in the Khodorkovsky/Yukos Moncy Laundering Case.

For the "Second Khodorkovsky case/Yukos Money Laundering Case" the prosecutors have chosen a model of the predicate offence, unprecedented in the recent

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[1437] Khodorkovsky, 'Statement of 1 July 2008'.

[1438] See Khodorkovsky and Lebedev's Legal Team, 'Khodataistvo O Prekrascenii Dela [Motion to Dissolve the Case]' (2007) <http://www.khodorkovsky.ru/docs/7637__Hodatajstvo.pdf>accessed 22 December 2007.

history of Russian criminal justice. According to their innovative scheme, all acts of sale of crude from the Yukos' production companies to the SPVs ("dummy" or "shell" companies, also controlled by Yukos,) at a price which was evidently below the market price, should be deemed as a predicate offence for the further acts of laundering. Therefore, the prosecution says that transfer-pricing sales represent acts of embezzlement. As all operations have been conducted under the alleged control of Khodorkovsky and the other members of the organised criminal group, the following operations with oil and funds represent a continuous series of money laundering acts.[1439] The defence lawyers' labeled the prosecutors arguementations as "insane" and they emphasised the absence of the predicate offence in the case, and the absence of money laundering in the affair as a whole.[1440] It should be noted that the detailed analysis of the Yukos affair as a whole shows that, initially, the investigators aimed to use the fact that the production companies had actually overproduced oil, to create their "Yukos Money Laundering Case".[1441] The offence of over-production, according to Russian criminal case law, could qualify as illegal entrepreneurship, which can be deemed a predicate offence for the further money laundering operations.[1442] Figure 23 represents the scheme of the relationships between the companies inside the Yukos group. This scheme was deemed by the investigators to be embezzlement and money laundering.

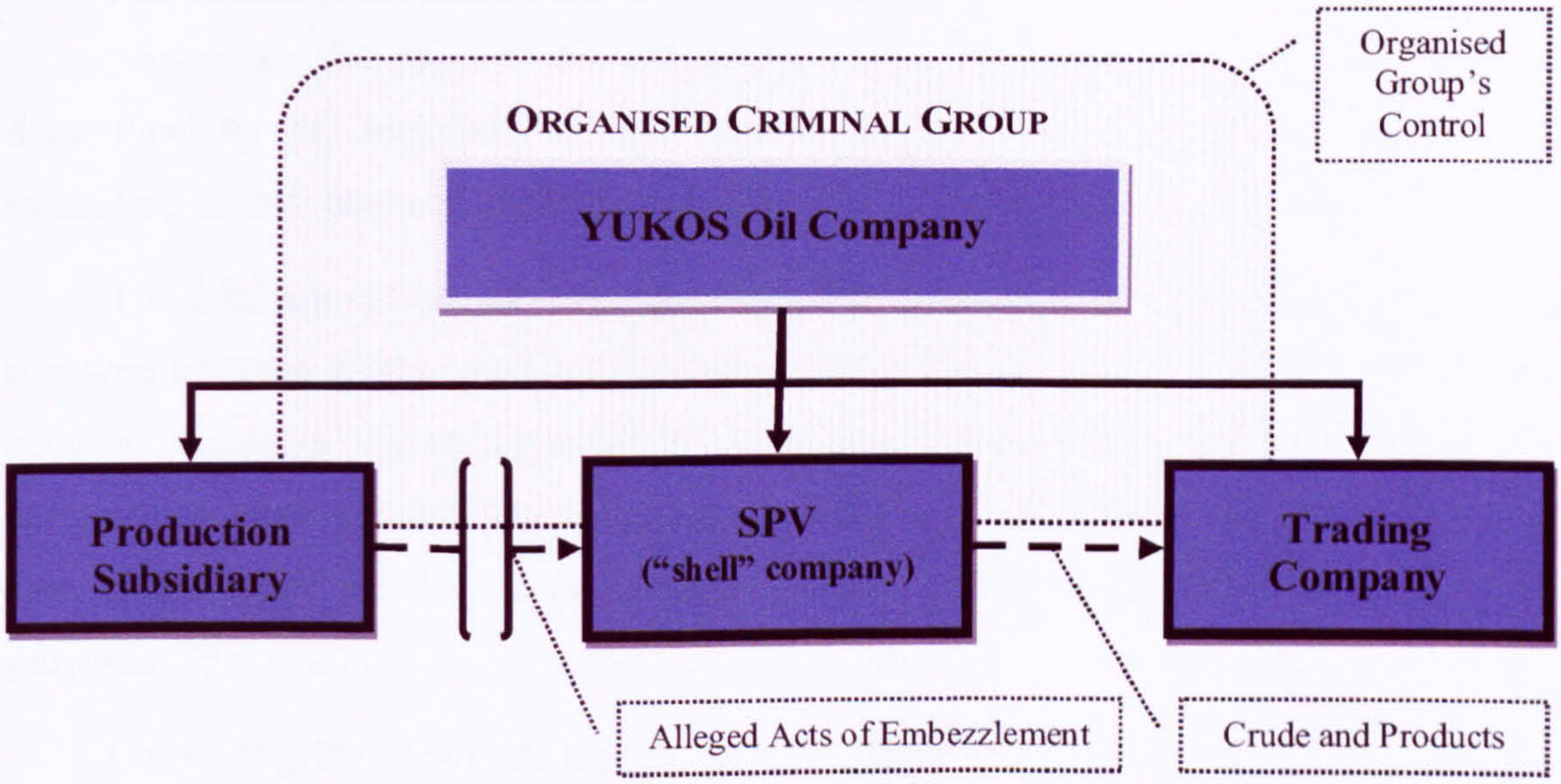
[1439] *The Summary of the Charges.*

[1440] Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 28-29.

[1441] E Naumova, 'Pavel Anisimov Taken to Court' (2005) 2 March Kommersant Online <http://www.kommersant.com/p551418/r_1/Pavel_Anisimov_Taken_to_Court/>accessed 20 July 2007; Mangileva, 'The Director of Samaraneftegas Sentenced Twice'.

[1442] CC RF art 171 and 174. See also Duyunov and others, *Commentaries on the Criminal Code of the Russian Federation* art 171, 174.

Figure 23. "The Principal Scheme of the Predicate Offence in the Yukos Case."



However, the investigators have declined this scheme, as acts of illegal entrepreneurship do not amount to a serious criminal offence in Russia, and the prosecutors have found them not completely suitable for such a significant criminal case.[1443] As Russian criminal law contains tax crime exception provisions in respect of money laundering offences, the Summary of the Charges does not mention tax evasion issues, describing the schemes used for the alleged corporate tax evasion as schemes designed and used for money laundering.[1444]

The arguement of the prosecutors, concerning the Yukos operational (and also tax avoidance and evasion) scheme, as analysed in the previous chapter, are based on several cornerstone assumptions.

Firstly, the sale and purchase agreement between Yukos-controlled entities were false, as they named Yukos as a purchaser, when it actually was not. The Summary of the Charges says:

[1443] CC RF art 171. See also Guev, *Commentaries on the Criminal Code of the Russian Federation for Entrepreneurs* art 171.

[1444] CC RF art 174.

> ...Khodorkovsky, Lebedev and their friends were perfectly well aware that Yukos Oil Company was not in fact a purchaser of petroleum, and that the products of the petroleum-extracting companies were shipped directly and independently to Russian and foreign customers.[1445]

Secondly, the price of oil and products was not a "fair market price" and was determined by the members of the organised group. It represented only the cost of extracting the raw material and was on average 2-4 times lower than the market price.[1446]

The third arguement was not expressly reflected in the Summary of the Charges, but it is seen from the Arbitration Court decisions on the Yukos tax claims and concerns public auctions, conducted by the Company's production subsidiaries for the oil produced. The actions have been declared sham, as concealing the true nature of the transaction, aimed at sale of the crude to the Yukos-controlled "sham" companies (SPVs) for tax evasion purposes.[1447]

Combining the above arguement with the arguements concerning Khodorkovsky's ultimate managerial position in the Yukos Corporate Group, the investigators concluded that the organised criminal group headed by Khodorkovsky had committed embezzlement of the Yukos' production subsidiaries' oil and funds.[1448]

The key element of this offence was the scheme where members of the organised group, through specially structured corporate mechanisms, coerced the production subsidiaries to sell crude below its fair market price, i.e. in violation of the arm's length principle.[1449] Violation of the existing transfer pricing rules, which resulted in the negative consequences in taxation of the Yukos Group, is only one of the implications of this offence.

The defendants' lawyers attack this arguement in general by pointing out that the notion of "fair market price" was hardly applicable in Russia in early 2000s because of the

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[1445] *The Summary of the Charges.*

[1446] ibid.

[1447] See *Interregional Tax Inspection N1 v Yukos [A40-61058/04-141-1510].*

[1448] The Moscow Times, 'Khodorkovsky Faces Laundering Charges'; MosNews, 'Khodorkovsky Charged with Money Laundering'.

[1449] See eg E Mangileva and E Naumova, 'Deputy Anisimov Doesn't Pass for Director' (2005) 15 March Kommersant Online <http://www.kommersant.com/p554494/r_1/Deputy_Anisimov_ Doesn_t_Pass_for_ Director>accessed 20 July 2007.

export restrictions and actual absence of internal market.[1450] They also stressed the Yukos subsidiaries' sale prices were fully comparable with the prices of other oil companies.[1451] However, previous experience shows that such "statistical" arguementations can be easily defeated by the opinions of the investigators' experts, which are welcomed by the court.[1452]

Transfer pricing in its conventional understanding, as it shown in the previous chapters, is "simply the process of setting prices between companies in the same group".[1453] It represents the realization of the arm's length principle in the tax law, particularly in taxation of related parties, including members of corporate groups. It is widely recognised, that the arm's length principle, as embodied in the model tax treaties and OECD Guidelines, is accepted throughout the world.[1454] This principle permits national tax authorities to adjust the accounts of enterprises under common control, if they consider that "conditions are made or imposed between the two enterprises in their commercial or financial relations, which differ from those which would be made between independent enterprises", in order to reallocate profit which would have accrued but for those conditions.[1455] By incorporating the separate entity concept, the arm's length principle places related and unrelated enterprises on an equal footing for tax purposes, avoiding the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity.[1456]

However, arm's length principle is multidimensional phenomenon, violation of which may have other consequences. These consequences depend on characteristics of a particular violation. For example, the Russian corporate law provides that a person, considered interested in a particular transaction must disclose its interest to the Company.

[1450] Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 27.

[1451] ibid.

[1452] See eg NovayaGazeta, 'Defence Attacks'.

[1453] D Hoi Ki Ho, 'International Transfer Pricing Regulation: Does East Meet West' (2007) 28 (7) Comp Law 212-23, 212.

[1454] R Ackerman and E Chorvat, 'Modern Financial Theory and Transfer Pricing' (2001-2002) 10 Geo Mason L Rev 637-74, 640.

[1455] Picciotto, 'Transfer Pricing and Corporate Regulation' 398; E Baistrocchi, 'The Transfer Pricing Problem: A Global Proposal for Simplification' (2005-2006) 59 Tax Law 941-80, 952-54.

[1456] See OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, Paris 1995) 1.7; OECD, *The OECD Guidelines for Multinational Enterprises: Policy Brief* (2001) 1-8.

If a person fails to do so, it will be responsible for damages incurred by a Company, including damages from sales below market price resulting from the violation of the arm's length principle. [1457] In the Yukos embezzlement and money laundering case, taking into consideration all the circumstances of the case (the fact that the subsidiaries sold crude under constraint, allegedly committed by members of the organised group through corporate mechanisms) violation of the arm's length principle takes a form of one of economic crime, namely embezzlement.

Embezzlement in Anglo-American jurisdictions[1458] is quite conventionally understood as fraudulent appropriation of property by a person to whom it has been entrusted.[1459] Historically, the U.S.A generally followed the English pattern.[1460]

Embezzlement is purely a statutory offence, and is punishable, as such, only as and to the extent that the legislature has by statute provided.[1461] By statute in most states, officers and agents of private corporations are made criminally liable for embezzling or fraudulently converting to their own use, money or property, to or in the possession of the company.[1462] The gravamen of embezzlement, as defined in the statutes, consists of the subsequent conversion of the property of an incorporated company, whose original possession by the accused was lawful, with a felonious intent on the part of the officer, agent, or employee so accused, to convert the same to the accused's own use.[1463]

In the U.S. the statutes and existing judicial practice in a case of embezzlement demand four factors to be proven in court:

1. There was a relationship of trust between the defendant and the victim.

[1457] See the Law on Joint Stock Companies art 81-84.

[1458] Analysis of the law in the EU countries shows basically the same understanding of the offence see eg N Stolowy, 'Company-Related Offences in French Legislation' (2007) January JBL 1-15, 2.

[1459] See DK Fantaye, 'Fighting Corruption and Embezzlement in Third World Countries' (2004) 68 J Crim L 170-76, 173; OG Obermaier and RG Morvillo, *White Collar Crime: Business and Regulatory Offences* (Law Journal Press, New York 2005) 2.34.1.

[1460] WR Lafave and JS Austin W, *Substantive Criminal Law* (West Group, New York 1986) 368-69; S Wilson, 'Law, Moralty and Regulation' (2006) 46 Brit J Criminology 1073-1099, 1082. Note that now in the UK embazzelment is not a separate crime and is punishable as one of the types of fraud. See Fraud Act 2006 s (4).

[1461] Lafave and Austin W, *Substantive Criminal Law* 368.

[1462] *House v United States* 78 F2d 296.

[1463] *People v Heilemann* 362 Ill 322, 199 NE 792.

2. This relationship must be proven to have resulted in the defendant's obtainment of the property or moneys in question.

3. Confirmation that the defendant unlawfully assumed rights to the property.

4. The appropriation must be proven intentional.[1464]

These requirements generally comply with Russian judicial practice.[1465] International practice also complies with Russian case law in that managers of companies, to whom company's funds and assets are entrusted, are recognised as abundant offenders in embezzlement.[1466]

Nevertheless, regardless of the legal, economic and political arguements, qualification of sales of crude and product below the fair market price as a form of embezzlement raises significant questions. Russian legislation and case law also consider as embezzlement, [1467] an act of personal misappropriation or transfer to a third person without any compensation, of the assets, which have been entrusted to the offender. The assets may also be under his control due to other legitimate reasons (agreement, order, etc.) and he could exercise the rights of possession, management or delivery in respect of these assets. The replacement of assets for less valuable ones shall also be considered as embezzlement.[1468] Therefore, according to the commentators, the *actus reus* in the offence of embezzlement according to the Russian legislation should involve the following characteristics:

(a) The offender has the legal and official control over the certain assets (he does not hold them illegally). This control may originate from an agreement, power of attorney or orders of the owner.

[1464] See JW Bartram, 'Pleading for Theft Consolidation in Virginia: Larceny, Embezzlement, False Pretenses and 19.2-284' (1999) 56 Wash & Lee L Rev 249-94, 271-80; Obermaier and Morvillo, *White Collar Crime: Business and Regulatory Offences* 2-36-2-46.

[1465] See Res of SC (USSR) № 4 and Res of SC № 51.

[1466] See eg Lopashenko, *Economic Crimes (Author's Commentary)* 49-50; Stolowy, 'Company-Related Offences in French Legislation' 2-10.

[1467] Embezzlement by means of the large-scale misappropriation. *The Summary of the Charges.*

[1468] See The Res of SC № 4 and and Res of SC № 51 para 19-20.

(b) The offender has a legal right to alienate the assets to himself or transfer assets to a third party.[1469]

This legislative and case law approach in application to Khodorkovsky/Yukos case raises two main questions in this respect.

The first is whether a chief executive officer or a "shadow director" of the managing company (head company of a corporate group) can be considered a person to whom the property of the corporate group in whole has been entrusted, in the meaning given to its definition by article 160 of the Russian Criminal Code and Russian Case Law.

Taking into consideration the particular language of the Charges, this question may be reformulated in the following way: Was the property of the Yukos production subsidiaries formally entrusted to Khodorkovsky and several other members of organised group, who took high managerial positions in the Yukos group? The critical point here is the absence of any criminal precedents on similar cases, and a lack of legal clarity in managerial and liability issues in Russian corporate groups.

The position of Khodorkovsky, as the overall head of the Yukos Group as an enterprise, and the key role that he played in the unified management of the corporate group, is critical to the assessment of the situation from the standpoint of Russian criminal law.[1470] The advocates, in their motion to dissolve the case, filed with the Investigatory Committee of GPO. They insist that the allegedly embezzled assets, including crude and products, were not entrusted to the Defendants and there is no actual evidence in the Case supporting the prosecutors' allegations.[1471]

However, it is likely that question of whether or not Khodorkovsky was formally entrusted with property of the Yukos production subsidiaries will get an affirmative answer.[1472] An examination of the language of the Summary of the Charges, which assume

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[1469] Res of SC № 51 para 19-24. See also Duyunov and others, *Commentaries on the Criminal Code of the Russian Federation* art 160.

[1470] See eg ibid.

[1471] Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 24-25.

[1472] That time he was sentenced for "embezzlement of other people's property entrusted to the guilty party in large scale" regarding the Apatit trading scheme. See *Russian Federation v Khokorkovsky et al (Judgement)* 14-19. However, later, the Moscow City Court stated in its cassation decision that "The apatit concentrate has not been entrusted to Khodorkovsky and Lebedev". See Lebedev's Legal Team, 'Supervision Appeal to the

the position of Khodorkovsky's actual control on the subsidiaries, the position of the commentators,[1473] and the judgements, brought in the "First Khodorkovsky case", where he was actually recognised as a head of a corporate group, only serve to support the case against him. The court decision on Khodorkovsky's position and responsibilities will set a precedent for other Russian corporate groups and may urge them to change their management structures.[1474]

The second question is whether transfer pricing transactions, conducted for the benefit of the parent company that fully owns its subsidiary, can be considered as damaging for the subsidiary?

Our analysis of the international legislation on corporate groups shows that the separate entity doctrine is conventionally unrestrictedly applicable to fully owned and controlled subsidiaries in corporate groups. However in Russian case law, the responsibility of the parent company for the damages caused to its fully owned subsidiary, as a member of a multi-level corporate group, is not clear.[1475] Nevertheless, Article 71 of the Law "On Joint Stock Companies" points out that an individual manager, or a managing company, owes same general fiduciary duties of loyalty and care to the company they manage [1476] as they do in UK and U.S. law.[1477] Article 6 of the Law also fixes the responsibility of the parent company whose instructions have led to the insolvency of its

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Presidium of the Moscow City Court' (2005) 26 December Lebedev pressceter <http://www.platonlebedev.ru/docs/default.asp?sid=2&mid=1478&open=1#doc>accessed 10 December 2007. This decision may create certain problems for the second case, but it is evident that this inconvenient precedent can be easily overruled.

[1473] VD Larichev and DV Kudryavtsev, 'Osobennosti Prestuplenii, Sovershaemykh Rukovoditelyami Bankov [The Characteristics of the Offences Committed by the Chief Bank Officers]' (2005) 2-3 Advokat [Advocat] 28 - 37 art 160; V Belik, 'Za Chto Finansovogo Direktora Mogut Privlech K Ugolovnoi Otvetstvennosti [CFO's Criminal Risks]' (2006) 7-8 Finansovyi Direktor [Fin Dir] <http://www.fd.ru/article/21264.html>accessed 5 May 2007.

[1474] See eg on managements risks in Russia Kommersant.com, 'Risks Less Manageable Than Prices' (2007) 21 December Kommersant Online <http://www.kommersant.com/p838658/r_528/ risk_management> accessed 22 December 2007.

[1475] Shitkina, *Holding Companies: Legal and Corporate Governance Issues* 328, 412.

[1476] The Law on Joint Stock Companies art 69-71.

[1477] E Makeeva, 'Pravovye Kollizii Vnutri Kholdinga [Legal Collisions inside Holding Companies]' (2005) 5 Konsul'tant [Consaltant]; A Molotnikov, *Otvetstvennost' v Aktsionernykh Obscestvakh [Accountability in Joint Stock Companies]* (Walters Kluwer, Moscow 2006).

subsidiary.[1478] The U.S. law would give a similar answer to this question by using "separate entity", "limited liability" and "piercing the veil" doctrines. [1479] The defence lawyers express the disapproval of the prosecutors' positions based on the assumption that the interests of Yukos' subsidiaries *were seriously damaged*, but do not provide any clear arguementation.[1480]

Concluding on the problem of the predicate offence in the Yukos money laundering case, it is important to stress that all Russian oil companies used different similar schemes, which varied in the level of prices, types of SPVs and other aspects.[1481] The new precedent, which is likely to be set in the new Khodorkovsky/Yukos case, is sure to create a new legal threat to all Russian production majors. This threat will exist at least for seven years, and could be used as a effective tool in a new wave of politically motivated redistribution of big property and industry in Russia.[1482]

The embezzlement charges clearly demonstrate that an unscrupulous political elite, who are looking for redistribution of large-scale property, [1483] can bend criminal law in any possible way, allowing for the effective suppression of the opponents. Any modifications to the substantive criminal law cannot change the situation significantly, as the problem arises when the law is selectively applied and selectively enforced.[1484] The analysis, conducted in this section, shows that even the state-owned concerns are likely to have problems, if the new Yukos case succeeds.[1485] However, this possibility does not prevent

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[1478] Shitkina, *Holding Companies: Legal and Corporate Governance Issues* 316-29.

[1479] See eg EM Dodd, 'Evolution of Limited Liability in American Industry: Massachusetts' (1947-1948) 1351 Harv L Rev 61-88; PI Blumberg, *Blumberg on Corporate Groups* (Second edn, Panel Publishers 2005) part 1-2.

[1480] See Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 27.

[1481] See eg Reuters and A France-Presse, 'TNK-BP Disputes Tax Claim' (2005) 13 April International Herald Tribune <http://www.iht.com/articles/2005/04/12/business/rusoil.php>accessed 9 May 2007; Mortished, 'BP Venture Pays $1bn in Back Taxes as Russia Gets Tougher'; A Medetsky, 'Tax Service Launches Russneft Suits' (2007) 14 June The Moscow Times. com 5 <http://www.themoscowtimes.com/stories/2007/06/14/041.html>accessed 17 June 2007.

[1482] See Gololobov, ' The Yukos' Five-Year Plan: A Deadlock Case'.

[1483] See eg Franchetti, 'Jailed Tycoon Mikhail Khodorkovsky 'Framed' by Key Putin Aide'.

[1484] See eg TNK-BP case R Hotten and A Blomfield, 'TNK-BP Strikes an Invisible Obstacle in Russia ' (2008) 25 May Telegraph.co.uk <http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/24/cnbp 124.xml>accessed 25 May 2008.

[1485] See Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

the new political elite from pushing new Yukos case to the trial, as they are sure that the weakness of the Rule of Law in Russia will allow them to avoid the application of the same rules to the companies that they control.[1486]

5.8. The Nexus between Money Laundering and Tax Evasion in the Khodorkovsky/Yukos Money Laundering Case.

The problem of the nexus between money laundering and tax evasion is one of extreme complexity. Money laundering is associated with all types of crimes - from tax evasion to kidnapping.[1487] The Anti-money Laundering Guidance for UK accountants says: "Tax related offences are not in a special category. The proceeds or monetary advantage arising from tax offences are treated no differently from the proceeds of theft, drug trafficking or other criminal conduct."[1488]

However, the opposite opinion also exists. The European Banking Association in its Report, augmenting its disagreement with creation of an offence of "fiscal" money laundering, pointed out that customer tax fraud does not create an identifiable asset to which the banker can apply the money laundering prevention measures. According to the banker's position, tax fraud consists in hiding legally obtained money, whereas money laundering consists of integrating money from illegal activities into the financial system. Accordingly, from a technical point of view, since tax fraud is the exact contrary of money laundering, it is not possible to fight these two offences with the same tools.[1489]

The Yukos embezzlement and money laundering case is a perfect example of a legal controversy that may rise in a jurisdiction where anti-money laundering legislation

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[1486] See eg Bremmer and Charap, 'The Siloviki in Putin's Russia: Who They Are and What They Want' 84.

[1487] See eg M Bridgers, 'The Nexus Between Tax Evasion and Money Laundering' in A Clark and P Burrell (eds), *A Practitioner's Guide to International Money Laundering Law and Regulation* (1st edn, City and Financial Publishing, Surrey 2002) 243-66, 250.

[1488] Consultative Committee of Accountancy Bodies, *Anti-Money Laundering (Proceeds of Crime and Terrorism) Second Interim Guidance for Accountants* (ICAEW, 2004) 489<http://www.icaew.com/index.cfm?route=143796>accessed 20 July 2007.

[1489] See Alldridge and Mumford, 'Tax Evasion and the Proceeds of Crime Act 2002' 371-73.

contains a tax exemption provision.[1490] The defence lawyers of several of the sentenced SPV managers argue that the verdicts of the criminal courts, brought on money laundering cases, [1491] interrelated with the Yukos embezzlement and money laundering case, directly contradict the decisions of the arbitration courts on the Yukos corporate tax case, and contradict decisions on tax evasion in the Yukos subsidiaries, and several other decisions.[1492]

This controversy concerns several rulings. The first is the ruling of the Supreme Court dated January 15, 2007 in the case of the former executive of Yukos subsidiary Samaraneftegaz, Pavel Anisimov, who was given 2.5 years on parole for tax evasion[1493]. The second is the decision of the Nefteyugansk regional court in 2006 concerning Yuganskneftegas manager Tagirzyan Gilmanov, who received a three-year parole term for aiding in tax evasion.[1494] It also concerns the decision delivered in March 2007 by the Moscow Arbitration Court on the case lodged by the federal tax service against the Yukos auditor - PricewaterhouseCoopers.[1495] These decisions are based on the same principle: Yukos was the owner of the oil produced by its subsidiaries, and its dealings with affiliated Yukos companies were aimed solely at tax evasion.[1496] However, in the sentence passed by Basmanny Court on the directors of the affiliated companies, which should be regarded as having a prejudicial character for the pending Khodorkovsky trial, it was clearly pointed out that they embezzled oil.[1497] According to this decision, the oil was not owned by

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[1490] See European Banking Federation, *Anti-Money Laundering Report 2005* (2005) 11, 57, 89<http://www.euractiv.com/29/images/FBE%202004%20Report%20Money%20launder_tcm29-141008.pdf>accessed 23 July 2007.

[1491] See BBC News, 'Moscow Court Imprisons Yukos Duo' (2007) 5 March BBC News <http://news.bbc.co.uk/1/hi/business/6419409.stm>accessed 20 May 2007.

[1492] See M Elder, 'Yukos Trial Postponed as Suspect Disappears' (2007) 17 January The Moscow Times. com <http://www.themoscowtimes.com/stories/2007/01/17/002.html>accessed 18 July 2007; Kommersant.com, 'Yukos Executive Goes to European Court'.

[1493] See Mangileva and Naumova, 'Deputy Anisimov Doesn't Pass for Director'; Naumova, 'Pavel Anisimov Taken to Court'.

[1494] See Cherkasova and Dorokhov, 'The Line of Sentences: The Yukos Cases Are Being Put on the Conveyor'; Rychkova and Lepina, 'The Prosecutor Doesn't Believe He's Innocent'.

[1495] See Belton, 'PwC Withdraws Yukos Audits'; Pleshanova, Moiseev and Grib, 'Pricewaterhousecoopers Blamed in Yukos Tax Affair'.

[1496] See also Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 28.

[1497] People's Daily, 'Yukos Officials Embezzled $13b' (2007) 2 March People's Daily Online <http://english.peopledaily.com.cn/200703/02/eng20070302_353657.html>accessed 2 March 2007.

Yukos, but by its subsidiaries.[1498] The defence lawyers commented: "If the oil was stolen by individuals, as the Basmanny court said, why did the arbitration court earlier force Yukos to pay taxes on its oil profits?"[1499]

The position of the lawyers on the uncertainties and ambiguities in the Yukos-related cases can be supported by the fact that none of the jurisdictions where the allegedly laundered Yukos' funds were transferred, invested or simply kept, have ever attempted to seize or arrest the funds in accordance with the international anti-money laundering treaties and domestic legislation, either in the context of tax evasion or the money laundering case.[1500]

Summarising the arguements of the defence, we can see the following controversies in the Yukos tax case and the Yukos embezzlement and money laundering case. Firstly, the tax case is based on the principal assumption that all the revenues of the corporate group should be apportioned to the Yukos Oil Company, which as the ultimate owner, should pay all the taxes, penalties and interest.[1501]

According to the lawyers, Yukos, as the ultimate owner, could not launder the funds belonging to it.[1502] Secondly, the embezzlement and money laundering case has different grounds: the organised group embezzled the crude and products from the production subsidiaries and laundered it through its network of "shell" companies. The laundered funds were partly dispersed inside the corporate group and were used as its own funds, part of which were paid as dividends to the alleged members of the organised group and effectively owned by them. The role of Yukos Oil Company in this case did not exceed the role of a mere SPV ("shell" company).[1503]

Recognizing the presence of the problem raised by the lawyers, we have to point out that formal apportionment of the corporate group's income to Yukos Oil Company

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[1498] Kommersant.com, 'Yukos Executive Goes to European Court'.

[1499] ibid.

[1500] See E Zapodinskaya, 'Basmanny Court Fabricates a Criminal Group' (2004) 24 March ibid <http://www.kommersant.com/p459847/r_1/Basmanny_Court_Fabricates_a_Criminal_Group/>accessed 20 July 2007.

[1501] See Ministry for Taxes and Levies, 'Yukos Resolution'; Yukos, 'Tax Slides Update'.

[1502] See also Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 28-29.

[1503] *The Summary of the Chargers.*

does not make it impossible that the operations of SPVs, and further operations with the funds, constitute money laundering. The Yukos tax case, which has already been decided by courts, is a corporate tax avoidance case with elements of tax evasion. So, following the logic of the Anglo-American doctrines, creatively applied in Russia, the courts ordered "recharacterization" of the transactions and income inside the corporate group, declaring several transactions sham, null and void. Nevertheless, declaring transactions null and void does not mean that they have not been used for the purpose of money laundering.[1504]

The defence's attempt to challenge the court's decision by using existing discrepancies and overlaps emphases the importance of understanding of the nexus between the Yukos tax and money laundering cases.[1505] For proper analysis of this problem the structural elements of the cases are represented in the Appendix 31.

The most important point, which is evident from the content of the table, is that in all the core Yukos-related cases (tax, money laundering), regardless to their legal substance, the same corporate structure has been used for an allegedly illegal purpose. However, from a legal standpoint, in the corporate case the Company used its own structure to avoid taxes for the benefit of the company; in the tax evasion case the top-managers of the Company used its structure (including submission of allegedly false information on the part of it) to evade taxes for the benefit of the Company again; in the embezzlement and money laundering case the "organised criminal group", several members of which were managers of the Company, used the corporate group in total as a tool to launder and legalize the embezzled funds, allegedly for the benefit of the members of the organised group.[1506]

It is obvious that all the offences are closely interrelated, as the tax avoidance and evasion operations amongst other shareholders benefited the core shareholders of the company, who were, allegedly the key members of the organised criminal group.[1507] Therefore, in all the criminal schemes the only instrument for the illegal operations was the

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[1504] See -- *Kommentarii K Grazhdanskomu Kodeksu RF [Commentaries to the Civil Code of the Russian Federation]* (Yurait-Izdat, Moscow 2005) art 169; M Mamaev, 'O Kvalifikatsii Nezakonnogo Obnalichivaniya Denezhnykh Sredstv [Qualification of Illegal Cash Operations]' (2006) 1 Zhurnal Rossiiskogo Prava [Journal of Russian Law] 44-52.

[1505] See eg Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 27.

[1506] See on the structure of the case Gololobov, 'The Yukos Money Laundering Case'.

[1507] See in general GS Cooper, 'The Return to Corporate Tax Evasion in the Presence of an Income Tax on Shareholders' (1996) 12 Akron Tax J 1-124, 20.

corporate structure of the group, including the SPVs. It should be noted that the sale operations with crude oil, violating the arm's length principle, were recognized as a key element of the tax avoidance and evasion allegations, and deemed a key element of the embezzlement and tax evasion case as acts of embezzlement.[1508] It is quite evident that the prosecutors used this scheme with the intention of creating a proper money laundering case, which would be impossible if they wanted to use tax evasion charges, because the tax crimes are exempt from the list of the potential predicate offences in the Russian Criminal Code.[1509] However, in this case, the Russian authorities aim to create a very dangerous precedent by effectively substituting a tax evasion offence for artificial money laundering schemes. Having been approved at the highest judicial level, such a scheme can be widely used for the criminal suppression of political opponents and illegal redistribution of property.[1510]

The Yukos case shows that, on the one hand, exemption of tax crimes from the list of *predicate* offences works for the benefit of potential offenders, as it protects them from ungrounded money laundering *investigations, if they* commit mere tax evasion. This is critically important for countries with transition economies that *do not have well established* anti tax avoidance and evasion legislation and the relevant case law. On the other hand, situations like Yukos' may easily encourage authorities to launch "artificial" money laundering cases, which would substitute tax evasion cases.[1511] Once established, such precedent would fix that any tax avoidance/evasion transactions used by a corporate group and based on transfer pricing sales could occasionally qualify as being a money laundering scheme. Any tax-free income recognized as derived from embezzlement and qualified as proceeds of crime, would make all the funds of the group "dirty". It creates unpredictable risks for corporate groups and their shareholders, which may only increase if the anti-money laundering legislation develops along the same lines.[1512]

[1508] See eg Clateman, 'Yukos Part VI: Tax Claims Revisited' 3-4.

[1509] See Amsterdam and Peroff, 'White Paper'.

[1510] See Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

[1511] Eg the case of Neftjanoi concern. See Banki.RU, 'Linshits Accused of Money Laundering'.

[1512] See Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

5.9. Conclusion.

The new embezzlement and money laundering charges, brought against Khodorkovsky and his allies in February 2007, have actually finalized the "white collar crime" side of the Yukos story.[1513]

One of the key aspects, closely related to the validity and international recognition of the embezzlement and money laundering charges, is the compliance of the contemporary Russian anti-money laundering legislation with the international principles and requirements, fixed in international treaties. The analysis, conducted in this chapter, demonstrates that, regardless of several officially recognized deviations and omissions, the Russian money laundering legislation generally complies with the international standards, especially in the sphere of substantive offences and their criminal prosecution.[1514] Moreover, the Russian anti-money laundering laws and regulations are being aggressively used by the existing political regime for suppression of its economic and political rivals. This has had the effect of turning anti-money laundering legislation into an effective macroeconomic instrument.[1515]

The charges, summarised in a brief official document, published on the General Prosecutor Office's web site, give a general impression of the principles of the new

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[1513] See MosNews, 'Khodorkovsky Charged with Money Laundering'; Presscenter, 'U.S. State Department Issues Comment on New Charges' (2007) <http://www.mbktrial.com/about/new_charges.cfm>accessed 10 March 2007.

[1514] See eg J Thomas, 'New Money-Laundering Report Gives Russia Good Marks' (2006) 1 March USINFO (The Washington File) <http://usinfo.state.gov/xarchives/display.html?p=washfile-english&y=2006&m=March&x=20060301120033 1CJsamohT0.9108393>accessed 1 March 2006; Zinmin and Boltonskii, 'A Comparative Analysis of the International and the National Laws of the Russian Federation on the Fight with Laundering of Illegal Gains'.

[1515] See eg E Zapodinskaya, 'Ot Basmannogo Do Lazurnogo [From Basmanny to Lazurnyi]' (2007) 31 July Kommersant Online <http://www.kommersant.ru/doc.aspx?DocsID=791282>accessed 12 October 2007.

case.[1516] The charges creatively use the findings of the previous Yukos and Khodorkovsky-related cases, representing them from the angle, convenient for the prosecution.[1517]

The new charges comprise the "backbone" case of the Yukos affair, to which all the other cases play a "secondary" and subordinated role, creating prejudicial precedent where they are needed.[1518] The embezzlement and money laundering case has crystallized the "pillar" principles, common to all other cases.[1519] It is also evident, that any other Yukos-related case, should any new one be launched, will have to be in a full compliance with those principles.

One of the basic principles of the case is the presentation and creative description of all the corporate and operational activities of the Yukos and Menatep Groups as a continuous process of preparatory and direct illegal activities, preplanned and controlled by the organised criminal group, headed by Khodorkovsky and his allies.[1520]

The second "pillar" principle is the emphasis of Khodorkovsky's control over the Yukos Oil Company, Menatep Group and other entities involved in the business and corporate schemes. The purpose of this emphasis is to demonstrate his actual knowledge and full control as head of the organised group over all the operations of the Yukos Oil Company and its partners.[1521] From the standpoint of the international anti-money laundering treaties and the Russian legislation, it enables the prosecutors to assume that Khodorkovsky and his friends, having actual knowledge about the illegal origin of the

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[1516] See *The Summary of the Charges.*

[1517] See R Amsterdam, 'Mikhail Khodorkovsky Will Never Have Justice in Russia' (2007) 14 March FT.com <http://www.ft.com/cms/s/b13dbd38-d1d0-11db-b921-000b5df10621.html>accessed 20 July 2007; Amsterdam and Peroff, 'White Paper'.

[1518] See Kommersant.com, 'Heads of Yukos's Subsidiary Suspected of Money Laundrying' (2006) 20 September Kommersant Online <http://www.kommersant.com/p706144/Heads_of_YUKOS's_Subsidiary_Suspected_of_..>accessed 25 March 2007; Kommersant.com, 'Yukos Executive Goes to European Court'.

[1519] See Gololobov, 'The Yukos Money Laundering Case'.

[1520] See eg Amsterdam and Peroff, 'White Paper'; Khodorkovsky and Lebedev's Legal Team, 'Motion to Dissolve the Case' 25-27.

[1521] See on the problem M Johns, 'Khodorkovsky Crimes' (2006) 49 Russ Life 5; Presscenter, 'Timeline of Events'.

corporate funds, arranged and controlled all the operations of the Yukos group, comprising a continuous "wash cycle".[1522]

In this situation, the only formal legal problem standing in front of the prosecution is the problem of the predicate offence in the Yukos case. The Russian criminal legislation contains a tax exception provision, which excludes all the tax crimes from the list of the potential predicate offences for the crime of money laundering. It put the prosecutors into the position where they had to "invent" a new type of predicate offence for corporate groups (vertically integrated holding companies). According to the Summary of the Charges, the predicate offence that actually generated the "dirty" funds was the continuous acts of sale of crude and product from the Yukos subsidiaries to the Yukos Oil Company or to the controlled SPVs below fair market price, i.e. in violation of the arm's length principle.[1523] Russian criminal legislation and case law contains several provisions that can be used for setting up such a precedent. However, promotion of this approach would lead either to creation of a new criminal "instrument", which would enable the authorities to bring charges of embezzlement and money laundering against management of any Russian corporate group that has used transfer pricing schemes, or would urge the authorities to demonstrate that application of this approach in the Yukos case is selective again.[1524]

The Yukos tax case and the Yukos embezzlement and money laundering case represent a perfect example of the nexus between money laundering and tax evasion in corporate groups. In the Yukos case, the violations of arm's length principle considered in the tax case as a violation of transfer pricing rules, was regarded as embezzlement in the money laundering story. This provided the starting point of the corporate group's transformation into a "washing machine".[1525] Effectively, the same off-shore and on-shore structures, comprising the corporate group were used with a threefold purpose: for day-to-day operational activities, for tax avoidance and evasion and for money laundering. This

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[1522] See Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

[1523] *The Summary of the Charges*. Gololobov, 'The Yukos Money Laundering Case'.

[1524] See Gololobov, 'The Yukos' Five-Year Plan: A Deadlock Case'.

[1525] See A Kramer, 'Criminal Case Likely to Put All of Yukos in State Hands' (2007) 6 February N Y Times <http://select.nytimes.com/gst/abstract.html?res=F10F12F8385B0C758CDDAB0894DF404482>accessed 18 July 2007; AE Kramer, 'Yukos Tax Case Coming Full Circle' (2007) 6 February Herald Tribune 1 <http://www.iht.com/articles/2007/02/06/business/yukos.php>accessed 30 April 2007.

phenomenon demonstrates, that in the current situation, when the international anti-money laundering legislator framework is extremely tight, corporate groups, functioning especially in transition economies, and those involved in illegal or semi-legal tax optimisations schemes, can easily become dirty money generators.[1526]

Multinational business groups from countries with transition economic systems aim to conquer the international securities markets, showing an unprecedented level of production and capitalization growth. The majority of such corporations, acting primarily in the oil, gas and metal sector, demonstrate a high level of compliance with advanced international corporate governance, accounting and other standards, retaining the best consultants, lawyers and auditors available on the market, who assist the companies' shares with their transformation into "blue chips". [1527] However, the Yukos case shows the general vulnerability of such compliance. This case puts on the international agenda the question of whether or not advanced international corporate standards, even when meticulously applied by companies from the countries with transition economies, can protect international investors from unexpected scandals and losses. It also raises the question of what role anti-money laundering legislation may play in the promotion of such scandals.

In the context of the Yukos case, the role of the gatekeepers, specifically international auditors, should be highlighted. The situation with PwC, one of the "big four", and the most experienced in Russian matters, shows that even nine year long audit guarantees nothing to the shareholders, and can be easily withdrawn for the benefit of the host state.[1528]

Ultimately, the Yukos case has unveiled the potential dangers of money laundering legislation in the hands of transition economy governments with and weak democratic traditions. Even if the anti-money laundering laws of the country comply with international pronouncements to the letter, there are still a number of ways to use them. They can

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[1526] See eg Banki.RU, 'Linshits Accused of Money Laundering'.

[1527] Ostrovsky, 'Russia's IPO Rush'; PricewaterhouseCoopers, *IPO Watch Europe: Review of the Year 2006* (IPO Watch Europe 2007).

[1528] See eg Adelaja, 'PwC Is Criticized for Pulling Yukos Audits'; M Elder, 'Echoes of Yukos Surround PwC Case' (2007) 11 July The Moscow Times.com <http://www.themoscowtimes.com/stories/2007/07/10/002.html>accessed 11 July 2007.

effectively be used with the purpose of pressing political opponents or redistributing of property. Therefore, the problem of the Yukos Embezzlement and Money Laundering Case stems mostly from the general problem with application of the principles of the Rule of Law in Russia. The Yukos Embezzlement and Money Laundering Case was launched with the main purpose of keeping Khodorkovsky in jail for at least another decade[1529] and in the course of the investigation many "tricks" were played, including the attack on PwC and the numerous extensions of investigation, which hardly complied with the principles of the Rule of Law.[1530] The Yukos Embezzlement and Money Laundering Case, even within the limits of the general Yukos case, exemplify selectivity of prosecution and instrumental use of the judicial system.

In the Yukos case, money laundering charges were interrelated with the charges of corporate tax evasion, which taken separately in Russia, represent a rather weak tool for suppressing the political opponents, but are perfect for the confiscation of assets. This allowed the investigators to represent the activities of a giant corporate group as a process of committing an organised criminal offence, lasting for more than seven years.

[1529] See M Franchetti, 'Oligarch Could Face Another 27 Years in Jail' (2007) 20 May Times online <http://www.timesonline.co.uk/tol/news/world/europe/article1810190.ece>accessed 22 May 2007.

[1530] *See eg* Amsterdam and Peroff, 'White Paper' 9-15.

Chapter 6.

Conclusion.

Since 2003, the events unfolding around Yukos have made headlines in the Russian and international press. These events taken altogether are now conventionally referred to as "the Yukos Affair" or "the Yukos case", both internationally and in Russia.

The Yukos Affair should be understood as a complex multidimensional case, which has had a significant impact on the Russian political, economic and legal landscape. Its commencement clearly flagged the end of the "oligarchy" period of the Post-Soviet Russian state and the beginning of the "Neo-KGB" state under Putin and silovarchs control. The Russian state ceased to be public and began morphing into a "corporate" state, being managed as a huge corporate conglomerate.

The Yukos case represents a web of civil and criminal cases launched and investigated against entities *comprising the Yukos* business group and their former employees, managers and shareholders. The Yukos case cannot be *understood separately* from the personality of Mikhail Khodorkovsky, the founder of Menatep Group and the former CEO and the core shareholder of Yukos. His tragic destiny has already become an example of a disastrous conflict between a man and a non-democratic transitional state, unseen since Stalinist times. The Yukos case started in 2003 and it is difficult to forecast when it will end.

The Yukos case is inseparably interrelated with recent Russian history and the privatisation of state industries is its constituent part. Perestroika, announced by Gorbachev, flagged the end of the Soviet Era, creating at the same time numerous new business opportunities for the young, the talented and the unscrupulous. Khodorkovsky and his friends were just one out of many groups of young entrepreneurs who started their business under the aegis of the withering Komsomol, which was looking for options for the investment of its funds in the new economic conditions. Several years later, having accumulated some capital and having made several useful friends, they began a banking

business that was regarded as the most profitable in the early 1990s in Russia. Their Bank Menatep quickly became the first investment bank in Russia and, like a handful of other successful banks, started creating its own business group.

Menatep, under Khodorkovsky's leadership, managed to become a member of an extremely close group of the emerging Russian financial institutions, headed by those multitalented and shrewd people who later received the name "oligarchs", and Menatep greatly benefited from large-scale privatisation. These entrepreneurs, internationally known as "the Group of Seven", persuaded President Yeltsin to give them the opportunity to buy the cream of Russian industry on conditions dictated exclusively by them in exchange for funding his misfortunate election campaign. The large-scale privatisation, a gigantic redistribution of former Soviet property, initiated by the oligarchs is still considered "the grab of the century". It gave rise to a number of tremendous fortunes, but also to an even greater number of bankruptcies, crises and notorious large-scale scandals.

Menatep played an aggressive role at all the stages of privatisation, forming, as a result, an industrial-business group Rosprom. Rosprom group controlled several major industrial companies, such as Apatit, Avisma, Rosprod and other. The most successful Menatep-Rosprom deal was the acquisition of Yukos Oil Company, one of the biggest Russian Oil producers, which was going through a general decline of exploration and production operations at the time.

Under Khodorkovsky's management and with Menatep's backing Yukos quickly overcame the post-privatisation problems and conducted corporate restructuring, turning it into a modern oil company. The policy of corporate transparency and adherence to the high corporate governance standards made Yukos a leader in the Russian blue-chip market. Through vast utilisation of modern production technologies, the company became a leading oil producer in Russia. At the pinnacle of its development it had the following corporate and legal characteristics:

- The management was centralized at the level of the head managing company of the corporate group – Yukos Moscow. Most of the corporate services, including legal, PR and GR were united at the level of the head managing company.

• All the main decisions concerning the group's business strategies were considered by the Yukos Oil Company's Board of Directors, which functioned as the board of a corporate group as a whole.

• The shares of the main subsidiaries were owned by the Yukos Oil Company, which was a publicly held joint stock company, listed in Russia and in the U.S.

• The company did not have any "external" shareholders in its main subsidiaries. So, the internal governance procedures were also significantly simplified.

• The company had a united financial and accounting policy, planning, tax management and disclosure procedure.

• The company prepared its consolidated accounts, audited by an independent auditor as consolidated corporate group accounts.

• The brand "Yukos" was used by the entire corporate group.

• The company had a consolidated system of trademarks and unified corporate regulations and procedures.

• The company communicated as a united corporate group with the third parties.

One of the distinct characteristics of the Yukos group, like the rest of the Russian major production companies, was aggressive use of tax optimisation schemes, based on transfer pricing and SPVs registered in the "internal off-shore zones". These schemes allowed the company to compete successfully with other oil majors and demonstrate outstanding financial results, making it extremely attractive for domestic and international investors. The company took all the necessary measures to incorporate its tax optimisation schemes in its cash flow and operational structure. It was done in such a way that Yukos would represent benefits from tax optimisation as resulting from its general production and financial performance. These outstanding financial results were then reflected in the Yukos accounts, audited by PwC, and thus played an important role in the promotion of Yukos as the most successful company in Russia. Therefore, one of Khodorkovsky's key achievements was the combination of questionable Russian tax optimisation strategies and western corporate governance and accounting standards. This "package" was successfully 'sold' to trusting international investors.

After Yeltsin's resignation and Putin's rise, Khodorkovsky and some of the Yukos core shareholders, recognising the inseparable ties between politics, state power and big business in Russia, made a series of political actions including the creation of several charitable public foundations. These were declaratively aimed at promotion of democratic values and children's education and the sponsorship of several political parties and political contacts with the West. All these politically provocative steps were also supplemented by aggressive lobbing in the Duma, and an attempt to merge Yukos with an international oil giant. The rising Siloviki group, headed by the President's personal friend Igor Sechin, succeeded in representing these controversial strategies to the President as an attempt at an organised power grab. The reaction was prompt and fierce. Acting upon the Kremlin's commands, the General Prosecutor Office launched a number of criminal investigations against the employees and managers of the Company. Khodorkovsky, his friend Platon Lebedev and a number of other managers were detained and the rest of the key managers left Russia. In parallel, the Ministry of Tax and Levies started a series of extraordinary audits that led to the imposition of tremendous back-taxes and fines on the Yukos Group. As a result, initially the Government arranged for a forceful sale of the key production unit of the company and a year later, acting together with a consortium of Western banks, commenced a bankruptcy procedure. This finally led to the company's liquidation. Yukos assets were sold off in a series of public tenders and the bulk of these assets was successfully acquired by the Russian state oil giant Rosneft. Due to these acquisitions, Rosneft became powerful enough to compete with the world oil majors and it represents one of the main pillars of the Russia's super-power energy state.

Regardless to the collapse of Yukos, the Yukos case still continues. In February 2007 new money laundering charges were brought against Khodorkovsky and his allies that resulted in yet another chapter of the case. The investigation has not been completed, but even in its elementary stage it is evident that it will set new standards for white collar crime and money laundering concepts in Russia and probably, internationally. It is also certain to have implications for the concept of transitional justice as well. The impact of the Yukos case on the international perception of the transitional risks in general, and Russian risks in particular, is significant as it has demonstrated that the conventional

strategies of investor protection such as: transparency, corporate governance and disclosure, may not work as expected in transitional economies.

One of the key problems arising from the Yukos case is the absence of recognition of the concept of the corporate group by Russian authorities and investigators, although large business conglomerates of financial-industrial groups are actually the main players in the Russian industry. The prosecutors have persistently been trying to show that the Yukos Oil Company is nothing more but an organised criminal group, which controlled numerous companies, used exclusively for illicit purpose. This raises the question whether the Yukos Oil Company complied in principle with the characteristics inherent to an international corporate group.

As a result of a detailed analysis conducted on the concept of contemporary corporate groups, which mostly function as multinational companies, several important aspects have been highlighted. Corporate groups emerged as a result of the interaction between the internationally recognised doctrines of limited liability and separate entity and mechanisms of corporate control. Limited liability guarantees a certain level of business independence for particular members of corporate groups and restricts a group's exposure to external and internal risks. Legal mechanisms of control allow a group to function under a unified management as a unitary business.

The structures of corporate groups may significantly vary, but for groups under Anglo-American and EU jurisdictions, the structure when one head or holding company directly or indirectly controls the shares of other members of the group is more common. Those corporate groups, composed of some companies with "external" shareholders (shareholders, which are not members of the group) are doomed to conflicts between shareholders of subsidiaries and the head (holding) company. This problem stems from the concept of unified management, which is focused on the profitability of the group in whole, but not its members.

However, there are a number of other doctrines, which protect members of corporate groups and their shareholders from potential abuses. The most important one is fairness as a basic principle of transactions inside a group and appropriate taxation of those transactions. The doctrine of fairness quite conventionally crystallises in the arms' length principle of dealings between members of a particular group, which is reflected in

international regulations and legislation of many countries. Implementation of this principle is guaranteed by a number of mechanisms, amongst which the most important are special rules of taxation for transactions that violate the arms' length principle.

These rules, although they may vary significantly depending on a jurisdiction and type of transaction, are aimed at the fair reapportionment of the taxable income between entities comprising a corporate group, which may be mostly located in different countries. The specifics of a particular group are strongly dependant on a group's structure, its level of centralisation and on the local business and legal conditions. For the majority of modern corporate groups, is essential to prepare groups' consolidated accounts, which are subject to consolidated audit, conducted by an independent auditor.

One of the most important points in legal regulation of corporate groups is special mechanisms of the recognition of groups in statutes of general and specific application. These statutes establish special rules for the recognition of corporate groups in certain circumstances, when such recognition is dictated by public interest, such as: antitrust, labor relations, trademarks, environmental control, etc. The problem of recognition of corporate groups by statutes, and the imposition of sanctions for violations committed by a member of a group, is related to the more general problem surrounding the recognition of the separate entity doctrine and imposition of liability on the parent company in some exceptional circumstances. This doctrine, commonly called in Anglo-American case law "piercing the veil jurisprudence", allows courts to impose liability on controlling companies of corporate groups when they intentionally use benefits of separate entity and limited liability doctrines to evade the law.

A comparative analysis of the main characteristics of the Yukos corporate group and characteristics recognized by the existing concepts of international corporate groups, shows that the Yukos Oil company was organised and functioned as genuine international corporate group from 2001-2004. The most distinct common characteristic of the Yukos group was a unified management and financial policy. Several differences could be attributed to the specifics of the Russian transitional legislation and business environment. For example, the principle of fairness in dealing between members of a corporate group was significantly distorted by the existing statutory limitations on export operations with crude, resulting in establishing of two types of "fair" market price: "internal" - for transactions inside the country and "external" - for export transactions. Moreover, there

was a long period when the local authorities had the right to grant tax concessions. From a legal and tax standpoint, the country at this time, ran a complicated and obscure system of internal off-shore zones, which were effectively used by the oligarchy and other structures.This can be defined as a period of "tax anarchism".

The Yukos case from a legal standpoint represents a complex web of different criminal and civil cases launched against Yukos-related entities and individuals. The case consists of two distinct groups of cases:

1) Tax cases against the Yukos Oil Company and its subsidiaries, launched with a purpose of grabbing the company's assets through a bankruptcy procedure, and;

2) Criminal cases against the Yukos' managers, employees and shareholders.

The Yukos criminal cases have two stages in their development. In the first stage two distinct groups of cases were launched. The first group was launched against Khodorkovsky and his close friend and the head of Menatep Group, Platon Lebedev. These cases included the case on the illegal privatisation of Apatit and several related cases (non-compliance with a court ruling, forgery of official documents), illegal privatisation (illegal acquisition of shares) in an academic institute, conspiracy to evade corporate tax obligations by an organised group, evasion of personal tax and social security obligations by an individual and others. This was publicly known as "The first Khodorkovsky case". In parallel with the case against Khodorkovsky, a number of other criminal cases against the employees and managers of the company were launched. They were related to different aspects of the corporate and business activities of the company, but the main factor connecting all of them was that almost none of these individuals were regarded by the authorities as criminal before the attack on Yukos. Many of these investigations were launched with the evident goal of squeezing the potential accused out of the country in order to weaken the company's defence.

The tax cases against Yukos and its subsidiaries were even more important for Siloviki than the criminal investigations. The Yukos tax case was aimed at ruining the financial strength of Khodorkovsky's empire and Yukos' image as the most transparent Russian company. The main tax cases against Yukos was based on the allegation of mixed tax avoidance and evasion resulting from the application of tax optimisation schemes based

on the use of SPVs registered in internal off-shore zones. The courts, applying previously rarely used Russian Civil anti-avoidance doctrines, supplemented by the elements of the international anti-avoidance doctrines, effectively declared all the Yukos' SPVs as being sham companies. The tax benefits, granted to them were declared, null and void, and the courts ordered the apportionment of all the operations, in reality conducted by the SPVs to Yukos Oil Company. Thus, the Yukos case was actually the first and only large tax case in Russia where the courts applied doctrines of substance over form, economic substance, step transaction and abuse of rights. These doctrines were applied in combination with Russian Civil doctrines, but the latter have never been used in such an uncompromising and aggressive way.

The analysis of these doctrines, including some issues of their genesis, shows that they are quite conventionally used to combat tax avoidance in Anglo-American jurisdiction. Their application in corporate groups/transnational companies' tax avoidance cases quite commonly leads to recharacterization a corporate group's transactions. In such cases the implications for the group are not usually disastrous, as the taxpayer has to pay its taxes as if there were not any tax schemes employed i.e. effectively the taxpayer has to compensate the ungrounded tax benefits and pay the interest.

The Anglo-American anti-evasion doctrines are less complicated and more unified than anti-avoidance ones. The concepts of tax-evasion are conventionally based on the principles of tax fraud, general dishonesty and sham. Contemporary Russian legislation does not contain such clear definitions of tax avoidance and tax evasion as the Anglo–American statutes and case law, but the concept of criminal tax offence is close to the Anglo-American evasion concept and is based on the provision of false declarations and data to the fiscal authorities. In any case, the genesis of the modern Anglo-American anti-avoidance and evasion doctrines lasted for a least a century and their application is still subject to permanent reconsideration, related to the problem of finding a proper balance between the fiscal interest of the state and the rights of individual taxpayers.

In the Yukos tax case, the courts ordered a complete recharacterization of the internal transactions of the group applying a composition of anti-avoidance and evasions doctrines aggressively and creatively, especially the doctrine of "abuse of rights" by tax evasion operations. All the profit, received by the SPVs, was apportioned to Yukos, which finally

had to pay the tax charged on this profit, the interest and the special penalty totaling approximately to 27.5 bn. dollars. However, the recharacterization of the Yukos group's operations was "unilateral" as it did not lead to compensation from the budget to those companies that effectively overpaid the taxes. Ultimately, the tax claims led to the forceful alienation of the company's main production unit and Yukos' subsequent bankruptcy and liquidation. The "domestic" anti-avoidance strategies used by the courts in the Yukos case received strong opposition from professionals, academics and entrepreneurs who recognized that these strategies created a risky and unpredictable business environment in Russia. As a result that the Supreme Arbitration Courts of Russia issued a clarification on application of economic substance, substance over form and step transactions doctrine, providing the courts with guidance on these doctrines which generally comply with existing international practice. However attempts to use the concept of "abuse of rights" in political and confiscatory cases in Russia still continues.

The presence of the criminal tax evasion element in the Yukos cases has not been properly addressed and creates significant confusion as all Yukos' operational schemes were subject to the numerous international audits and due diligences. This problem cannot be addressed by international courts or European Court of Human Rights, as it is closely tied up with the mass of Russian data held by the prosecution and courts. So, taking into consideration the liquidation of the company, constant criticism of the existing court decisions for their inconsistency on the Yukos taxes, and problems with the Rule of Law in Russia, this problem is likely to be addressed in the future only at an academic level. As for now, the existing decisions and available data allow assessment of the Yukos tax optimisation strategies only as acts of tax avoidance, common to almost all oligarchy business groups in Russia in the mid 1990s to early 2000. The recharacterization of the Yukos' transactions, if conducted in accordance to internationally recognized anti-avoidance doctrines, or the recent post-Yukos Russian legal pronouncements, would have led to significant sums of taxes and interest payable to the budget, but would have never resulted in confiscation of the company's assets and its liquidation.

One the "pillars" of the Yukos affair, which has been evident from its very beginning, is the issue of political motivation.

The problem of "political prosecution" can be analysed through the existing doctrines of "political prisoner" and "political refugee", which, in their turn, are closely related to the terms "political justice", "political trial", "political opinion" and other terms in the sphere of human rights protection and extradition/political asylum.

The recognition of former Yukos employees and managers as "political refugees", and the fight against the extradition requests, was faily straightforward, as administrative bodies and courts in various international jurisdictions established with ease, that the Yukos employees had been prosecuted and pursued for reasons other than the enforcement of criminal law in its common or international aspect, i.e. the international courts applied recognized concept of "the political offence exception".

Granting "political prisoner" status to Khodorkovsky or to any other detained Yukos' employee or executive was more complicated, as historically the status of "political prisoner" had been granted to those allegedly involved in political crime. Amnesty International demonstrated an evident unwillingness in granting Khodorkovsky political prisoner status as the very existence of political crimes in the EU and Anglo-American jurisdiction is currently under question, and in the Khodorkovsky/Yukos case the victims were mostly accused of economic (white collar crime) criminal offences. The position of Amnesty International was also based on the fact that Khodorkovsky had been quite rich and had not himself clearly recognized the political nature of his prosecution, even in the courtroom. Nevertheless, the evidence made internationally available by Khodorkovsky's lawyers distinctly confirms the presence of political justice in the Khodorkovsky/Yukos case and gives proper grounds for recognition presence of such criteria, established by PACE for political prisoners, as unfairness and discrimination of the proceedings and detention.

The presence of political motives in the Yukos case was recognized by a number of international and governmental bodies including PACE and the U.S. Senate. The case law confirming the presence of political motivation in the case is not so extensive and is represented mostly by the decisions of the extraditions courts of the UK, Italy, Cyprus and Lithuania. However, the recent decision of the Swiss Supreme Court, prohibiting any mutual cooperation with Russia in the Yukos case, can be deemed a great contribution to the political motivation paradigm.

Regardless to the evident confirmation of the political thrust in the Yukos case, its politically motivated character may be ultimately recognized only by the European Court of Human Rights, which is now considering approximately nine applications from different Yukos-related individuals but still has not issued any final decisions.

The results of the first stage of the Yukos affair were disastrous for Yukos' managers and the company itself. All the Yukos-related criminal cases, including Khodorkovsky's case, ended with guilty verdicts and severe sentences. The appeals did not significantly change the situation. The company was doomed to bankruptcy, regardless to numerous attempts by the management to rescue it, including the filing of a Chapter 11 restructuring application with the U.S. court. However, the Siloviki group deemed the results of the first stage of the Yukos Affair as insufficient, as the authorities and the prosecutors did not manage to prove at an international level that the Yukos case was not politically motivated, or that Khodorkovsky was a real criminal deserving an eight-year sentence.

In such circumstances, the Siloviki, headed by Igor Sechin, managed to persuade the President to sanction a new case against Khodorkovsky and his allies. The new case was grounded on findings made in the previous decisions on the criminal and tax cases relating to Yukos. Nevertheless, the legal concept of the new case was different from the previous ones in that it was based on the money laundering and embezzlement charges, modeled in accordance with the recently adopted laws on money laundering, which complied with the principles of recent international anti-money laundering treaties. According to the charges brought against Khodorkovsky, an organised criminal group headed by him and Lebedev, organised a continuous large-scale embezzlement of crude produced by the Yukos productions subsidiaries. They coerced their management to sell the crude below the market price to the SPVs, allegedly controlled by the members of the organised criminal group. The embezzled oil was then funneled through the same system of SPVs, which was used for tax avoidance and evasions purposes. The crude was then refined and sold, either on the domestic market or through the international network of the controlled off-shore companies. The funds obtained from the trading operations were used for funding further production or invested in different instruments abroad. All the operations with crude, and proceeds from its sale following acts of alleged embezzlement were considered by the prosecution as transactions aimed at laundering and legalizing of the illicit funds. So,

according to the prosecutors, the company, functioning as a corporate group, represented a huge "washing machine", inside which circulated illicit funds derived from the embezzlement offences. Several main assumptions made by the prosecution provided the basis of the new criminal case. These assumptions were:

1) The role of Khodorkovsky, as a CEO of the Yukos, core shareholder of Menatep Group and the head or controlling person of other entities allegedly involved in the "washing cycle". By putting this arguement into the charges the prosecutors aimed to prove that Khodorkovsky and his friends - the members of the organised group intentionally controlled all the laundering operations.

2) The embezzlement of the crude, carried out by the companies comprising the Yukos corporate group, was achieved through members of the organised group pressurizing their managers to sell it on a low price. This questionable concept overlaps with the findings of the Yukos tax case, where the same operations were treated as elements of tax avoidance and evasion offence.

3) The prosecutors effectively used a significant gap in legal regulation of corporate group activities in the Russian Federation. The laws on holding companies, or any similar laws, have never been adopted in Russia and this creates significant problems for Russian corporate groups, especially in the tax and criminal sphere. The existence of corporate groups is recognized only by several statutes of specific and general application, such as the anti-trust law. Thus private business groups, whose formation was based on the unitary business doctrine, functioned in a legal "vacuum", when the discretion of the controlling and prosecution bodies was unlimited. The lack of regulation and practice allowed the prosecutors to consider all entities comprising the Yukos group as independent. Therefore, they alleged that any corporate decisions taken at group level, were just actions of the organised criminal group, and were aimed at illegal control of the independent companies. Also, the fulfillment of the united financial policy was seen as aimed at tax evasion and money laundering, and the use of SPVs was deemed as the creation of, and the illegal use of, shell companies. Nevertheless, this approach did not hamper the existing practice of the state owned concerns, like Gasprom and Rosneft, which pervasively applied transfer-pricing strategies which were not unlike ones used by Yukos.

4) The utilization of the same internal and external off-shores structures for the purposes of tax avoidance and evasion and money laundering. This overlap, on the one hand, confirms the internationally recognized nexus between tax evasion and money laundering, but, on the other hand, demonstrates the questionable and creative approach of the prosecution to the new charges. The investigators, taking into consideration the tax exemption rule, existing in Russian criminal law, replaced the genuine fiscal offences with evidently fabricated embezzlement to make "a strong case" against Khodorkovsky and his allies.

5) Yukos, headed by Khodorkovsky and controlled by the organised criminal group, undertook measures to conceal the illicit character of its operations by using the annual and quarterly accounts. These accounts were prepared in compliance with the internationally accepted accounting principles and audited by one of the biggest international auditing firms, PwC. This assumption is strongly supported by the position of PwC, which being under the tremendous pressure of the prosecution and the Russian government, took side of the General Prosecutors Office in the Yukos case.

Such an approach, taking into consideration the negative perception of the Yukos case by the international community, would allow the Russian authorities not only to try to white-wash the case's "dirty image" internationally, but to seize the remaining Khodorkovsky assets. In reality, it will allow Khodorkovsky to be kept in jail for some twenty years.[1531]

The Khodorkovsky/Yukos case has significantly changed the contemporary Russian political and legal landscape, confirming the erosion of the Rule of Law in Russia and giving a politicised taint to the Russian judicial system. Politically it meant an end to the oligarch era and the beginning of the silovarchs epoch. Economically it flagged the beginning of creation of the Russian super energy power state, the pillars of which are the statutory-owned conglomerates, powerful enough to compete with the existing transnational giants.

[1531] On the perspectives of the Khodorkovsky's early release see Appendix 32.

The research shows that the Yukos group, despite possessing, regardless to several differences, all the main characteristics of an international corporate group, became involved in the money laundering case due to the following reasons:

1) The privatisation and the following transition period predisposed the emergence of an extremely competitive environment for all corporate groups from 1990 – early 2000. During this transitional period all major business groups used questionable tax and cash flow optimisation strategies, were involved in numerous abuses of minority shareholders rights, and aggressively practiced lobbing and corruption. Privatisation deals were generally not transparent and were questionable. This formed the "risky" post-transitional legacy of the main Russian corporate groups.

2) Seeking international recognition and additional sources of funds, some Russian corporate groups, including Yukos as a leader, adopted advanced international corporate governance, accounting and disclosure policies. Through the dedicated application of these policies and the retention of numerous advisers, these companies managed to "polish" their image, combining it with slightly modified, but virtually the same tax optimisation schemes as before. This strategy put their shares at the top of Russian blue-chip rankings and helped them become favourites of the international investment community.

3) Adoption of the new criminal and anti-money laundering legislation, based on the international principles, provided the new Russian authorities with a useful and internationally recognized tool for suppression of its opponents.

4) The political clash between the owners of Yukos and the new Russian FSB regime led to the politically motivated application of new Russian criminal and anti-money laundering legislation to the questionable transitional "legacy" of Yukos.

The Yukos case thus provides several important lessons for the international community:

1. The modern concept of white collar crime, including tax and money laundering offences is uncertain. It is often quite difficult to perceive whether any crime has been committed, and what the characteristics of this crime are. Although the anti-money laundering legislation of many transition countries, including Russia, comply with

the principles, declared in international treaties, the general uncertainty surrounding the white collar crime concept, supplemented by politicized transitional justice, makes such legislation an effective instrument for the suppression of economic and political opponents.

2. The period of transition and post-transition should be deemed as a time of general legal uncertainty and a time of potentially widespread application of elements of redistributive and political justice. In a period of transition very often property rights are acquired through questionable mechanisms of privatisation, corruption and lobbing, thus they cannot be guaranteed during the period of post-transition. The methods of deprivatisation, re-nationalization and redistribution may differ significantly, depending on the specifics of a particular case. In the case of Yukos, its property was redistributed to the state companies through the mechanism of tax claims, based on the company's activities in the period of transition.

3. Taking into consideration the problems raised during the course of the Yukos case, issues of transparency and good corporate governance in companies from countries with transitional, or post-transitional, political and economic systems should be considered from a different angle. When a company from a country with transitional economy formally complies with all international standards and listing requirements, but its previous commercial activity contains embedded risks and its property rights are not guaranteed, this company can become a "trap" for international investors. The Yukos case distinctly shows that formal mechanisms of investors' protection do not work properly in countries with transitional and post-transitional economies.

The Yukos case demonstrates how the parallel development of advanced corporate governance strategies, willingly implemented in the transitional economies as fund raising instruments with international assistance, and genesis of the modern anti-money laundering doctrine, also readily implemented in non-democratic countries under international pressure, may give rise to unexpected corporate collapses.

All the named implications of the Yukos Affair confirm the need for a significant reconsideration of the investor-protection strategies for those wishing to invest in business groups that have emerged from the countries with transitional economies. The rules and standards regulation application of anti-money laundering legislation to corporate groups must also be reconsidered.

Although it has been five years since the Yukos case was effectively launched and it has already established quite a number of domestic and international legal benchmarks, it still represents a huge "Pandora's box" which is likely to give birth to shocking new precedents.