PCA Case No. AA 227

IN THE MATTER OF AN ARBITRATION BEFORE A TRIBUNAL CONSTITUTED IN ACCORDANCE WITH ARTICLE 26 OF THE ENERGY CHARTER TREATY AND THE 1976 UNCITRAL ARBITRATION RULES

- between -

YUKOS UNIVERSAL LIMITED (ISLE OF MAN)

- and -

THE RUSSIAN FEDERATION

FINAL AWARD

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18 July 2014

Tribunal
The Hon. L. Yves Fortier PC CC OQ QC, Chairman
Dr. Charles Poncet
Judge Stephen M. Schwebel

Mr. Martin J. Valasek, Assistant to the Tribunal
Mr. Brooks W. Daly, Secretary to the Tribunal
Ms. Judith Levine, Assistant Secretary to the Tribunal

Registry
Permanent Court of Arbitration

Representing Claimant:

Professor Emmanuel Gaillard
Dr. Yas Banifatemi
Ms. Jennifer Younan
SHEARMAN & STERLING LLP

Representing Respondent:

Dr. Claudia Annacker
Mr. Lawrence B. Friedman
Mr. David G. Sabel
Mr. Matthew D. Slater
Mr. William B. McGurn
Mr. J. Cameron Murphy
CLEARY GOTTLIEB STEEN & HAMILTON LLP

Mr. Michael S. Goldberg
Mr. Jay L. Alexander
Dr. Johannes Koepp
Mr. Alejandro A. Escobar
BAKER BOTTS LLP

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LIST OF DEFINED TERMS

Term	Definition
2000 Audit Report	Field Tax Audit Report No. 08-1/1, dated 29 December 2003, finding that Yukos operated a tax evasion scheme
2000 Decision	Decision No. 14-3-05/1609-1, dated 14 April 2004, holding Yukos liable for a tax offense and reassessing approximately USD 3.48 billion in taxes against Yukos for the year 2000
2001 Decision	Decision No. 30-3-15/3, dated 2 September 2004, holding Yukos liable for a tax offense and reassessing approximately USD 4.1 billion in taxes against Yukos for the year 2001
2002 Decision	Decision No. 52/896, dated 16 November 2004, holding Yukos liable for a tax offense and reassessing approximately USD 6.7 billion in taxes against Yukos for the year 2002
2003 Decision	Decision No. 52/985, dated 6 December 2004, holding Yukos liable for a tax offense and reassessing approximately USD 6 billion in taxes against Yukos for the year 2003
2003 Interim Dividend	Yukos' declaration of a USD 2 billion interim dividend in November 2003
2004 Decision	Decision No. 52/292, dated 17 March 2006, holding Yukos liable for a tax offense and reassessing approximately USD 3.9 billion in taxes against Yukos for the year 2004
ADR	American Depositary Receipt
A Loan	USD 1 billion loan entered into on 24 September 2003 by Yukos from the Western Banks and secured by certain of Yukos' oil export contracts and by YNG
April 2004 Injunction	Ruling by the Moscow Arbitrazh Court dated 15 April 2004 prohibiting Yukos from alienating and encumbering its assets
Baikal	Baikal Finance Group, the entity which purchased YNG at auction and which was bought by Rosneft
BBS Companies	Behles Petroleum S.A., Baltic Petroleum Trading Limited and South Petroleum Limited
B Loan	USD 1.6 billion loan entered into on 30 September 2003 by Yukos from Société Générale S.A. and fully collateralized in cash by GML

Term	Definition
Chrétien letters	Letters from Jean Chrétien to Prime Minister Fradkov, dated 6 and 15 July 2004, and to President Putin, dated 30 July 2004, 10 September 2004 and 17 November 2004
Claimants	Hulley, VPL, and YUL
Claimants' Post-Hearing Brief	Claimants' Post-Hearing Brief, dated 21 December 2012
Claimants' Skeleton	Claimants' Skeleton Argument, dated 1 October 2012
Confidential Sale Agreement	Confidential sale agreement between the Western Banks and Rosneft dated 13 December 2005
Counter-Memorial	Respondent's Counter-Memorial on the Merits, dated 4 April 2011, as corrected 29 July 2011
Cyprus-Russia DTA	Agreement Between the Government of the Republic of Cyprus and the Government of the Russian Federation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, signed on 5 December 1998
DCF	Discounted Cash Flow
Dresdner	ZAO Dresdner Bank
Dresdner Summary Letter	Dresdner Summary Valuation Opinion Letter dated 6 October 2004
Dresdner Valuation Report	Dresdner Valuation Report of YNG dated 6 October 2004
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
ECHR	European Convention on Human Rights
ECT (or Treaty)	Energy Charter Treaty, 2080 UNTS 95, signed on 17 December 1994
ECtHR	European Court of Human Rights
ECtHR Yukos Judgment	OAO Neftyanaya Kompaniya Yukos v. Russia, ECtHR, Appl. No. 14902/04, Judgment, 20 September 2011
EGM	Extraordinary General Meeting
English Judgment	BNP Paribas S.A. v. Yukos Oil Company, High Court of England and Wales, Case No. HC 05 C0 12 19, [2005] EWHC 1321 (Ch), Judgment, 24 June 2005
GML	GML Limited (formerly named Group Menatep Limited), a company incorporated in Gibraltar and parent company of YUL

Term	Definition
Final Awards	Final Awards in these three arbitrations (PCA Case Nos. AA226 (Hulley), AA227 (YUL) and AA228 (VPL)) (including the present Award)
Hearing on the Merits (or Hearing)	Hearing on the merits held at the Peace Palace in The Hague from 10 October to 9 November 2012
Hulley	Hulley Enterprises Limited, a company organized under the laws of Cyprus and Claimant in PCA Case No. AA226, owned by YUL
ICJ	International Court of Justice
ILC	International Law Commission of the United Nations
ILC Articles on State Responsibility	ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts, 2001
Interim Awards	Interim Awards on Jurisdiction and Admissibility issued on 30 November 2009 in these three arbitrations (PCA Case Nos. AA226 (Hulley), AA227 (YUL) and AA228 (VPL))
Law 9-Z	Law of the Republic of Mordovia No. 9-Z, which is the framework by which Mordovia offered tax benefits to corporate entities operating in the region
Memorial	Claimants' Memorial on the Merits, dated 15 September 2010
Moravel	Moravel Investments Limited
Notices of Arbitration and Statements of Claim	Claimants' Notices of Arbitration and Statements of Claim by Hulley and YUL, dated 3 February 2005; and by VPL, dated 14 February 2005
NYSE	New York Stock Exchange
Oligarchs	Respondent's style of reference to the individuals who have or had a beneficial interest in the trusts behind Claimants, namely Messrs. Khodorkovsky, Lebedev, Nevzlin, Dubov, Brudno, Shakhnovsky, and Golubovitch
Parties	Claimants and Respondent
PCA	Permanent Court of Arbitration
PCIJ	Permanent Court of International Justice
PwC	PricewaterhouseCoopers, the former auditor of Yukos

Term	Definition
PwC's Withdrawal Letter	Letter from PwC to the bankruptcy receiver, Mr. Eduard Rebgun, dated 15 June 2007, by which PwC withdrew its Yukos audits
Quasar	Quasar de Valores SICAV S.A. et al. v. The Russian Federation, SCC Arbitration, Award, 20 July 2012
Rehabilitation Plan	Rehabilitation plan the in context of bankruptcy proceedings proposed by Yukos' management and approved by a majority vote during an EGM on 1 June 2006
Rejoinder	Respondent's Rejoinder on the Merits, dated 16 August 2012
Reply	Claimants' Reply on the Merits, dated 15 March 2012
Resolution No. 53	Resolution of the Plenum of the Supreme Arbitrazh Court No. 53, dated 12 October 2006
Respondent	The Russian Federation or Russia
Respondent's Post-Hearing Brief	Respondent's Post-Hearing Brief, dated 21 December 2012
Respondent's Skeleton	Respondent's Skeleton Argument, dated 1 October 2012
RosInvestCo	RosInvestCo UK Ltd. v. The Russian Federation, SCC Arbitration V (079/2005), Final Award, 12 September 2010
Rosneft	Russian State-owned entity that bought Baikal
Russian Civil Code	Civil Code of the Russian Federation
Russian Constitution	Constitution of the Russian Federation
Russian Tax Code	Tax Code of the Russian Federation
Share Exchange Agreement	Agreement pursuant to which Yukos would acquire 72 percent (plus one share) of Sibneft shares from Sibneft's principal shareholders in exchange for 26.01 percent of the fully diluted share capital of Yukos
Share Purchase Agreement	Agreement pursuant to which Yukos would acquire 20 percent (minus one share) of Sibneft shares from Sibneft's principal shareholders for a cash consideration of USD 3 billion
Sibneft	Russia's fifth largest oil company in 2003 when it agreed to a merger with Yukos
Stichting 1	Stichting Administratiekantoor Yukos International

Term	Definition
Stichting 2	Stichting Administratiekantoor Small World Telecommunication Holdings B.V.
Stichtings	Stichting 1 and Stichting 2
TRO	Temporary Restraining Order
UNCITRAL Rules	Arbitration Rules of the United Nations Commission on International Trade Law, 1976
U.S. GAAP	United States' Generally Accepted Accounting Principles
VAT Law	Law of the Russian Federation governing Value Added Tax
VCLT	Vienna Convention on the Law of Treaties, 1155 UNTS 331, signed on 23 May 1969
VPL	Veteran Petroleum Limited, a company organized under the laws of Cyprus and Claimant in PCA Case No. AA 228
Western Banks	Syndicate of Western banks led by Société Générale S.A. and including BNP Paribas S.A., Citibank N.A., Commerzbank Akziengesellschaft, Calyon S.A., Deutsche Bank A.G., Hillside Apex Fund Limited, ING Bank N.V., KBC Bank N.V., Stark Trading, Shepherd Investments International Limited, Thames River Traditional Funds PLC (High Income Fund), UFJ (Holland) N.V. and V.R. Global Partners L.P.
YNG	Yuganskneftegaz, Yukos' core production subsidiary
Yukos (or OAO Yukos Oil Company)	OAO Yukos Oil Company, a joint stock company incorporated in Russia in 1993
Yukos CIS	Yukos CIS Investment Limited
Yukos Finance	Yukos Finance B.V.
Yukos International	Yukos International U.K. B.V.
YUL	Yukos Universal Limited, a company organized under the laws of the Isle of Man and Claimant in PCA No. AA 227, shareholder of Yukos
ZATO	Zakrytoe Administrativno-Territorial'noe Obrazovaniye, or Closed Administrative Territorial Unit.

INTRODUCTION

1. In February 2005, three controlling shareholders of **OAO Yukos Oil Company** (or "**Yukos**")—Hulley Enterprises Limited ("**Hulley**"), a company organized under the laws of Cyprus, Yukos Universal Limited ("**YUL**"), a company organized under the laws of the Isle of Man, and Veteran Petroleum Limited ("**VPL**"), a company organized under the laws of Cyprus (collectively, "**Claimants**")—initiated arbitrations against the **Russian Federation** ("**Respondent**" or "**Russia**"), which together with Claimants constitute the "**Parties**."

2. The three arbitrations were heard in parallel with the full participation of the Parties at all relevant stages of the proceedings. Mindful of the fact that each of the three Claimants maintains separate claims in separate arbitrations that require separate awards (the "**Final Awards**"), the Tribunal nevertheless shall discuss these arbitrations as a single set of proceedings, except where circumstances distinct to particular Claimants necessitate separate treatment.

3. The Final Awards address: (a) those of Respondent's objections to jurisdiction and admissibility that remain to be decided after the Interim Awards on Jurisdiction and Admissibility of 30 November 2009 (the "**Interim Awards**");[1] (b) Claimants' claims on the merits; and (c) quantum.

4. By any standard, and as will be seen, these have been mammoth arbitrations. At the highest, Claimants are claiming damages from Respondent of "no less than US$ 114.174 billion."[2] Since February 2005, the Tribunal has held five procedural hearings with the Parties and issued 18 procedural orders. In the fall of 2008, the Tribunal held a ten-day hearing on jurisdiction and admissibility in The Hague and, in November 2009, issued three Interim Awards, each over 200 pages. A twenty-one day **Hearing on the Merits** (or "**Hearing**") took place in The Hague from 10 October to 9 November 2012. The written submissions of the Parties span more than 4,000 pages and the transcripts of the hearings more than 2,700 pages. Over 8,800 exhibits have been filed with the Tribunal.

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1 *Hulley Enterprises Limited v. The Russian Federation*, PCA Case No. 226, Interim Award on Jurisdiction and Admissibility, 30 November 2009 (hereinafter "Interim Award (Hulley)"); *Yukos Universal Limited v. The Russian Federation*, PCA Case No. 226, Interim Award on Jurisdiction and Admissibility, 30 November 2009 (hereinafter "Interim Award (YUL)"); *Veteran Petroleum Limited v. The Russian Federation*, PCA Case No. 226, Interim Award on Jurisdiction and Admissibility, 30 November 2009 (hereinafter "Interim Award (VPL)").

2 Claimants' Reply on the Merits, 15 March 2012 ¶ 1199(3) (hereinafter "Reply").

5. The facts of this dispute have been the subject of attention in the media for more than a decade, involving as they do, as central actors, Mr. Vladimir Putin, the President of the Russian Federation, and a Russian "oligarch", Mr. Mikhail Khodorkovsky, who, at the outset of the dispute, was the principal shareholder and Chief Executive Officer of Yukos, then the largest oil company in Russia and one of the largest oil companies in the world.

6. Throughout this lengthy and heavily contested arbitration, in circumstances that were often trying and stressful, counsel for the Parties acted in a highly professional way. The Tribunal is most grateful for their assistance. The Tribunal particularly acknowledges the grace and acuity of the participation of Mr. Robert Greig, who was forced by ill health to retire in the midst of the proceedings.

7. Having studied carefully the voluminous record of these three arbitrations, and having weighed the arguments of the counsel who have so ably represented the Parties, the Tribunal is now ready to deliver its Final Awards.

I. PROCEDURAL HISTORY

8. The Interim Awards recount in detail the procedural history of the arbitrations from their commencement up until the date those Awards were issued. The Tribunal has also issued 18 procedural orders, each of which contains a relevant procedural history. In this Part of the Final Award, the Tribunal recalls only the key procedural details from the early phase of the proceedings and summarizes developments since November 2009.

A. COMMENCEMENT OF THE ARBITRATION

9. On 2 November 2004, all three Claimants delivered to the President of Russia notifications of claim with respect to Russia's alleged violation of its obligations under the Energy Charter Treaty ("**ECT**" or "**Treaty**") and sought to settle the disputes amicably pursuant to Article 26(1) of the ECT.[3]

10. Having failed to settle their disputes amicably within the three-month period prescribed under Article 26(2) of the ECT, on 3 February 2005, Hulley and YUL initiated arbitration proceedings through Notices of Arbitration and Statements of Claim against Respondent.

[3] Energy Charter Treaty, Lisbon, 17 December 1994, 2080 UNTS 95 (hereinafter "ECT" or "Treaty").

Subsequently, through a Notice of Arbitration and Statement of Claim dated 14 February 2005, VPL initiated arbitration proceedings against Respondent. Claimants' requests for arbitration against Respondent were made pursuant to Article 26(4)(b) of the ECT and the Arbitration Rules of the United Nations Commission on International Trade Law, 1976 ("**UNCITRAL Rules**").

11. Claimants alleged that Respondent had expropriated and failed to protect Claimants' investments in Yukos, resulting in "enormous losses," and sought all available relief in respect of those losses.

B. CONSTITUTION OF THE TRIBUNAL

12. The history of the constitution of the Tribunal is recounted in detail in the Interim Awards. The Tribunal is composed of Judge Stephen M. Schwebel (appointed by Respondent on 8 April 2005), Dr. Charles Poncet (appointed as a replacement arbitrator by Claimants on 24 September 2007) and The Hon. L. Yves Fortier PC CC OQ QC (appointed as Chairman on 21 July 2005 by the agreed appointing authority, the Secretary-General of the Permanent Court of Arbitration ("**PCA**")).

13. On 1 August 2005, the Parties agreed on The Hague as the legal seat of the arbitrations.

14. On 15 October 2005, Respondent submitted its Statements of Defense, in which it objected to the Tribunal's jurisdiction and denied Claimants' allegations of expropriation and unfair and inequitable treatment.

15. On 31 October 2005, a preliminary procedural hearing was held in The Hague, at which the Parties and members of the Tribunal signed Terms of Appointment confirming, *inter alia*, that: (a) the members of the Tribunal had been validly appointed in accordance with the ECT and the UNCITRAL Rules; (b) the proceedings would be conducted in accordance with the UNCITRAL Rules; (c) the International Bureau of the PCA would act as registry; (d) the dispute would be decided in accordance with the ECT and applicable rules and principles of international law; (e) the language of the arbitration would be English; and (f) all pleadings, documents, testimonial evidence, deliberations and actions taken by the Tribunal would remain confidential in perpetuity, unless the Parties were to release the arbitrators from this obligation. The Tribunal also set a procedural calendar and determined that it would rule on Respondent's

plea concerning jurisdiction and the admissibility of the claim as a preliminary question. The calendar was confirmed in **Procedural Order No. 1** on 8 November 2005.

C. PRELIMINARY PHASE ON JURISDICTION AND ADMISSIBILITY

16. Respondent filed its First Memorials on Jurisdiction and Admissibility on 28 February 2006 and Claimants filed their Counter-Memorials on Jurisdiction and Admissibility on 30 June 2006.

17. On 8 September 2006, the Tribunal issued **Procedural Order No. 2** dealing with document production. The Tribunal invited the Parties to agree on whether requests relating to the Parties' respective "unclean hands" contentions and Respondent's contention that the corporate personality of Claimants "must be disregarded" because they are "an instrumentality of a criminal enterprise" should be considered during the jurisdiction and admissibility phase or deferred to the merits phase.

18. On 31 October 2006, the Tribunal issued **Procedural Order No. 3**, in which it deferred consideration of the Parties' contentions concerning "unclean hands" and Respondent's "criminal enterprise" contention to the merits phase. On 3 November 2006, Claimants submitted a stipulation of facts, and on 8 November 2006, Respondent submitted its observations on the stipulation.

19. Between November 2006 and November 2008, the Tribunal issued six further procedural orders relating to the conduct of the jurisdiction and admissibility phase of the arbitrations. During this period the Parties exchanged two rounds of written submissions on jurisdiction and admissibility, as well as Skeleton Arguments for the hearing. As noted in the Interim Awards, the written record in the jurisdictional phase contained detailed and extensive filings of hundreds of pages, accompanied by over a thousand exhibits and dozens of witness statements.

20. The **hearing on jurisdiction and admissibility** was conducted at the Peace Palace in The Hague, from 17 to 21 November, 26 to 29 November and 1 December 2008.

21. On 30 November 2009, the Tribunal rendered the **Interim Awards**, stating in operative part:

> For the reasons set forth above, the Tribunal:
>
> (a) DISMISSES the objections to jurisdiction and/or admissibility based on Article 1(6) and 1(7), Article 17, Article 26(3)(b)(i) and Article 45 of the ECT;

(b) DEFERS its decision on the objection to jurisdiction and/or admissibility based on Article 21 of the ECT to the merits phase of the arbitration, consistent with [paragraph numbers], above;

(c) CONFIRMS that its decision on the objections to jurisdiction and/or admissibility involving the Parties' contentions concerning "unclean hands" and Respondent's contention that "Claimant's personality must be disregarded because it is an instrumentality of a criminal enterprise" is deferred to the merits phase of the arbitration, consistent with Procedural Order No. 3;

(d) HOLDS that, subject to the preceding two sub-paragraphs, the present dispute is admissible and within its jurisdiction, and that the Tribunal has jurisdiction over the Russian Federation in connection with the merits of the present dispute;

(e) RESERVES all questions concerning costs, fees and expenses, including the Parties' costs of legal representation, for subsequent determination; and

(f) INVITES the Parties to confer regarding the procedural calendar for the merits phase of the arbitration, and to report to the Tribunal in this respect within 60 days of receipt of this Interim Award.

22. On 4 February 2010, Respondent wrote to the Tribunal "to protest Claimants' counsel's publication of the [Interim Awards] in violation of applicable obligations," noting that the Interim Awards had appeared on various websites.

D. BIFURCATION AND OTHER SCHEDULING MATTERS

23. On 24 February 2010, the Parties informed the Tribunal that they disagreed as to whether or not to bifurcate the proceedings between a liability and a damages phase, and as to the sequence and timing of document production. Following an exchange of submissions on these issues, a hearing was held at the International Dispute Resolution Centre in London on 7 May 2010.

24. The Tribunal issued **Procedural Order No. 10** on 13 May 2010, in which it: (a) decided that documentary discovery would take place in a single phase, after the Parties' first round of written pleadings on the merits; (b) deferred the decision on bifurcation of the proceedings between a liability and a quantum phase and on the issue of referral arising under Article 21 of the ECT until after the Parties' first round of written pleadings on the merits; and (c) fixed a procedural calendar. The Tribunal specified that the Parties' first round of written pleadings on the merits was to address all issues, including the deferred preliminary questions, liability, quantum and the issue of referral under Article 21 of the ECT. With respect to documentary discovery, the Tribunal confirmed that some of its earlier rulings on requests relating to "unclean hands" and "criminal enterprise" in the jurisdiction and admissibility phase had been without prejudice to the Parties' ability to restate one or more of these requests in the merits

phase. The Parties also agreed for each filing that they would submit one brief and one set of exhibits for all three cases.

25. In accordance with Procedural Order No. 10 (as amended by the Tribunal on 23 June 2010), Claimants filed their Memorial on the Merits ("**Memorial**") on 16 September 2010. It spanned 424 pages and was accompanied by 1045 exhibits, nine witness statements and two expert reports (with annexures). On 17 November 2010, further to a request by Respondent, Claimants provided an electronic copy of the appendices to the report of Claimants' damages expert.

26. On 4 November 2010, Respondent informed the Tribunal that Baker Botts LLP was joining Cleary Gottlieb Steen & Hamilton LLP as Respondent's counsel in these arbitrations.

27. Respondent filed its Counter-Memorial on the Merits ("**Counter-Memorial**") on 4 April 2011 and submitted a corrected version on 29 July 2011. The Counter-Memorial spanned 787 pages and was accompanied by 2868 exhibits and eight expert reports (some with annexures).

28. On 29 April 2011, the Parties filed their respective submissions on the bifurcation of the proceedings and the issue of referral arising under Article 21 of the ECT. A hearing on these matters was held at the Church House Conference Centre in London on 9 May 2011.

29. On 31 May 2011, the Tribunal issued **Procedural Order No. 11**, in which it: (a) denied Respondent's request that the proceedings be bifurcated between a liability and a damages phase; (b) reserved its decision on referral under Article 21(5)(b)(i) of the ECT to a later stage of the proceedings, when the evidentiary record would be completed; and (c) ordered the Parties to proceed in accordance with the amended procedural calendar.

E. DOCUMENT PRODUCTION AND CONFIDENTIALITY

30. The Parties exchanged requests for documents on 17 June 2011 and the following month exchanged objections and comments on objections to the document requests. Respondent also requested an oral hearing on disclosure issues and repeated a request for more time to file its Rejoinder.

31. On 11 August 2011, the Tribunal ruled on certain procedural aspects of document production and the timing of submissions, and informed the Parties that it "considered then, as it does

today, that the Amended Procedural Calendar is in compliance with the requirement of due process and equality between the parties taking into account all the circumstances."

32. On 16 September 2011, the Tribunal issued **Procedural Order No. 12**, in which it ruled on the Parties' document requests (with some rulings being "without prejudice" to a further decision after the reply rounds of written submissions).

33. By letter of 23 September 2011, Respondent informed the Tribunal that the European Court of Human Rights ("**ECtHR**") had, on 20 September 2011, issued a judgment in *OAO Neftyanaya Kompaniya Yukos v. Russia* ("**ECtHR Yukos Judgment**"),[4] which addressed the "same circumstances" on which Claimants' claims in these arbitrations are based.

34. On 16 December 2011, Claimants produced documents pursuant to Procedural Order No. 12. Respondent did not produce documents, but wrote to the Tribunal, expressing concern that Claimants had provided no assurance that documents collected for disclosure would be kept confidential and used only for the purposes of these arbitrations. Respondent requested the Tribunal to issue a directive "requiring the Parties to protect the confidentiality of all documents disclosed by the other, using them solely for purposes of these arbitrations." Claimants objected to Respondent's "eleventh hour" request for a confidentiality order.

35. On 19 December 2011, the Tribunal ordered Respondent to provide by the end of that day documents to Claimants that had been ordered to be produced in Procedural Order No. 12, requested written submissions on confidentiality and directed that until it decided the confidentiality issue, the documents produced by both Parties were to remain confidential and be used solely for purposes of these arbitrations. Pursuant to the Tribunal's directive, Respondent produced documents on 19 December 2011.

36. On 18 January and 2 February 2012, the Parties exchanged submissions on the scope of confidentiality of the documents produced. From January to May 2012, the Parties exchanged extensive correspondence concerning compliance with Procedural Order No.12.

37. On 27 February 2012, the Tribunal issued **Procedural Order No. 13**, in which it: (a) ordered that all documents produced by a Party to the other Party and the Tribunal following an order of the Tribunal "be and remain confidential in perpetuity" and "be used solely for the purpose of

[4] *OAO Neftyanaya Kompaniya Yukos v. Russia*, ECtHR, Appl. No. 14902/04, Judgment, 20 September 2011, Exh. R-3328, (hereinafter "ECtHR Yukos Judgment").

the pursuit or defense of these arbitrations and not for any other purpose;" (b) listed the persons involved in these arbitrations to whom these documents could be disclosed; and (c) invited the Parties to refrain from discussing these arbitrations in public in order not to exacerbate their dispute or otherwise compromise the integrity of these arbitration proceedings.

38. Claimants filed their Reply on the Merits ("**Reply**") on 15 March 2012. It spanned 474 pages and was accompanied by a further 629 exhibits and two expert reports (with annexures).

39. On 30 April 2012, the Tribunal issued **Procedural Order No. 14**, granting some of Respondent's document production requests which had earlier been denied "without prejudice" in Procedural Order No. 12. Claimants produced documents pursuant to Procedural Order No. 14 on 29 May 2012. On 29 June 2012, Respondent produced additional documents "in accordance with the parties' continuing obligation to disclose requested documents as they are discovered" under Procedural Order No. 12. Throughout June and July 2012, the Parties exchanged extensive correspondence as to whether that was in violation of Procedural Order No. 12.

40. On 16 August 2012, Respondent filed its Rejoinder on the Merits ("**Rejoinder**"). It spanned 819 pages and was accompanied by 1739 exhibits and seven expert reports (with annexures).

F. HEARING ON THE MERITS

41. On 28 August 2012, a pre-hearing telephone conference took place during which the Parties agreed on a number of issues, but disagreed on others. For example, Respondent requested that the Tribunal set a deadline for the exchange between the Parties of witness "impeachment" evidence prior to the Hearing on the Merits, while Claimants raised several "due process" issues and requested permission to file written submissions in support of their requests. The Parties then exchanged written comments on these issues.

42. By exchange of letters dated 10 September 2012, Claimants provided the names and order of three Respondent witnesses they wished to cross-examine and Respondent advised the names and order of ten of Claimants' witnesses whom it wished to cross-examine.

43. On 12 September 2012, the Tribunal issued **Procedural Order No. 15** dealing with logistical and procedural issues for the Hearing on the Merits.

44. On 14 September 2012, the Tribunal issued **Procedural Order No. 16**, in which it determined the outstanding procedural issues for the Hearing on the Merits, *inter alia* (a) denying

Respondent's requests relating to the exchange of "impeachment" evidence (noting that "in international arbitration practice, documents used at an evidentiary hearing should generally be submitted with the Parties' written pleadings, in accordance with the established procedural calendar"); and (b) granting Claimants permission to file certain documents that would "complete the record" in relation to selected exhibits that Respondent had included in its Rejoinder.

45. Claimants filed additional exhibits on 20 September 2012. On 25 September 2012, Respondent objected to certain of these exhibits on the grounds that they exceeded the scope of Procedural Orders No. 15 and 16. Following an exchange of views by the Parties, the Tribunal ruled on Respondent's objection in **Procedural Order No. 17** dated 2 October 2012.

46. On 1 October 2012, the Parties submitted their respective **Skeleton Arguments** in aid of the oral arguments to be presented at the Hearing on the Merits.

47. On 4 October 2012, Respondent advised that it no longer intended to cross-examine one of Claimants' tax law experts, Mr. Philip Baker QC. The same day Claimants withdrew the witness statement of former Russian Prime Minister, Mr. Mikhail Kasyanov, which had been submitted with the Memorial, on the ground that Mr. Kasyanov had informed Claimants' counsel that "he will not appear at the hearing in these arbitrations."

48. On 8 October 2012, Claimants advised that they no longer intended to cross-examine one of Respondent's tax law experts, Professor Rosenbloom.

49. The **Hearing on the Merits** took place at the Peace Palace, The Hague from 10 October to 9 November 2012. Over the course of the Hearing, the following were in attendance:

Tribunal
The Hon. L. Yves Fortier PC CC OQ QC
Dr. Charles Poncet
Judge Stephen M. Schwebel

Claimants	**Respondent**
Counsel	*Counsel*
Professor Emmanuel Gaillard	Dr. Claudia Annacker
Dr. Yas Banifatemi	Mr. Lawrence Friedman
Mr. Philippe Pinsolle	Mr. David Sabel
Ms. Jennifer Younan	Mr. Matthew Slater
Dr. Paschalis Paschalidis	Mr. William McGurn
Mr. Ilija Mitrev Penusliski	Mr. Jay Alexander
Ms. Kamalia Mehtiyeva	Mr. Samuel Cooper
Mr. Gueorgui Babitchev	Mr. Michael Goldberg
Mr. Emmanuel Jacomy	Mr. Cameron Murphy

Mr. Scott Vesel
Ms. Ximena Herrera-Bernal
Ms. Elise Edson
Ms. Ketevan Betaneli
Ms. Coralie Darrigade
Mr. Thomas Voisin
Mr. Dimitrios Katsikis
Mr. Benjamin Siino
Mr. Jean-Marc Elsholz
Ms. Gracia Angulo Duncan
Mr. Benoit Arnauld
Ms. Nanou Leleu-Knobil

Party Representatives
Mr. Tim Osborne
Mr. Christopher Cook
Mr. Rodney Hodges

Claimants' Witnesses
Fact Witnesses
Mr. Vladimir Dubov
Dr. Andrei Illarionov
Mr. Jacques Kosciusko-Morizet
Mr. Bruce Misamore
Mr. Leonid Nevzlin
Mr. Frank Rieger
Mr. Steven Theede

Expert
Mr. Brent Kaczmarek

Assistant to the Tribunal
Mr. Martin Valasek

Permanent Court of Arbitration
Mr. Brooks W. Daly, Secretary to the Tribunal
Ms. Judith Levine, Assistant Secretary to the Tribunal
Ms. Olga Boltenko
Ms. Evgeniya Goriatcheva
Ms. Hinda Rabkin
Ms. Elsa Sardinha

Interpreters
Mr. Yuri Somov
Mr. Ilya Feliciano

Court Reporter
Mr. Trevor McGowan

Ms. Laurie Achtouk-Spivak
Ms. Marina Akchurina
Mr. Yury Babichev
Mr. Nowell Bamberger
Mr. Adam Bryan
Ms. Chiara Capalti
Ms. Ania Farren
Ms. Giulia Gosi
Mr. Michael Jacobsohn
Mr. Magnus Jones
Mr. Lorenzo Melchionda
Mr. Milo Molfa
Ms. Sara Nadeau-Seguin
Ms. Daria Pavelieva
Mr. Jacopo Roberti di Sarsina
Ms. Teale Toweill
Ms. Marina Weiss
Mr. Larry Work-Dembowski

Party Representatives
Mr. Konstantin Vyshkovskiy
Ms. Maria Maslyakova

Respondent's Witnesses
Experts
Professor James Dow
Mr. Oleg Y. Konnov

50. On behalf of Claimants, oral arguments were presented by Dr. Yas Banifatemi, Professor Emmanuel Gaillard, Mr. Philippe Pinsolle and Ms. Jennifer Younan. On behalf of Respondent, oral arguments were presented by Dr. Claudia Annacker, Mr. Lawrence Friedman, Mr. David Sabel and Mr. Matthew Slater.

51. During the Hearing, on 14 October 2012, the Parties filed brief written submissions on a document production request made by Respondent in follow up to Procedural Order No. 14. On 15 October 2012, the Tribunal ruled that the time for document production requests had passed, and noted that Respondent was free to ask the Tribunal to draw adverse inferences from any alleged non-compliance by Claimants with the Tribunal's document production orders.

G. POST-HEARING PROCEDURES

52. At the close of the Hearing on 9 November 2012, the Tribunal directed the Parties to submit Post-Hearing Briefs of no more than 100 pages by 21 December 2012. On 13 November 2012, the Tribunal confirmed that the Post-Hearing Briefs were to be prepared on the basis of a closed evidentiary record as at 9 November 2012.

53. During November 2012, the Parties provided electronic copies of all additional materials relied upon during the Hearing, demonstrative exhibits and slides from arguments. They also submitted agreed and contested corrections to the transcript to the court reporter, who in turn circulated amended transcripts on 11 December 2012.

54. On 21 December 2012, the Parties filed their **Post-Hearing Briefs** spanning 100 pages each.

55. On 1 August 2013, the Tribunal invited the Parties to comment on a judgment issued on 25 July 2013 by the ECtHR.[5]

56. On 30 August 2013, the Parties submitted their comments on the ECtHR judgment.

57. On 26 September 2013, Respondent drew the Tribunal's attention to developments in two other international arbitrations against the Russian Federation connected with Yukos. Claimants submitted comments in response on 8 October 2013.

58. On 10 January 2014, the Tribunal sent a letter to the Parties noting that Mr. Mikhail Khodorkovsky, former CEO of Yukos, had been pardoned and released from prison, and inviting the Parties to submit their observations on the impact, if any, of these developments on the present arbitral proceedings. The Parties submitted their comments in response on 24 January 2014, and further observations in reply on 4 February 2014.

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[5] *Khodorkovskiy (2) and Lebedev (2) v. Russia*, ECtHR, Appl. Nos. 11082/06 and 13772/05, Judgment, 25 July 2013, (hereinafter "*Khodorkovsky v. Russia 2*").

59. The Parties filed their costs claims on 17 April 2014, and submitted comments on the opposing side's costs claims on 6 May 2014.

60. On 7 May 2014, the Tribunal formally declared the record in these arbitrations closed.

61. On 9 June 2014, Respondent informed the Tribunal that it was prepared to agree that the Final Awards may be publicly disclosed under certain conditions. Respondent also requested that the Tribunal modify its Procedural Order No. 13 to lift confidentiality restrictions with respect to documents disclosed in the course of these proceedings, to allow them to be used in "related proceedings" recently commenced against the Russian Federation. Claimants submitted comments in response on 16 June 2014, and Respondent further commented on 20 June 2014.

62. On 27 June 2014, the Tribunal issued **Procedural Order No. 18** in which it: (a) ordered that these Final Awards remain confidential for a period of ten calendar days following electronic dispatch to the Parties, after which period the PCA would post the Final Awards to its website and so notify the Parties and the Tribunal, whereupon all confidentiality obligations in respect of the Final Awards shall terminate; and (b) modified Procedural Order No. 13 to provide for limited disclosure of documents in related proceedings.

II. FACTUAL BACKGROUND

63. The disputes between the Parties to the present proceedings involve various measures taken by Respondent against Yukos and associated companies primarily in the period between July 2003 and November 2007, when Yukos had emerged after the dissolution of the Soviet Union to become the largest oil company in the Russian Federation. The measures complained of include criminal prosecutions, harassment of Yukos, its employees and related persons and entities; massive tax reassessments, VAT charges, fines, asset freezes and other measures against Yukos to enforce the tax reassessments; the forced sale of Yukos' core oil production asset; and other measures culminating in the bankruptcy of Yukos in August 2006, the subsequent sale of its remaining assets, and Yukos being struck off the register of companies in November 2007. Claimants contend, and Respondent denies, that Respondent failed to treat Claimants' investments in Yukos in a fair and equitable manner and on a non-discriminatory basis, in breach of Article 10(1) of the ECT, and that Respondent expropriated Claimants' investments in breach of Article 13(1) of the ECT. Claimants seek full reparation in excess of USD 114 billion.

64. The factual matrix of this case is complex. A detailed exposition of the relevant facts, including specific references to the record, is set out for each part of the narrative in Part VIII (broken down into eight chapters, starting with Yukos' tax optimization scheme and the Russian Federation's tax assessments against Yukos and ending with the bankruptcy of Yukos and the withdrawal of audit opinions by PricewaterhouseCoopers ("**PwC**")). It is also in Part VIII that the Tribunal makes determinations in respect of the many highly contested issues of fact and observations on the significance of various facts and findings. By contrast, the purpose of the introductory overview of the facts contained in this Part II of the Award is only to provide sufficient background for what follows.

A. THE PARTIES TO THESE PROCEEDINGS

1. Claimants and Related Entities

65. The three Claimants in these related cases are all part of the Yukos group of companies, which had at its center Yukos, headed by Chief Executive Officer Mr. Mikhail Khodorkovsky.

66. Claimant in PCA Case No. AA 226, Hulley, was incorporated in the Republic of Cyprus on 17 September 1997 and was a 100 percent owned subsidiary of YUL.

67. Claimant in PCA Case No. AA 227, YUL, was incorporated on 24 September 1997 in the Isle of Man (a Dependency of the United Kingdom).

68. Claimant in PCA Case No. AA 228, VPL, was incorporated in the Republic of Cyprus on 7 February 2001.

69. Hulley held approximately 56.3 percent, YUL held approximately 2.6 percent and VPL held approximately 11.6 percent of the outstanding shares in Yukos. Collectively therefore, Claimants approximately had a 70.5 percent shareholding in Yukos.

2. Respondent

70. Respondent in these three arbitrations is the Russian Federation.

B. OAO YUKOS OIL COMPANY

71. After the dissolution of the Soviet Union, Yukos was incorporated as a joint stock company in 1993 by Presidential Decree. Fully privatized in 1995–1996, it was a vertically integrated

group engaging in exploration, production, refining, marketing and distribution of crude oil, natural gas and petroleum products. Its three main production subsidiaries were Yuganskneftegaz ("**YNG**"), Samaraneftegaz and, from 1997, Tomskneft.

72. In May 2002, Yukos became the first Russian company to be ranked among the top ten largest oil and gas companies by market capitalization worldwide. In the fourth quarter of 2002, Claimants submit that Yukos became the largest oil company in Russia in terms of daily crude oil production.

73. At its peak in 2003, it had around 100,000 employees, six main refineries and a market capitalization estimated at over USD 33 billion. According to Claimants, after its projected 2003 merger with then Russia's fifth largest oil company Sibneft ("**Sibneft**"), YukosSibneft would have become the fourth largest private oil producer worldwide, behind BP, Exxon and Shell. At the time of Respondent's alleged adverse actions in the summer of 2003, Yukos was engaged in negotiations with ExxonMobil and ChevronTexaco for a merger or other form of business combination. Claimants contend that this level of success was the result of efforts to modernize Yukos' operations and implement Western business practices. According to Claimants, Yukos' success and the increasing social and economic influence gained by its management—including financial support given by Mr. Khodorkovsky to opposition parties—were perceived as a political threat by the Russian authorities and accordingly Yukos would fall from grace and be targeted for destruction. Respondent, however, contends that Yukos was a "criminal enterprise", engaged in a variety of tax evasion schemes and other fraudulent activities.

C. THE RUSSIAN LOW-TAX REGION PROGRAM

74. The low-tax region program was established in the 1990s to foster economic development in impoverished areas of the Russian Federation. The Russian low-tax regions were permitted to exempt taxpayers from federal corporate profit tax for the purpose of fostering taxpayers' investments in the low-tax regions, provided the taxpayer complied with certain requirements.

75. The Russian low-tax regions that are relevant to Yukos' "tax optimization" scheme include:

- Closed Administrative Territorial Units (known as "**ZATOs**"): Lesnoy and Trekhgorniy; and
- Other low-tax regions: Mordovia, Kalmykia and Evenkia.

76. With respect to the tax benefits available in the ZATOs (Lesnoy and Trekhgorniy), in 1999, the ZATOs were permitted to exempt taxpayers fully from federal corporate profit tax. In 2000, most ZATOs were permitted to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget (*e.g.*, up to 19 percent). In 2001, all ZATOs were permitted to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget (*e.g.*, also up to 19 percent). In 2002, however, these exemptions were revoked.

77. With respect to the tax benefits available in other low-tax regions, in 2000 and 2001, Mordovia, Kalmykia and Evenkia were permitted to exempt taxpayers fully from the portion of the federal corporate profit tax that was payable to their budget (*e.g.*, from up to 19 percent to zero percent). From 1 July 2002 until 31 December 2003, low-tax regions were permitted to exempt taxpayers from the portion of the federal corporate profit tax payable to their budget, but only up to four percent. An exception existed for 'grandfathered' tax investment agreements entered into prior to 1 July 2001, such that these taxpayers could still receive a zero percent profit tax rate if they fulfilled certain other conditions. As of 1 January 2004, the existing tax investment agreements were terminated, but the Tax Code of the Russian Federation (the "**Russian Tax Code**") still allowed low-tax regions to reduce the federal corporate profit tax payable to their budget up to four percent.

78. Respondent contends that Yukos' restructuring of its trading operations from high-tax jurisdictions, such as Moscow and Nefteyugansk, to trading companies incorporated in the low-tax jurisdictions of Lesnoy, Trekhgorny, Mordovia, Kalmykia and Evenkia was aimed at evading taxes, rather than to achieve any genuine economic result. Respondent alleges that Yukos interposed between Yukos and its customer its "sham" trading shells registered in Russian low-tax regions. Yukos' oil producing subsidiaries sold the extracted oil to the trading companies at a fraction of the market price. The trading companies then sold the oil either abroad at a market price or to Yukos' refineries, and subsequently re-bought it at a reduced price and re-sold it at the market price. Respondent asserts that prices increased step by step from sham shell to sham shell, generating artificially inflated profits through non-armslength transactions. Those profits were then taxed at reduced rates in the low-tax regions, where the sham trading shells were registered. Respondent contends that the tax authorities identified abuses by the Lesnoy trading shells, which resulted in further investigations and, ultimately, in the tax assessments against Yukos and related proceedings.

79. Claimants contend that Yukos, like other Russian companies at that time, was merely taking advantage of the legislation in place in the low-tax regions. Claimants assert that any findings of "abuse" by the Russian tax authorities was a function of the arbitrary and unpredictable interpretations of the law in Russia.

80. The details of the Russian low-tax region program and Yukos' tax optimization scheme are set out more comprehensively in Chapter VIII.A of this Award.

D. CRIMINAL PROCEEDINGS

81. Starting in July 2003, a series of criminal investigations were initiated by the Russian Federation against Yukos management and activities. According to Claimants, these actions included the "targeting" of Yukos' employees, auditor PwC, in-house counsel, lawyers involved in various Yukos-related cases, as well as searches and seizures, threats to revoke its oil licenses, and mutual legal assistance requests and extradition proceedings against Yukos management. Claimants characterize these actions as harassment, motivated by Mr. Khodorkovsky's participation in Russian opposition politics, that were intended—together with tax reassessments—to lead to the expropriation of Yukos' assets. Respondent contends that its actions were in response to illegal acts committed by Yukos and its officers and shareholders.

82. Between July and October 2003, three key Yukos officers were arrested. In July 2003, Mr. Platon Lebedev, Director of Hulley and YUL, was arrested on charges of embezzlement and fraud; he was sentenced to nine years in prison in May 2005. In October 2003, Mr. Vasily Shakhovsky, President of Yukos-Moscow, was charged with and later convicted of tax evasion. In October 2003, Mr. Khodorkovsky himself was arrested and charged with crimes including forgery, fraud and tax evasion; he was also sentenced to a nine-year prison term in May 2005. As a result of these arrests, a number of high-ranking Yukos executives fled Russia, such as Mr. Leonid Nevzlin, Deputy Chairman of the Yukos Board of Directors until 2003. On 2 February 2007, new charges of embezzlement and money laundering were brought against Messrs. Khodorkovsky and Lebedev, leading to further convictions in December 2010. Messrs. Khodorkovsky and Lebedev were each imprisoned for over a decade.

83. Claimants contend that by April 2006, no fewer than 35 top managers and employees of Yukos had been interrogated, arrested or sentenced, and that lawyers acting for Yukos had been obstructed in their work. During the same period, Russian authorities conducted searches,

seizures and interrogations of Yukos property and personnel. Claimants contend that all of these actions amounted to harassment and intimidation, that they deprived Yukos' management of the ability to manage and control Yukos as a business, and that the underlying motive was to expropriate Yukos' assets.

84. Respondent contends that in addition to participation in tax fraud schemes, Yukos participated in a massive transfer pricing scheme by which hundreds of millions of dollars from the sales of oil and other products were illegally siphoned off to offshore entities for the benefit of Khodorkovsky/Lebedev and other controlling Russian "Oligarchs".[6]

85. Respondent also contends that Yukos officials have been engaged in violent crimes, such as the murder, attempted murder and assault of persons seeking to enforce Russian tax laws or otherwise perceived to threaten Yukos interests. Claimants deny Respondent's allegations of criminal acts as well as acts of tax evasion.

86. Respondent denies that Yukos and its officers were targeted in a discriminatory way, contending that Russian taxation measures have also applied to other offenders and that the searches and seizures were taken as part of legitimate taxation measures and conducted in accordance with normal Russian practice and the appropriate procedural protections available under Russian law.

87. The particulars of Claimants' allegations concerning harassment, intimidation and arrests are presented in Chapter VIII.C of this Award.

E. ADDITIONAL MEASURES

88. In the period between October 2003 and December 2004, Yukos and its subsidiaries faced a series of major setbacks, including the alleged frustration of its merger with Sibneft, hefty tax reassessments, fines, VAT exactions, the freezing of shares and assets, the threatened revocation of licenses, and the forced sale of Yukos' main oil production subsidiary, YNG. These measures were followed by the bankruptcy of Yukos in August 2006.

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[6] Respondent's Counter-Memorial on the Merits dated 4 April 2011, as corrected 29 July 2011, p.1 n.1 (hereinafter "Counter-Memorial"): Respondent employs the term "Oligarchs" throughout its pleadings to refer to Messrs. Khodorkovsky, Lebedev, Nevzlin, Dubov, Brudno, Shakhnovsky, Golubovitch; the individual owners standing behind Claimants (hereinafter the "Oligarchs").

1. Alleged Frustration of Merger Between Yukos and Sibneft

89. In October 2003, a merger was about to be completed between Yukos and Sibneft, Russia's fifth largest oil company. According to Claimants, the resulting entity, YukosSibneft, would have become the world's fourth largest oil company. In November 2003, however, after Yukos had already acquired 92 percent of Sibneft's shares as part of the merger and after the arrest of Mr. Khodorkovsky, Sibneft's controlling shareholder, Mr. Roman Abramovich, called off the merger process and the transactions were then unwound by a series of court decisions. Further details are included in Chapter VIII.D of this Award.

2. Tax Reassessments for Years 2000–2004

90. On 28 April 2003, the Tax Ministry issued a Field Tax Audit Report for the years 2000 and 2001 that raised no questions concerning Yukos' tax optimization structure. On 1 September, 1 October and 1 November 2003, the Tax Ministry issued certificates confirming that Yukos had no outstanding debts.

91. On 8 December 2003, the Tax Ministry ordered a tax re-audit of Yukos for the year 2000. On 29 December 2003, the tax authorities of the Russian Federation issued the first of five tax assessments against Yukos that were based on the alleged abuse by Yukos of its tax optimization scheme.

92. The Tax Ministry demanded payment from Yukos for approximately USD 3.5 billion for 2000, which was largely upheld by the Moscow Arbitrazh Court. Similarly large tax reassessments were issued in the period between 2004 and 2006 for subsequent tax years. 2001 taxes were re-assessed in the amount of approximately USD 4.1 billion, 2002 taxes in the amount of approximately USD 6.8 billion, 2003 taxes in the amount of approximately USD 6.1 billion, and 2004 taxes in the amount of approximately USD 3.7 billion. By the time the Tax Ministry issued the last of these demands, Yukos faced a tax bill of more than USD 24 billion, of which approximately USD 10.6 billion constituted allegedly evaded revenue-based taxes (including interest and fines), and the remainder (approximately USD 13.6 billion) comprised of VAT and related, interest and fines.

93. Respondent contends that the reassessments were a consequence of Yukos' activities relating to the tax fraud scheme. Claimants submit, however, that the reassessments were so excessive that the Russian authorities' strategy of destroying Yukos became plain.

94. At the same time that tax reassessments were being filed against Yukos and its subsidiaries, Russian authorities began freezing shares and other assets belonging to Yukos and related entities. In October 2003, Russian prosecutors froze shares held by YUL and Hulley in Yukos. Orders issued by the Moscow Arbitrazh Court in April and June 2004 prevented Yukos from disposing of its assets. An application by Yukos in July 2004 to have sufficient assets released to meet its tax liabilities was ignored and a surcharge of approximately USD 240 million was applied for late payment of taxes. Claimants also maintain that Yukos' numerous proposals throughout this period to settle the tax claims were ignored or rejected by the Russian authorities, despite the fact that the government settled with taxpayers in several other cases.

95. In July 2004, Russian authorities began seizing Yukos' shares in YNG, Samaraneftegaz and Tomskneft. YNG bank accounts were also frozen. The Russian authorities also used mutual legal assistance treaties to affect Yukos' interests abroad.

96. Respondent does not dispute the freezing of Yukos' assets but contends that freezing assets of a debtor, including shares owned by it, is a standard enforcement measure for tax levies and judgments. Respondent maintains that its freezing orders did not cover all of the assets of Yukos in Russia and that Yukos remained in possession of large assets abroad.

97. The details of the tax assessments against Yukos and of Yukos' attempts to settle the tax claims are set out in Chapters VIII.B and VIII.E, respectively.

3. Auction of YNG

98. In July 2004, the Russian Federation indicated that it intended to appraise and sell YNG to pay off Yukos' back taxes. A valuation carried out by investment bank ZAO Dresdner Bank ("**Dresdner**") at the request of the Russian Federation valued YNG at between USD 15.7 billion and USD 18.3 billion. A valuation carried out by JP Morgan, at the request of Yukos, valued YNG at between USD 16 billion and USD 22 billion. The Russian Ministry of Justice announced that YNG was worth USD 10.4 billion.

99. After Yukos' attempts to enjoin the sale of YNG by legal recourse in the United States failed, YNG was sold at auction on 19 December 2004 for USD 9.37 billion to sole bidder and newly incorporated entity, Baikal Finance Group ("**Baikal**"), which was quickly bought by Russian State-owned Rosneft ("**Rosneft**").

100. Further particulars on this aspect of the case are presented in Chapter VIII.F of this Award.

4. Bankruptcy Proceedings

101. Claimants allege that the Russian Federation first reported in March 2005 that it intended to "push Yukos into bankruptcy in order to redistribute its remaining assets." On 6 March 2006, a syndicate of foreign bank creditors of Yukos filed a bankruptcy petition before the Moscow Arbitrazh Court, pursuant to a Confidential Sale Agreement with Rosneft (the "**Confidential Sale Agreement**"). YNG—then owned by Rosneft—filed a separate bankruptcy petition against Yukos, which was subsequently joined to that of the bank syndicate. On 28 March 2006, bankruptcy proceedings were commenced against Yukos, placing it under external supervision, and on 4 August 2006, Yukos was declared bankrupt.

102. Yukos' remaining assets were nearly all acquired by State-owned Gazprom and Rosneft, with the bankruptcy auctions raising a total of USD 31.5 billion. In November 2007, Yukos was liquidated and struck off the register of legal entities.

103. The specifics relating to Yukos' bankruptcy are set out in Chapter VIII.G of this Award.

5. Withdrawal of PwC's Audits

104. In June 2007, PwC (which had served as both auditor and consultant to Yukos starting in 1997) withdrew all of its audits of Yukos from 1995 to 2004.

105. This final aspect of the factual matrix is treated in detail in Chapter VIII.H of this Award.

III. PARTIES' WRITTEN SUBMISSIONS

106. As indicated in the Procedural History above, the Parties submitted two rounds of memorials on the merits. Each side took full advantage of the written phase of these proceedings, filing detailed and extensive written submissions. Claimants' Memorial runs to 424 pages and was accompanied by 1045 exhibits and 12 witness statements. Respondent's Counter-Memorial is 787 pages long, and was accompanied by 2868 exhibits and 8 witness statements. Claimants' Reply runs to 474 pages, and was accompanied by over 600 further exhibits. Finally, Respondent's Rejoinder runs to 819 pages, and was submitted with over 1700 further exhibits and seven witness statements. The Parties filed Post-Hearing Briefs of over 100 pages.

Throughout the arbitration the Parties filed extensive written submissions on various procedural issues.

107. The Tribunal studied these submissions carefully. The Parties' principal arguments are re-stated in the Tribunal's analysis of the issues in Parts VIII to XIII below. For the purposes of introduction, the Tribunal reproduces below *verbatim* the written "skeleton arguments" that the Parties submitted prior to the Hearing on the Merits at the Tribunal's request.

A. CLAIMANTS' SKELETON ARGUMENTS

108. The text of the paragraphs below is produced directly from paragraphs 1 to 82 of Claimants' Skeleton Argument submitted on 1 October 2012 ("**Claimants' Skeleton**")(footnotes omitted).

I. INTRODUCTION

1. The dispute between the Parties arises from the various actions taken by the Russian Federation against Yukos Oil Company ("Yukos" or the "Company") and related persons and entities, which culminated in the expropriation of the Company for the exclusive benefit of the Russian State and State-owned entities, thereby destroying the Claimants' investments in Yukos. As the Claimants have demonstrated, by (i) failing to treat the Claimants' investments in Yukos in a fair and equitable manner and on a non-discriminatory basis, and (ii) expropriating the Claimants' investments therein, the Russian Federation breached its obligations under Articles 10(1) and 13(1) of the Energy Charter Treaty ("ECT"), respectively, for which the Claimants are entitled to full reparation.

2. The Claimants' positions on the merits are described in detail in their written submissions. This skeleton argument summarizes, for the benefit of the Tribunal, the Claimants' principal arguments, with reference to key supporting materials. It does not replace or supplement those submissions, nor is it a substitute for oral argument.

II. FACTUAL BACKGROUND

3. The various actions taken by the Russian Federation against Yukos, and related persons and entities, were aimed at the destruction and expropriation of the Company. The expropriation of Yukos was achieved in 3 overlapping steps: *first*, the paralysis of the Company (A); *second*, the manufacturing of a pretext for the taking of the Company's assets, namely, the fabrication of debt (B); *finally*, the use of that pretext to take Yukos' assets piece by piece, including its most valuable asset, Yuganskneftegaz, and transfer them to the State-owned companies Rosneft and Gazprom (C). Each of these steps was accompanied by serious due process violations. The result was the liquidation of Yukos in November 2007, and the complete and total deprivation of the Claimants' investments therein.

A. PARALYSIS OF YUKOS

4. Prior to the Russian Federation's attack, Yukos was a flourishing oil company. In May 2002, it was the only Russian company to be ranked among the top 10 largest oil and gas companies by market capitalization worldwide. In the fourth quarter of 2002, it became the largest oil company in Russia in terms of daily crude oil production. In October 2003, it completed its merger with Sibneft, another of

Russia's leading oil companies, creating the world's fourth largest private oil producer, behind BP, ExxonMobil and Shell. Yukos was also engaged in advanced discussions with American oil majors, ExxonMobil and ChevronTexaco, in relation to a merger or other form of business combination. This success was the result of concerted efforts to modernize the Company and implement Western business practices.

5. Starting in the summer of 2003, the Russian Federation took a series of actions aimed at undermining the ability of the Company's management to run the business. These included: (i) the arrests of Messrs. Lebedev and Khodorkovsky, Yukos' CEO; (ii) the targeting, intimidation and/or prosecution of other high-ranking Yukos managers, employees and related persons; (iii) the harassment, prosecution and/or arrest of Yukos' in-house counsel and lawyers involved in various Yukos-related cases; (iv) the conduct of widespread and aggressive searches and seizures; (v) the seizure of the Claimants' shares in Yukos; (vi) the threats to revoke Yukos' oil licenses; (vii) the numerous mutual legal assistance requests and extradition proceedings to affect Yukos and entities/persons associated with the Company abroad; and (viii) the targeting and harassment of Yukos' auditor, PwC. These actions were taken in violation of the most basic standards of due process and fair treatment.

6. Contrary to the Respondent's allegations, the actions described above deprived Yukos' management of the ability to manage and control the Company, thereby facilitating its dismantling and ultimate destruction. One early casualty of the Russian Federation's attack on Yukos was the YukosSibneft merger.

B. MANUFACTURING A PRETEXT — THE FABRICATION OF DEBT

1. The fabrication of massive tax claims against Yukos for the years 2000-2004

7. In December 2003, the Russian Federation's campaign against Yukos entered into a new phase with the fabrication of massive tax claims against the Company.

8. On December 8, 2003, 6 weeks after Mr. Khodorkovsky's arrest, the Tax Ministry ordered a tax re-audit of Yukos for the year 2000. Only 3 weeks later, it issued a Field Tax Audit Report exceeding 100 pages in length and proposing to collect from Yukos US$ 3.4 billion in alleged tax arrears, interest and fines on the purported basis that the use of regional tax incentives by Yukos trading companies constituted unlawful tax evasion by Yukos itself.

9. The December 2003 re-audit of Yukos was extraordinary in many respects. Less than 8 months earlier, on April 28, 2003, the Tax Ministry had issued a Field Tax Audit Report for the years 2000 and 2001 that raised no questions concerning Yukos' tax optimization structure. That audit had taken 5 months to conduct, followed by 2 months for drafting the report. On several occasions after this audit, including on September 1, October 1 and November 1, 2003, the Tax Ministry confirmed that Yukos had no outstanding tax debts. Prior tax audits of the Mordovian trading companies likewise raised no major concerns and specifically found their use of regional tax incentives to be lawful.

10. The Respondent alleges that the Russian authorities lacked knowledge of Yukos' tax optimization structure and only "discovered" its allegedly abusive features in the course of the 3-week audit carried out in December 2003. This allegation is not credible. As the record demonstrates, the Russian authorities had long been aware of Yukos' practices, and the Respondent has failed to identify a single piece of material information relevant to the alleged tax claims that it lacked prior to the December 2003 repeat audit. In particular:

- Yukos was one of Russia's largest taxpayers and was therefore under constant scrutiny by the Russian tax authorities, who had never found any significant problems prior to the attack on Yukos.
- The use of trading companies incorporated in low-tax regions was a common practice among Russia's vertically integrated oil companies, a fact that was well known to Russian authorities.
- Several trading companies' affiliations with Yukos were reflected in their names, for instance, Yukos-M and Yu-Mordovia.
- Prior to using trading companies in Mordovia—the source of the overwhelming majority of the purported tax claims—Yukos discussed the issue with federal and regional officials, who approved Yukos' plan. Mordovia's Government then signed investment agreements with these trading companies specifying the amounts of monthly payments. Audits of the Mordovian trading companies confirm the tax authorities' knowledge of the factual circumstances later alleged to constitute "abuse".
- As the Respondent concedes, Yukos' financial statements disclosed that companies within Yukos' consolidation perimeter enjoyed tax benefits under the low-tax region program and the overall amounts of such benefits.
- VAT refund submissions documented the entire chain of transactions prior to export, including, in particular, the trading companies' transactions with Yukos' production companies, refineries, and the holding company.
- Yukos' monthly submissions to obtain access to export pipelines confirmed that the trading companies' tax payments were in relation to the trading of oil produced by Yukos' production subsidiaries and exported under Yukos' export quotas.

11. The Tax Ministry went on to fabricate similar tax claims against Yukos covering the years 2001-2004. As discussed below, the timing of these claims was instrumental in carrying out the Russian Federation's expropriation plan. By the time the Tax Ministry issued the last of these demands, Yukos faced a tax bill of more than US$ 24 billion, of which only US$ 5.2 billion constituted allegedly evaded revenue-based taxes, the remainder being comprised of VAT, interest, and fines. These payment demands dwarfed the Company's consolidated net income for the relevant periods.

2. The purported tax claims were unprecedented, arbitrary and manifestly expropriatory

12. *Purported bases for revoking regional profit tax incentives.* Yukos' tax optimization structure fully complied with the legislation in force and current practices. Indeed, the Respondent does not allege that Yukos or the trading companies failed to comply with the federal or regional legislation. Nor does it allege that the trading companies failed to fulfill the terms of the investment agreements signed with the regional governments. Rather, it claims that the trading companies failed to satisfy additional, unwritten requirements beyond the statutory eligibility criteria, including, in particular, an alleged "proportionality of investments" requirement that directly contradicted both the legislation and the investment agreements signed by the regional governments. This justification is not credible.

13. *Re-attribution.* The primary weapon in the expropriation of Yukos' assets was the reattribution of the alleged tax liabilities of the trading companies to Yukos. Russian law did not allow such re-attribution, and the Respondent cannot point to a single example of such a re-attribution other than the Yukos case. Had the Russian authorities genuinely believed that the tax benefits had been improperly granted to the trading companies, which was not the case, the proper course under Russian law

would have been to pursue those companies for the allegedly underpaid taxes. Alternatively, had they genuinely believed that sales had occurred at below market prices, Russian tax law contained a specific statutory mechanism for such transfer-pricing situations. However, the Russian authorities ignored these statutory provisions. Re-attribution served 2 purposes: *first*, shifting liability to Yukos itself paved the way for the expropriation of the Company's assets; *second*, re-attribution provided the basis for massive VAT claims.

14. *VAT.* Simultaneously invoking and contradicting their own re-attribution theory, the tax authorities re-attributed to Yukos all the revenues from the trading companies' transactions, but refused to re-attribute to Yukos the trading companies' entitlements to VAT refunds for export transactions. The purported basis for denying refunds was that the paperwork, although proper and timely, had been submitted by the trading companies rather than Yukos. This enabled the tax authorities to claim an additional US$ 13.59 billion—56.20% of the total claims against Yukos—despite the uncontested fact that no VAT was owed on these transactions. Such a step was clearly confiscatory in nature. Further, the fact that, even when Yukos attempted to submit the updated VAT returns in its own name, its submissions were rejected as improper and untimely, confirms that the purported VAT claims had nothing to do with taxation. The Respondent has been unable to offer any defense whatsoever for the fundamentally contradictory way in which its re-attribution theory was deployed.

15. *Fines.* The tax authorities further inflated their claims through the unjustified imposition of fines, including by imposing fines after the statute of limitations had expired; by doubling fines for "willfulness" despite the fact that Yukos did not—and could not possibly—"know" of the alleged illegality; and by doubling fines again for "repeat offenses" despite the fact that at the time of the alleged "repeat" offenses Yukos had never been previously held liable for a similar offense. Overall, these inflated fines amounted to US$ 8.5 billion, *i.e.*, 35.13% of the total alleged tax liabilities, with the "repeat" offender fines alone amounting to US$ 3.92 billion.

16. The common thread unifying the Russian Federation's approach was an overarching desire to manufacture and inflate claims against Yukos, with a view to expropriating the Company. As Yukos' tax lawyer noted after reviewing the December 2003 audit report, "[e]ven if we assume political pressure on the court the extent of the violations committed by the Ministry for Taxes and Levies will make it impossible even for the most biased judge to support the clearly unlawful inspection act". The Russian courts proved Yukos' tax lawyer wrong, rubber-stamping the fabricated tax debts.

3. Due process violations in the administrative and judicial proceedings

17. The administrative and judicial proceedings with respect to the alleged tax debts were conducted in blatant disregard of Yukos' basic due process rights. This involved, *inter alia*, pressure on the courts to ensure that only Government-friendly judges would preside over Yukos' challenges—and subsequently rewarding those judges for their efforts; overly speedy proceedings, denying Yukos adequate time and facilities to prepare its defense; and arbitrary denials of Yukos' motions to join to the proceedings the trading companies and the Mordovian Government. Coupled with the harassment of Yukos' lawyers noted above, the Russian Federation ensured the hasty conclusion of these proceedings, bringing it one step closer to its objective, namely the taking of Yukos' assets.

C. APPROPRIATION OF YUKOS' ASSETS – SEIZING YUKOS' ASSETS AND TRANSFERRING THEM TO STATE-OWNED COMPANIES

1. Yukos was prevented from settling its alleged tax debts or discharging them in full

18. *The swift and manifestly disproportionate enforcement of the 2000 tax reassessment.* On April 14, 2004, the tax authorities issued their payment demands for the year 2000. Yukos was given until April 16, 2004, *i.e.*, less than 48 hours, to pay in full US$ 3.48 billion in alleged tax arrears, interest and fines.

19. Even this symbolic "voluntary" payment period was illusory. On April 15, 2004, the very next day after the demand for payment was issued, the tax authorities obtained from the Moscow Arbitrazh Court an *ex parte* injunctive order freezing, as a purported security measure, all of Yukos' non-cash Russian assets, with the exception of oil and oil products.

20. On June 30, 2004, following Yukos' unsuccessful appeal, an enforcement writ was issued giving the Tax Ministry 3 years to collect the 2000 tax debt. Rather than engage in discussions with the Company about the discharge of this debt within that period, the bailiffs initiated enforcement proceedings that very same day. The Company was given 5 days to pay voluntarily US$ 3.42 billion in alleged tax arrears, interest and fines for the year 2000 and threatened with a 7% enforcement fee if it failed to do so.

21. At the same time, the bailiffs ordered the seizure of (i) monies deposited in Yukos' accounts with 16 Russian banks, and (ii) the Company's Russian non-cash assets (which had previously been the subject of a freeze). On July 1, 2004, a wave of seizures on Yukos' non-monetary assets began, culminating in the seizure on July 14, 2004 of Yukos' shares in its 3 main production subsidiaries—Yuganskneftegaz, Samaraneftegaz and Tomskneft.

22. It should be recalled that all these seizures were conducted within the framework of the enforcement proceeding initiated on June 30, 2004 to recover from Yukos US$ 3.42 billion in alleged tax liabilities for 2000. These seizures covered virtually all of Yukos' assets, whose value was staggeringly higher.

23. Further, within days, on July 20, 2004, the Ministry of Justice announced its intention to appraise and sell Yuganskneftegaz to satisfy the 2000 alleged tax debt.

24. The decision to seize and sell Yuganskneftegaz, which accounted for approximately 12% of Russia's oil output and whose value on any estimation dramatically exceeded that of the alleged tax debt, can only be reconciled with a desire to destroy the Company and appropriate its core assets. This reality is confirmed by the fact that the decision was taken less than 3 weeks after the writ of execution had been issued and when all of Yukos' domestic assets remained seized and available to satisfy the 2000 tax debt.

25. *The failure to consider Yukos' proposals of alternative means of paying the alleged debt.* Further confirmation of the Russian Federation's expropriatory intent is the systematic rejection of Yukos' numerous offers to the bailiffs, courts and other Russian authorities and officials to settle or discharge its tax debts. These included: (i) the offers of Yukos' Russian non-core assets and its stake in Sibneft, initially 34.5% and subsequently reduced to 20% minus 1 share following the seizure of the 14.5% stake in Sibneft on July 9, 2004, in the context of the Chukotka Arbitrazh Court proceedings; (ii) Yukos' petition to pay its alleged tax debt for the year 2000 in installments; (iii) Yukos' amicable proposal to the Ministry of Finance to defer the payment of the federal share of its alleged debt for 6 months or to pay it in tranches; (iv) the proposals by Mr. Jean Chrétien, former Canadian Prime Minister, to Prime Minister Fradkov and President Putin of a global settlement of the

disputes, which envisaged the payment to the Russian Federation of approximately US$ 8 billion over the course of 2 years; (v) Yukos' October 2004 full settlement proposal in the range of US$ 21 billion, which included non-core assets and Sibneft shares, as well as a concession to re-elect a new board of directors that would include people selected by the Government.

26. Each of these offers, as well as numerous others, was either denied or, in most cases, simply ignored. The Respondent's attempts to provide *post-hoc* rationalizations for its conduct by qualifying each of Yukos' offers as unacceptable or inadequate are unfounded. In any event, the Russian authorities' failure to work with—or even respond to—the multiple offers by Yukos, one of the largest private taxpayers in Russia, or to consider other options for enforcement, confirms that the Russian Federation was not interested in collecting taxes. This is even more so in light of the fact that the Russian authorities had no difficulty entering into settlement discussions and negotiating repayment plans with other Russian oil companies, including, *inter alia*, Rosneft and Sibneft.

2. The forced sale of Yukos' shares in Yuganskneftegaz

27. *Fabrication of further debt to maintain the pretext.* Despite the effect of the seizures described above, by the time of the Yuganskneftegaz auction, Yukos had paid off the 2000 tax reassessment in its entirety, eliminating the *raison d'être* of the decision to sell Yuganskneftegaz. Recognizing this difficulty as well as the gross disparity between the alleged tax debts and the value of Yuganskneftegaz, the Tax Ministry set about fabricating new claims.

- On September 2, 2004, the Tax Ministry served Yukos with a tax reassessment for 2001 in the amount of US$ 4.1 billion. Yukos was given only 2 days to pay voluntarily this amount, with the bailiffs initiating enforcement proceedings on September 9, 2004.
- On November 16, 2004, the Tax Ministry served Yukos with a tax reassessment for 2002 in the amount of US$ 6.76 billion, the largest among the 5 tax reassessments for the years 2000-2004. Yukos was given only 1 day to pay voluntarily this amount, with the bailiffs initiating enforcement proceedings on November 18, 2004.
- On December 6, 2004, the Tax Ministry served Yukos with a tax reassessment for 2003 in the amount of US$ 6.1 billion, giving the Company 1 day to pay in full. On December 9, 2004, the bailiffs initiated enforcement proceedings.

28. In each case, the bailiffs allowed Yukos at most 5 days for voluntary payment and charged the 7% enforcement fee for failure to comply with these unreasonably short time limits.

29. Thus, in the 4 months from September 2004 up until the auction of Yuganskneftegaz on December 19, 2004, the Russian Federation managed to increase Yukos' alleged tax liability by approximately US$ 17 billion.

30. *Efforts to depress the auction price of Yuganskneftegaz.* At the same time, with a view to facilitating the Russian Federation's acquisition of Yuganskneftegaz at a bargain price, the Russian Tax Ministry also fabricated claims against Yuganskneftegaz. These claims were premised on the application of statutory provisions on transfer pricing, which the tax authorities systematically refused to apply in relation to Yukos itself. Significantly, these claims concerned the same oil trading revenues that had already been re-attributed to Yukos, thus resulting in double taxation.

31. Thus, on October 29, 2004, the tax authorities simultaneously: (i) issued a Repeat Field Tax Audit Report for 2001 requesting Yuganskneftegaz to pay US$ 2.35 billion in alleged tax arrears, interest and fines;[93] and (ii) rendered a Decision

holding Yuganskneftegaz liable for an alleged tax offense for the year 2002 and requiring payment of US$ 1.03 billion in alleged tax arrears, interest and fines.

32. On December 3, 2004, a Field Tax Audit Report was issued for the year 2003, imposing on Yuganskneftegaz an additional US$ 1.22 billion in alleged tax arrears, interest and fines.

33. In addition to fabricating these US$ 4.6 billion in additional alleged liability, the Russian authorities also began to sow doubts about the security of Yuganskneftegaz's oil licenses to depress further the Company's value.

34. That all these payments demands, imposed simultaneously on Yukos and its main production subsidiary, were issued in the run-up to the auction of Yuganskneftegaz is no coincidence. Nor is it a coincidence that, after Yuganskneftegaz was acquired by Rosneft, the tax claims along with the oil license concerns promptly disappeared. Together with the generous payment terms accorded to Rosneft's new subsidiary but systematically denied to Yukos, these facts confirm both the discriminatory nature of the Russian Federation's treatment of Yukos, and the true purpose of the purported tax reassessments against Yuganskneftegaz, namely, to facilitate the expropriation of the Company and not to collect taxes.

35. *Sham auction of Yuganskneftegaz.* As noted above, the Ministry of Justice publicly announced its plan to sell Yuganskneftegaz on July 20, 2004, purportedly in order to satisfy the 2000 alleged tax debt.

36. On August 12, 2004, the bailiffs appointed ZAO Dresdner Bank ("Dresdner") to carry out the valuation of Yuganskneftegaz in preparation for its sale. On October 6, 2004, Dresdner issued a confidential report valuing Yuganskneftegaz on a standalone basis at US$ 18.6 billion – 21.1 billion.

37. On November 18, 2004, the bailiffs announced that Yuganskneftegaz would be auctioned to satisfy Yukos' outstanding tax debt, with the Russian Federal Property Fund issuing the formal auction notice the following day. The opening price for 100% of the ordinary shares, or 76.79% of Yuganskneftegaz's total share capital, was set at US$ 8.65 billion, a price well below its true value. The auction date was set for December 19, 2004, which was the earliest possible date to hold the auction and only 1 month away.

38. In an attempt to prevent the auction of its core asset, Yukos filed an application with the Moscow Arbitrazh Court to declare unlawful the Bailiff's Resolution of November 18, 2004 and sought interim measures. These efforts failed.

39. Confronted, yet again, with the futility of its efforts to obtain justice before the Russian courts, on December 14, 2004, Yukos filed for Chapter 11 bankruptcy protection before the U.S. Bankruptcy Court for the Southern District of Texas. By that date, only 3 companies, Gazpromneft (the new wholly-owned subsidiary of State-owned Gazprom), First Venture and Intercom, had sought antimonopoly clearance required in anticipation of the auction. On December 16, 2004, the U.S. Court issued a Temporary Restraining Order ("TRO") enjoining Gazpromneft, its potential lenders, First Venture and Intercom from participating in the auction of Yuganskneftegaz.

40. Nonetheless, on December 19, 2004, which was a Sunday, the Russian authorities proceeded with the auction of Yuganskneftegaz. Gazpromneft and OOO Baikalfinancegroup ("Baikal") were registered as participants. Baikal was a previously unknown company established at the address of a local bar in the provincial town of Tver on December 6, 2004. With only US$ 359 in capital, it mysteriously managed to pay a cash deposit in the amount of US$ 1.77 billion to register for the auction on December 16, 2004.

41. At the auction, Baikal opened the bidding at US$ 9.35 billion. Gazpromneft's representative asked for a recess and left the room to make a telephone call. Upon his return, he did not make a single bid and Baikal was pronounced the winner of the auction with its opening bid of US$ 9.35 billion. The whole bidding process lasted approximately 10 minutes.

42. The Respondent's allegation that the low price for Yuganskneftegaz reflected attempts by Yukos to "sabotage" the auction is unconvincing. Neither "litigation risk" nor the TRO had a material effect on the participants or the outcome of the auction. The reality is that, ignoring the advice of its own appraisal firm, the Russian authorities systematically acted in ways that negatively affected the ability and willingness of potential bidders to participate, as well as the price they would be willing to pay. Market participants also understood that political support was required to participate in auctions for Yukos assets.

43. The use of Baikal as a conduit for the eventual transfer of Yuganskneftegaz to a State-owned company was confirmed when, only a few days later, on December 23, 2004, Rosneft issued a statement announcing its acquisition of Baikal. Meeting journalists that day, President Putin confirmed his knowledge of the acquisition, stating that: "Today, the state, resorting to absolutely legal market mechanisms, is looking after its own interests. I consider this to be quite logical". Rosneft then enabled Baikal to repay the principal and interest on its debt by granting it, on December 30, 2004, a 1-year interest-free loan.

44. Rosneft benefited significantly from this acquisition, with Rosneft's estimated value increasing dramatically from US$ 7 billion in December 2004 to US$ 80 billion for its IPO in mid-2006. Based on the valuation disclosed by Rosneft at the time, Yuganskneftegaz was worth US$ 55.78 billion. Further, as noted above, the tax bills raised against Yuganskneftegaz as a Yukos subsidiary were almost entirely set aside by the Russian courts following its acquisition by Rosneft.

45. Looked at from any angle, the Russian Federation's approach to enforcement of the alleged tax debts, culminating in the transfer of Yuganskneftegaz to Rosneft in a sham auction, confirms that the Russian Federation's real goal was to expropriate the Company, and not to collect taxes.

46. Even after the sham auction of Yuganskneftegaz, there was no legitimate reason to put Yukos into bankruptcy. There were no substantial creditors apart from the Russian Federation, and the seizure of Yukos' assets remained in place, so there was no risk of assets being dissipated and no need to resolve conflicting creditors' claims. Yukos still possessed 2 substantial production subsidiaries—Samaraneftegaz and Tomskneft—as well as refining and marketing assets, and several non-core assets that it could readily have disposed of to pay off its outstanding debts and remain a going concern. However, the Russian authorities' priority was not recouping taxes; nor did they have any intention of allowing Yukos to survive as a going concern. The initiation of the bankruptcy proceedings provided a convenient way to sideline Yukos' management and to facilitate the taking of the Company's remaining assets.

47. *Forcing Yukos into bankruptcy.* As a result of the Russian Federation's attack, Yukos defaulted on a US$ 1 billion loan granted by a syndicate of Western banks. On December 13, 2005, Rosneft entered into a confidential agreement with the syndicate under which Rosneft agreed to pay the outstanding amount owed by Yukos in exchange for the assignment to Rosneft of the syndicate's rights of claim against Yukos. *Crucially*, the payment of Yukos' debt by Rosneft was conditioned upon the initiation of Yukos' bankruptcy by the syndicate. Pursuant to that agreement, on March 6, 2006, the syndicate filed a petition with the Moscow Arbitrazh Court to declare Yukos bankrupt, and on March 14, 2006, Rosneft paid off the loan.

48. On March 28, 2006, the Moscow Arbitrazh Court ordered the commencement of bankruptcy proceedings, placed Yukos under supervision, appointed Mr. Rebgun as interim administrator, and formally substituted Rosneft for the syndicate as creditor.

49. The Respondent argues that "sound commercial interests" explain both the syndicate's sale of the loan and Rosneft's reasons for acquiring the same. However, even if that were the case, the Respondent still fails to answer the basic question: why not simply have the syndicate of banks assign their claim to Rosneft, and let Rosneft put Yukos into bankruptcy? The only plausible explanation for this elaborate stratagem was to conceal the Russian Federation's role in initiating the bankruptcy of Yukos.

50. *Ensuring the Russian State's control over the bankruptcy proceedings.* After Rosneft initiated the bankruptcy through the syndicate, the Russian courts ensured that the Russian State, either directly or through Rosneft, would become Yukos' main creditor.

51. *First*, the Russian courts bent over backwards to ensure that the tax authorities' purported claims would be admitted, by: (i) delaying a scheduled hearing in order to give "the State more time to prove new tax claims", namely, the US$ 3.9 billion in tax payment demands for 2004, which the tax authorities rushed to issue on March 17, 2006, 11 days after the bankruptcy petition was filed; (ii) merging Yukos' challenge to that payment demand into the bankruptcy proceedings; and (iii) approving all the tax authorities' purported claims against Yukos for the years 2000-2004 following a wholly perfunctory review of the voluminous case files. Consequently, the Federal Taxation Service was by far Yukos' largest creditor with 60.50% of all registered bankruptcy claims.

52. *Second*, in the period leading up to the first meeting of Yukos' registered creditors on July 20, 2006, some 29 purported claims were admitted on behalf of Yuganskneftegaz, now Rosneft's subsidiary, totaling approximately US$ 4.42 billion. Subsequently, Rosneft secured admission of an even larger claim of US$ 5.55 billion premised on an allegation that Yuganskneftegaz had suffered "lost profits" in this amount during the period 2000-2003. These purported claims of US$ 9.97 billion enabled Rosneft to more than recoup the US$ 9.35 billion paid for Yuganskneftegaz and thereby acquire the Company for free. With the admission of these and various smaller claims, Rosneft became Yukos' second largest creditor with 37.17% of all registered bankruptcy claims.

53. *Third*, while the Russian court hearing Yukos' bankruptcy showed great flexibility in admitting any and all claims to benefit the Russian State, it was intransigent and formalistic in finding pretexts not to recognize substantial claims of creditors related to Yukos or to Yukos' shareholders.

54. These combined efforts resulted in the complete monopolization of Yukos' bankruptcy proceedings by the Russian State, which held 97.67% of all bankruptcy claims, guaranteeing its control over the bankruptcy process.

55. *Rejection of Yukos' Rehabilitation Plan.* The Financial Rehabilitation Plan proposed by Yukos' management ("the Rehabilitation Plan") set out a series of concrete measures that would enable Yukos to pay off its alleged liabilities fully within 2 years, while remaining a viable going concern. This would be achieved by, among other things, creating a "cash pool" from the sale of ancillary assets, cash flows generated by Yukos' remaining core assets, and more than US$ 1.5 billion from the sale of Yukos' 53.7% stake in the Lithuanian oil company Mazeikiu Nafta and Yukos' 49% stake in Slovakian oil transport major Transpetrol.

56. By contrast, according to Mr. Rebgun, the potential proceeds from the sale of Yukos' remaining assets, which he significantly undervalued at US$ 17.75 billion (after deducting the 24% profit tax payable on auction proceeds), were not sufficient

to cover the US$ 18.3 billion of registered bankruptcy claims. Accordingly, he did not even bother to propose any measure for the Company's financial restoration but simply recommended liquidation. In the event, despite the fact that the bankruptcy auction prices represented significant markdowns from market value, the bankruptcy estate netted approximately US$ 35.55 billion—twice the amount Mr. Rebgun had put forward to argue in favor of liquidation.

57. Ultimately, the Federal Taxation Service and Rosneft held 93.87% of votes at the meeting of Yukos' creditors of July 25, 2006. It therefore came as no surprise that they rejected the Rehabilitation Plan and voted to liquidate Yukos' assets, despite the fact that Yukos' assets exceeded its alleged liabilities, and the Company was clearly solvent.

58. *The bankruptcy auctions.* Yukos' remaining assets were transferred to the Russian State at well below their fair market value through a series of 17 auctions held between March 2006 and August 2007. Rosneft thereby directly or indirectly acquired Yukos' key remaining assets, including Samaraneftegaz (Lot No. 11) and Tomskneft (Lot No. 10), which were sold at a gross discount of approximately 37% and 33%, respectively, of their fair market value. For its part, Gazprom acquired through Eni/Enel the 20% minus 1 share stake in Sibneft that the Russian Federation had persistently refused to let Yukos sell to pay off alleged tax debts. As with the sham auction of Yuganskneftegaz, there was no genuine competition in the bankruptcy auctions and, in many instances, including those for Samaraneftegaz and Tomskneft, the only participants were Rosneft and a previously unknown entity whose sole role was to satisfy the formal requirement that there be a minimum of 2 bidders.

59. Finally, when, by the end of July 2007, it became clear that despite the low auction prices, the bankruptcy might still generate some surplus, further claims were admitted in the bankruptcy proceedings on behalf of the Russian State, through the Federal Taxation Service and Rosneft. This ensured the completeness of Yukos' destruction and the transfer of its value and assets to the Russian State. Thus, the Russian Federation received, either directly or through State-owned Rosneft or Gazprom, approximately 99.71% of the bankruptcy proceeds and over 95% of Yukos' remaining assets, including all of Yukos' main production assets.

60. On November 12, 2007, the Moscow Arbitrazh Court formally endorsed all the activities of Yukos' receiver Mr. Rebgun, closed the Company's receivership and ordered that Yukos be struck off the register of legal entities. The latter happened on November 21, 2007: Yukos was removed from the register of companies, its shares were legally extinguished and so, too, were the Claimants' investments.

D. CONCLUSION

61. Seen together, the Russian Federation's actions can only be reasonably understood as a deliberate and sustained effort to destroy Yukos, gain control over its assets and eliminate Mr. Khodorkovsky as a potential political opponent. Indeed, viewed any other way, they make no sense and the Respondent has been unable to provide a plausible alternative explanation for its actions.

III. LAW

A. THE RUSSIAN FEDERATION IS IN BREACH OF ITS OBLIGATIONS UNDER ART. 10(1) ECT

62. Under Article 10(1) ECT, the Russian Federation undertook to "encourage and create stable, equitable, favorable and transparent conditions for Investors", to accord at all times "fair and equitable treatment" to investments made in its territory and not to "in any way impair by unreasonable or discriminatory measures [the]

management, maintenance, use, enjoyment or disposal" of such investments, which "shall also enjoy the most constant protection and security".

63. The Russian Federation violated the above mentioned undertakings in the most egregious manner. In particular, it violated its obligation under Article 10(1) ECT to provide to the Claimants' investments fair and equitable treatment, by failing to meet basic requirements of procedural propriety and due process, engaging in conduct that was unreasonable, arbitrary, disproportionate and abusive, and failing to ensure a stable and transparent legal and business framework. The Russian Federation's actions also constituted a denial of justice in breach of the fair and equitable treatment standard of Article 10(1) ECT, as demonstrated by, *inter alia*, the removal of judges refusing to rule in the Russian State's favor and the lack of independence and impartiality of judges hearing Yukos' cases.

64. The Russian Federation also breached Article 10(1) ECT by discriminating against the Claimants' investments. In particular, it (i) singled out Yukos and treated it in a markedly different manner from other similar oil companies in Russia, (ii) treated Yuganskneftegaz differently before and after its acquisition by State-owned Rosneft, in the hands of which the former Yukos subsidiary's alleged tax liabilities all but disappeared, and (iii) ensured a differential treatment in the bankruptcy proceedings between creditors related to Yukos, on the one hand, and State-related creditors, on the other.

65. The Respondent's primary defense is to invoke Article 21 ECT to argue that the Claimants' claims should be dismissed on the ground that they are "based exclusively on measures '*with respect to Taxation Measures.*'" As discussed below, not only is the Respondent's interpretation of Article 21 ECT untenable, but the Russian Federation's conduct had nothing to do with the genuine exercise of its taxation power and is thus not covered by Article 21 ECT.

66. The Respondent has moreover attempted to restrict the scope of its treaty obligations by misrepresenting the content of the fair and equitable treatment and discrimination standards in Article 10(1) ECT. Such attempts are groundless and should be rejected.

B. THE RUSSIAN FEDERATION IS IN BREACH OF ITS OBLIGATIONS UNDER ART. 13(1) ECT

67. The Russian Federation expropriated the Claimants' investments in breach of Article 13(1) ECT.

68. As of October 2003, Yukos was one of the largest oil companies in the world. It held 92% of Sibneft, 3 core production subsidiaries (Yuganskneftegaz, Samaraneftegaz and Tomskneft), as well as refining and marketing subsidiaries. As of November 21, 2007, it ceased to exist as a company, owing to a series of actions by which the Russian Federation seized its assets and transferred their title to State-owned Rosneft and Gazprom. The only plausible explanation for the Russian Federation's actions is the twin desire of dismantling the Company and transferring its assets to the State and the removal of Mr. Khodorkovsky as a potential political opponent. The result of those actions was a complete and total deprivation of the Claimants' investments therein.

69. The Russian Federation moreover failed to satisfy any of the 4 conditions set out in Article 13(1) ECT. The expropriation of the Claimants' investments was manifestly: (i) not in the public interest; (ii) discriminatory; (iii) carried out without due process of law; and (iv) not accompanied by the payment of any compensation, let alone prompt, adequate and effective compensation.

70. Unable to deny the total deprivation of the Claimants' investments and the transfer of title of Yukos' assets to State-owned Rosneft and Gazprom, the Respondent

disaggregates its actions and argues that, when taken in isolation, each of them was, under Russian law, a proper response to Yukos' alleged conduct. While, in fact, many of those actions amounted to a gross distortion or abuse of Russian law, lawfulness under domestic law is not, in any event, the proper inquiry under Article 13(1) ECT. Under the applicable international law standards, the actions of the Russian Federation, in their totality, constitute an expropriation of the Claimants' investments in breach of Article 13(1) ECT for which compensation is due.

IV. DAMAGES

71. The Russian Federation is under an obligation to make full reparation to the Claimants for the financial consequences of its breaches of Articles 10(1) and 13(1) ECT. This standard of reparation is not challenged by the Respondent.

72. The magnitude of these financial consequences cannot be underestimated. As a result of the Respondent's actions, the Claimants have lost the entire value of their investments in YukosSibneft, as well as the benefits they should have received from those investments. The Claimants' valuation expert, Navigant, has quantified the Claimants' damages for the loss of their investments in YukosSibneft at US$ 114.174 billion.

73. Navigant has also quantified the Claimants' damages for the loss of their investments in YukosSibneft in 3 alternative scenarios, assuming that: (i) the Respondent does not bear responsibility for the demerger between Yukos and Sibneft, which it does; (ii) further, all tax reassessments were legitimate, which they were not; and (iii) in addition, the sale of Yuganskneftegaz was legitimate, which it was not, and assessing the Claimants' damages at US$ 107.966 billion, US$ 69.583 billion, and US$ 33.317 billion, respectively.

74. In its Counter-Memorial, the Respondent chose not to challenge Navigant's valuation of the Claimants' expropriated investments underlying their principal claims for damages, instead seeking to divert the Tribunal's attention through a series of flawed objections. When the Respondent did make an effort to address the subject, in its Rejoinder, its arguments were inaccurate and entirely divorced from historical data and contemporaneous valuations of YukosSibneft's assets.

75. Navigant has provided the only reliable and methodologically sound model for calculating the compensation due to the Claimants by the Russian Federation for the expropriation of their investments in breach of Articles 10(1) and 13(1) ECT.

V. THE RESPONDENT'S OBJECTIONS SHOULD BE REJECTED

76. *The Respondent's rehashed 'fork-in-the-road' objection is both* res judicata *and groundless.* The Respondent contends that the Tribunal lacks jurisdiction over the Claimants' claims because the Claimants are allegedly pursuing identical claims before the ECtHR. This very same objection was first raised in the jurisdiction and admissibility phase of these arbitrations and unequivocally dismissed by the Tribunal. It is entirely inappropriate for the Respondent to reopen this issue, which is *res judicata*, on the basis that it was allegedly poorly decided. Further, the Respondent's allegations that the Interim Awards were based on an "incorrect assumption" or that there are "special circumstances" justifying a new examination of the issue are unfounded. The Respondent's objection based on Article 26(3)(b)(i) ECT is manifestly without merit and must fail.

77. *The Respondent's attempt to rely on Article 21 ECT is misguided.* The issues arising in relation to Article 21 ECT have already been briefed at length in the jurisdiction and admissibility phase of these arbitrations. In deferring the Respondent's objection based on Article 21 ECT to the merits phase, the Tribunal indicated that it did not wish to rule in a vacuum on the issue of the background to, and motivation behind, the Russian Federation's actions. In light of the Parties' pleadings on the

merits, it is clear that those actions had nothing whatsoever to do with the genuine exercise of the Russian Federation's taxation powers, but were rather solely intended to destroy Yukos and gain control of its assets. Article 21 ECT clearly was not meant to shield a Contracting Party from such egregious conduct.

78. Even assuming, however, that the Russian Federation's actions were a genuine exercise of its taxation powers, which they were not, those actions would nonetheless fall outside the scope of Article 21 ECT, which is limited to the enactment of tax provisions. Further, even if Article 21 ECT were applicable, which it is not, Article 21(5) ECT ensures that Article 13(1) ECT's substantive protection from expropriation remains fully intact. Finally, under any interpretation of Article 21 ECT, many of the Russian Federation's actions had nothing to do with taxation and thus fall outside the ambit of Article 21 ECT altogether.

79. Conversely, under the Respondent's interpretation of Article 21 ECT, save for expropriatory "charges or payments, to the exclusion of enforcement and collection measures, including interest and fines", investors would stand unprotected from any and all State actions, so long as the respondent State in an arbitration labels its actions as "taxation"—regardless of whether such actions had anything to do with taxation, or were being pursued with the sole aim of expropriating or otherwise harming an investor's investment. Such an interpretation, which would turn Article 21 ECT into a gaping hole in one of the key multilateral treaties on investment protection, is clearly untenable and should be rejected.

80. *The Respondent's so-called "unclean hands" theory is without merit.* The Respondent argues that over a period of approximately 12 years, an array of actors engaged in a variety of allegedly "illegal and bad faith misconduct" that somehow deprive the Claimants' investments of ECT protection. The Respondent's position is fundamentally unfounded for several reasons. *First*, the so-called "unclean hands" theory finds no support in the text of the ECT, customary international law, or investment treaty jurisprudence. *Second*, even assuming the existence of such a general principle of international law, which the Claimants deny, its scope would be dramatically more limited than the Respondent contends, such that the Respondent has not alleged any facts that could establish its applicability in the present case. As demonstrated by the Claimants, the Respondent's theory is premised almost exclusively on allegations of collateral illegalities, unrelated either to the making of the Claimants' investments, or to the Claimants' claims in these arbitrations, and all but one of which assert misconduct by third parties. *Third*, and in any event, the Respondent has failed utterly to substantiate any of its allegations. *Finally*, the principles of estoppel and proportionality prevent the Respondent from invoking such alleged illegalities in an attempt to escape liability for its violations of the ECT.

81. In its Rejoinder, while recounting its laundry list of alleged misconduct, the Respondent devotes attention solely to its allegation concerning the application of the 1998 Russia-Cyprus Double Taxation Agreement ("DTA"). Apart from the fact that: (i) this allegation has no bearing on the merits of these arbitrations; and (ii) these arbitrations are not the appropriate forum to hear and decide an alleged dispute on the application of the DTA, the Claimants have, in any event, demonstrated that this allegation is baseless. The Respondent's so-called "unclean hands" objection is thus without merit and must fail.

VI. REQUEST FOR RELIEF

82. For the reasons set out above, the Claimants respectfully request the Arbitral Tribunal to render an Award granting the relief set out in paragraph 1199 of the Claimants' Reply.

B. RESPONDENT'S SKELETON ARGUMENTS

109. The text of the paragraphs below is produced directly from paragraphs 1 to 104 of Respondent's Skeleton Argument submitted on 1 October 2012 ("**Respondent's Skeleton**") (annexes omitted).

I. The Russian Federation Properly Assessed Taxes And Fines Against Yukos

1. Yukos fraudulently evaded billions of dollars of Russian corporate profit tax from 1999 to 2004, abusing the program authorized by the Russian Government in the early 1990s to foster economic development in designated economically underdeveloped areas. Under this program, corporate profits in the low-tax regions were taxed at substantially reduced rates if the taxpayer complied with the applicable legal rules, including Russia's anti-tax abuse principles.

2. In order to properly avail itself of the benefits available in a low-tax region, Yukos was required to comply with three legal regimes: (a) the federal statute authorizing the low-tax region program and the region's own statutes; (b) Yukos' agreements with the regional authorities; and (c) Russia's federal anti-tax abuse "bad faith taxpayer" doctrine.

3. The federal bad faith taxpayer doctrine is rooted in Russia's federal Constitution, and has been applied by Russian tax authorities and courts in thousands of cases since the mid-1990s to condemn abusive transactions that, in substance, constitute unlawful tax evasion. As described by Yukos' own tax lawyers in commentaries they published before the assessments at issue in these arbitrations, this doctrine condemns as tax evasion transactions in which "the taxpayer's actions were aimed solely to reduce the amount of its tax payments rather than to achieve an economic result, [as] this would demonstrate that the relevant transaction was inconsistent with law because the motive underlying such transaction was to avoid tax […]. A person's actions aimed solely at tax evasion may not be regarded as actions made in good faith."

4. Yukos abused the low-tax region program, and evaded Russian corporate profit tax in violation of the bad faith taxpayer doctrine, by implementing what Yukos referred to internally as its "tax optimization" scheme. Pursuant to this scheme, Yukos established dozens of sham "trading companies" in low-tax regions that had no business purpose, and then shifted its own profits to the sham trading companies. These sham trading shells had no genuine economic substance and served no purpose other than to reduce Yukos' tax liabilities, an arrangement described by Yukos' own lawyers as constituting unlawful tax evasion.

5. The European Court of Human Rights ("ECtHR") unanimously rejected Yukos' challenge of the tax assessments that are at issue here, on the basis of the same core principles that underlie these arbitrations. The ECtHR found that Yukos' "tax optimization" scheme consisted of "switching the tax burden from [Yukos] and its production and service units to letter-box companies in domestic tax havens in Russia," and that these "letter box companies" had "no assets, employees or operations of their own [and] were nominally owned and managed by third parties, although in reality they were set up and run by [Yukos] itself."

6. According to the ECtHR, the "letter-box companies" (a) purchased oil and oil products from Yukos' production companies at a fraction of their true market prices, (b) "acting in cascade, then sold the oil either abroad, this time at market price or to [Yukos'] refineries and subsequently re-bought it at a reduced price and re-sold it at the market price," (c) thereby accumulated most of Yukos' profits in the low-tax regions, resulting in Yukos paying substantially lower taxes on those

profits, and (d) then unilaterally transferred to Yukos, as a gift or in purported repayment of sham loans, the profits that had been improperly taxed at reduced rates in the low-tax regions. The ECtHR unanimously concluded that this scheme "was obviously aimed at evading the general requirements of the Tax Code […]."

7. The Russian tax authorities concluded that Yukos' "tax optimization" scheme constituted unlawful tax evasion under the bad faith taxpayer doctrine. In particular, the Russian tax authorities found, and the Russian courts later agreed, that Yukos had abused the low-tax region program because its trading shells (a) did not engage in any genuine business activities in the low-tax regions, but were instead controlled by Yukos from Moscow, (b) purchased oil and oil products at below-market prices solely to artificially concentrate Yukos' profits in low-tax regions, and (c) made only paltry investments in the low-tax regions that were dwarfed by the tax benefits they claimed, thereby failing to fulfill the purpose of the low-tax region program.

8. Yukos did not then -- or later -- offer any rationale for selling Yukos' oil through its network of low tax region trading companies other than reducing Yukos' own tax liabilities, nor have Claimants done so in these arbitrations.

9. Yukos was aware of the bad faith taxpayer doctrine and the risk that its scheme would result in substantial tax assessments if the Russian authorities were ever to learn of it. Among other things, (a) Yukos knew that the authorities had previously denied the low-tax region benefits claimed by several sham trading shells in the Lesnoy region and Sibirskaya based on the same Russian anti-abuse rules that were later applied to Yukos (the Russian authorities only later learned that Yukos exercised *de facto* control over and management of Sibirskaya and the Lesnoy trading shells, and that Yukos surreptitiously liquidated the latter in order to prevent the collection of their overdue taxes), (b) Yukos managers had expressly warned the company's senior executives in internal memoranda that public disclosure of the scheme "will result in substantial tax claims against the Company," (c) as Yukos' former deputy general counsel later conceded, none of the company's external lawyers was willing to render an opinion endorsing its scheme (to the contrary, in refusing to render a "clean" opinion, one cited the need to comply with the same bad faith taxpayer doctrine that later led the Russian tax authorities and courts to find that Yukos was guilty of tax evasion), and (d) Yukos had access to the numerous court decisions applying the bad faith taxpayer doctrine to abusive tax schemes -- including those finding Lukoil, one of Yukos' major competitors, liable for substantial additional amounts for having abused the low-tax region program -- and to the published legal commentaries discussing the bad faith taxpayer doctrine and its requirements, including those written by its own tax lawyers.

10. Yukos' knowledge that its "tax optimization" scheme was unlawful is further confirmed by Yukos' repeated lies to the tax authorities, the Russian courts, the ECtHR, and Yukos' own external auditors, including Yukos' knowingly false assertion that it was not affiliated with (and did not control) the sham trading shells, a point now conceded even by Claimants. Yukos' repeated false denial of its affiliation with the sham trading shells can only be explained by the company's awareness of the illegality of its scheme.

11. Yukos' tax evasion was not victimless. The billions of dollars in tax benefits it wrongfully claimed caused commensurate damage to the regional budget of Moscow, where Yukos, as the real party in interest, should have paid profit tax at the full rate.

12. Claimants' claims that the Russian authorities' measures were expropriatory and unfair are meritless. First, Claimants' contention that the legal principles applied by the Russian courts were "novel" or "vague" is, as the ECtHR unanimously found, refuted by the numerous Russian court decisions that applied these principles and similar ones to hold taxpayers liable for tax evasion since the mid-1990s, including

their abuse of the low-tax region program. Moreover, the published legal commentaries, including the guidance published by Yukos' own tax counsel, describe those principles in the same terms as they were applied to Yukos. The relevant Russian judicial precedents include those compiled for the Tribunal by Russian tax law expert Oleg Konnov, whose description of the history and content of the bad faith taxpayer doctrine Claimants have not sought to rebut with any expert testimony.

13. Mr. Konnov shows that the fines assessed against Yukos were also proper because, among other reasons, no taxpayer -- in Russia or elsewhere -- could legitimately claim to be surprised that it may not invoke a limitations period that has expired only because of its own obstruction of tax audits.

14. Claimants also ignore the extensive international precedents demonstrating that the principles applied by the Russian authorities and the actions they took against Yukos' tax evasion were consistent with those of ECT signatories and other nations worldwide.

15. Second, Claimants' attack on Yukos' VAT assessments -- holding Yukos liable for the VAT due on revenues nominally realized by the sham trading shells but properly attributable to Yukos itself -- is also meritless. As the ECtHR unanimously held, the Russian authorities acted properly in disregarding Yukos' sham trading shells for profit tax purposes and denying Yukos the benefit of the shells' 0% VAT filings. Claimants also ignore Yukos' still unexplained failure to submit proper 0% VAT returns in its own name after it received its December 29, 2003 tax audit report. It is not disputed that Yukos could have filed proper VAT returns -- nothing prevented it from doing so -- or that had it done so, it would have avoided more than half of its challenged tax liabilities.

16. Third, Claimants' assertion that the tax assessments were discriminatory is contradicted by the facts. The ECtHR unanimously rejected this charge. Several large Russian companies, including a number of Yukos' principal competitors, were also held liable for tax evasion and assessed substantial amounts of tax on grounds similar to those relied on by the Russian authorities and courts in dealing with Yukos. But unlike Yukos, these other companies promptly paid their taxes and, in the case of Lukoil, publicly abandoned its own "tax optimization" scheme.

17. There were also numerous material differences between Yukos' conduct and that of many other Russian oil companies: (a) no other Russian oil company committed abuses that were as egregious as those of Yukos, (b) none did so for as long as Yukos, (c) none attempted to conceal its abuses as did Yukos (to the extent of lying about them to the tax authorities, the courts, and even its own auditors), (d) none obstructed their tax audits as did Yukos, including by sending documents and employees to distant locations before they could be reviewed and interviewed, (e) none made investments in the low-tax regions that were so miniscule in comparison to the tax benefits they claimed, (f) none diverted billions of dollars offshore to prevent the collection of overdue taxes, and (g) none refused to pay their assessed taxes when ultimately required to do so.

18. Fourth, Claimants' contention that the Russian authorities knew and approved of Yukos' scheme is completely unsupported by any credible evidence, as the ECtHR again unanimously found. Claimants' contention cannot be reconciled with Yukos' unflagging efforts to conceal its scheme from the Russian authorities. Yukos would obviously have had no reason to hide its scheme if it believed the authorities were already aware of it, let alone had approved it, or if it thought its scheme was lawful and its disclosure would not lead to substantial tax claims. Yukos' efforts to conceal its scheme are reflected in (a) the company's convoluted offshore structures, serving no purpose other than to mask Yukos' affiliation with its sham trading shells, (b) Yukos' *seriatim* restructuring of its Lesnoy trading shells after their abuse of that

region's low tax program was discovered, (c) Yukos' management's internal warnings that disclosure of its scheme "will result in substantial tax claims against the Company," (d) Yukos' failure to disclose its scheme in its purportedly "transparent" financial statements, and (e) Yukos' repeated lies about its scheme to the tax authorities, the courts, the ECtHR, and its own auditors.

19. In any event, as a matter of Russian law and as Claimants concede, even if the tax authorities had known of Yukos' scheme -- and there is no evidence they did -- they would not have been estopped from later challenging it.

20. Fifth, Claimants' contention that the assessments against Yukos were fabricated as part of a politically motivated campaign to dismantle Yukos – an allegation on which Claimants have unambiguously staked their claims, contending that the assessments "cannot be explained in any other way" -- is, as the ECtHR again unanimously found, unsupported by any credible evidence. If the assessments were, as Claimants insist, the product of a massive political conspiracy spanning several years and involving numerous government agencies, engineered and implemented by hundreds if not thousands of officials, including no fewer than 60 judges at four different levels of courts, along with a large cast of third parties around the globe, then surely after nearly a decade of challenges -- by Yukos, its minority shareholders, and now Claimants -- at least one internal government memorandum, instruction or minute of a meeting evidencing or referring to the grand conspiracy alleged by Claimants would have surfaced, or one disgruntled former Government official would have reported having participated in a meeting or telephone call where the alleged conspiracy was discussed. Instead, Claimants rely solely on double and triple hearsay renditions of purported conversations by vocal opponents of the Russian Government, inaccurate and uninformed reports by political commentators, and sheer innuendo, none of which, even as proffered, competently supports Claimants' conspiracy allegations.

21. Claimants' failure to prove the supposed vast conspiracy confirms that it is merely one more sham perpetrated by the Oligarchs who controlled Yukos and were ultimately responsible for its demise.

22. Yukos' dealings with PricewaterhouseCoopers ("PwC") provide yet another example of Yukos' blaming the Russian Federation for the consequences of its own misconduct.

23. PwC withdrew all of its Yukos audit opinions in June 2007 (after refusing to continue to audit the company's U.S. GAAP financial statements in 2003, itself an extraordinary event for a supposedly "transparent" company), following confirmation that Yukos' senior managers had repeatedly lied to PwC about, among other things, Yukos' *de facto* control over the management of its sham trading shells -- an essential element in the company's "tax optimization" scheme.

24. Claimants' attempt to blame the Russian Federation for PwC's withdrawal of the firm's audit opinions finds no support in the record. To the contrary, both PwC's senior Russian representative at the time (in a contemporaneous private conversation with U.S. Embassy officials in Moscow) and PwC's senior Yukos auditor (in sworn U.S. deposition testimony) confirm that PwC, in withdrawing its audit opinions, acted in accordance with applicable auditing standards, a conclusion supported by Mr. John Ellison, a former KPMG LLP partner, in his unchallenged expert report. The U.S. deposition testimony of Mr. Douglas Miller, the PwC partner in charge of auditing Yukos, is especially relevant, because (a) it was sought by counsel for Messrs. Khodorkovsky and Lebedev on the grounds that it would provide the best opportunity to obtain a truthful account of the reasons for PwC's actions, and (b) Mr. Miller repeatedly rejected Claimants' "harassment" theory.

25. On all of these points, the *RosInvestCo* and *Rovime* awards are inconsistent with the facts and Russian law, and ignore a wealth of uncontested international practice.

II. The Russian Federation Is Not Responsible For And Did Not Cause The Unwinding Of The Sibneft Merger

26. The Russian Federation is not responsible for the unwinding of Yukos' proposed merger with Sibneft because Claimants do not allege -- let alone establish -- that Sibneft was then exercising governmental authority or acting under the instructions of Russian State organs. Nor was the Russian Federation the cause of the unwinding of the merger. To the contrary, the Russian Federation repeatedly supported the proposed merger, and Claimants themselves acknowledge that the Russian Federation provided all of the approvals necessary for the merger, including approvals granted long after the Russian Federation's supposed attack on Yukos.

27. The merger in fact collapsed because Yukos refused to accommodate Sibneft's request that Mr. Khodorkovsky, following his resignation from Yukos' management, be replaced by a Sibneft nominee as head of the to-be merged company. Sibneft's proposal would have left Yukos representatives in all of the surviving company's other senior management positions.

28. Documents that Claimants were ordered to produce in these proceedings (over their objection) show that Claimants and Sibneft's principal shareholders agreed to unwind the merger without the payment of additional compensation by either side, an agreement fatal to Claimants' request for damages relating to the proposed merger. The same documents also reveal that Yukos' management proposed its own plan to unwind the merger without the payment of additional compensation, and that this plan contemplated the initiation of a "sham" lawsuit challenging the previously-completed exchange of Yukos and Sibneft shares. The contemplated lawsuit bears a striking resemblance to the actual lawsuit (challenged by Yukos in these arbitrations) that was brought by two of Yukos' shareholders and ultimately led to the legal unwinding of the merger without the payment of additional compensation.

29. Claimants' assertion that the US$ 2 billion giga-dividend was required by the Sibneft merger is patently untrue. The record shows that the giga-dividend was approved on November 28, 2003 (and not on September 25, 2003, as Claimants falsely asserted in their Reply), one day after Yukos was informed that the Sibneft merger would not proceed. At the Extraordinary General Meeting of Yukos' shareholders held on November 28, Claimants voted against all the other shareholder proposals linked to the completion of the Sibneft merger, but supported payment of the giga-dividend "for Yukos" (that is, for Claimants to the extent of 70% of the dividend).

III Yukos Bears Sole Responsibility For The Consequences Of The Assessments Properly Made Against It, Because It Could Have Avoided Those Consequences -- And Reduced Its Liability By Well More Than Half – By Paying The Amounts Due During The First Quarter Of 2004, While Continuing To Challenge The Assessments In Full

30. During the first quarter of 2004, Yukos could have avoided well more than half of its ultimate tax exposure by paying its corporate profit taxes and the interest then due and by filing proper amended VAT returns in its own name. Had Yukos taken these few simple steps -- abiding by its own tax counsel's published advice as to how a taxpayer should mitigate its tax liabilities -- it would also have avoided all of the subsequent enforcement measures about which Claimants complain, and still preserved its right to seek a refund of all the taxes it paid.

31. If Yukos had mitigated its liabilities in this way, its total exposure under the Russian court rulings that Claimants challenge in these arbitrations would have been capped at less than US$ 9.8 billion, rather than the US$ 25.8 billion that was ultimately assessed.

32. Yukos had more than ample resources in the first quarter of 2004 to cap its tax exposure at less than US$ 9.8 billion and to satisfy that liability, even after paying its unprecedented US$ 2 billion giga-dividend, but it elected not to do so.

33. Instead, Yukos pursued an irrational and ultimately self-destructive course of action, for which only the managers of Yukos, installed and controlled by Claimants, are to blame. This course of action included (a) Yukos' continuing denial of any liability for its assessed taxes, (b) Yukos' now acknowledged false denial that it controlled the sham trading shells, (c) Yukos' repeated obstruction of the actions taken by the Russian authorities to enforce and collect the company's overdue taxes, (d) Yukos' dissipation of its own assets and those of the companies it controlled, to frustrate the collection of the taxes it owed, and (e) Yukos' attempt to put pressure on the Russian Government by mounting an aggressive international lobbying and disinformation campaign that sought to politicize what, for the Russian authorities, was always a matter of tax evasion and collection.

34. All of the subsequent enforcement proceedings and other measures about which Claimants now complain were thus the result of Yukos' own adamant refusal to acknowledge or mitigate its tax liabilities, and its repeated attempts to dissipate and conceal its assets and to frustrate the enforcement and collection of its overdue taxes. Had Yukos not persisted in this self-destructive course of action, there would have been no April injunction (discussed below), and YNG would not have been sold.

35. Permitting Claimants to benefit from Yukos' self-inflicted wounds would contravene basic legal principles, and provide Claimants with a windfall -- beyond the billions of dollars they have already extracted from Yukos, including by way of dividends, share sales, and *stichting* assets -- to which they are not entitled.

IV. The Russian Federation Acted Properly In Enforcing The Tax Assessments Against Yukos, Including By Auctioning YNG

36. The tax assessments were enforced against Yukos in compliance with Russian law and after ample notice to Yukos. As the ECtHR unanimously concluded, there is "no reason to doubt that throughout the proceedings the actions of various authorities had a lawful basis and that the legal provisions in question were sufficiently precise and clear." The enforcement actions were also measured and appropriate in the circumstances and entirely consistent with international practice.

37. Claimants' and Yukos' contention that Yukos was "surprised" by the timing of the assessment for 2000 and the need to make prompt payment is false and indicative of Yukos' lack of good faith. Promptly upon receipt of the December 29, 2003 audit report, Yukos' internal and external counsel advised Yukos that, under established Russian law and practice, it should expect to receive a final tax assessment within about a month, and that this assessment would require Yukos to make full payment promptly, most likely within one day. In the event, the tax assessment for 2000 was issued on April 14, 2004, more than two months later than Yukos' advisors had expected, and required payment in two days, not one.

38. Although Yukos had ample notice of when and how much it would be required to pay, it made no effort to marshal the necessary assets, instead claiming that it was not able to pay, even though Claimants now acknowledge that Yukos had sufficient resources to pay all of its 2000 taxes.

39. By the time of Yukos' April 2004 assessment, the tax authorities had learned that Yukos controlled the Lesnoy shell companies and had sought to prevent the payment of their overdue taxes by dissolving them. The tax authorities thus understandably applied to the Moscow Arbitrazh Court in April 2004 for enforcement of Yukos' 2000 tax liability and for an injunction prohibiting Yukos from selling or encumbering the company's shareholdings in its Russian subsidiaries.

40. As the ECtHR held, the authorities' actions were neither arbitrary nor unfair:

> "[T]he Ministry's action was lodged under the rule which made it unnecessary to wait until the end of the grace period if there was evidence that the dispute was insoluble and, regard being had to the circumstances of the case, [the Court] finds no indication of arbitrariness or unfairness […] in this connection." [emphases added]

41. The April injunction did not affect Yukos' use of its substantial on- and off-shore cash resources, and did not affect Yukos' offshore assets at all. Yukos nonetheless falsely claimed that the injunction prevented Yukos from paying its taxes, again evidencing its lack of good faith and credibility.

42. No further enforcement efforts were taken for more than two months. During this period, Yukos continued to generate close to US$ 2 billion each month in gross receipts that Yukos partly transferred off-shore and partly used to voluntarily pay its loan to GML's Moravel shell subsidiary -- but not to pay its tax liabilities.

43. Yukos also began a pattern of diminishing the value of its assets, often to the benefit of Claimants and the Oligarchs whose interests they represented. For example, Yukos forced its production subsidiaries to guarantee Yukos' already outstanding US$ 1.6 billion loan from Moravel, corroborating the concerns that had led the authorities to obtain the April injunction.

44. Following Yukos' failure to make (or even to promise to make) any tax payments, as well as its dissipation of substantial assets, Russia's bailiffs finally attached a number of Yukos' on-shore bank accounts at the end of June 2004 -- ten weeks after the April tax assessment and 26 weeks after Yukos' legal advisors advised that it needed to be prepared to pay promptly. It was only then that Yukos began to pay some, but not all, of its taxes.

45. The authorities also sought to seize Yukos' shares in its production subsidiaries to prevent Yukos from encumbering them. True to form, Yukos attempted to frustrate the bailiffs' efforts by terminating the share registry company contract for its production subsidiaries and concealing their registries, directing that they be sent from central Moscow to remote locations around the country.

46. Yukos also took steps to reduce the value of its largest production subsidiary, YNG. First, Yukos caused YNG to stop paying its mineral extraction taxes, imperiling its production licenses. Second, Yukos and its trading shells stopped paying YNG for its crude oil, leaving YNG with more than US$ 4 billion in unpaid invoices. And third, Yukos continued to divert funds to GML, its majority shareholder, arranging for the payment of more than US$ 700 million to Moravel, even after the cash freeze orders were in place.

47. Yukos also made a series of bad faith offers to "settle" a portion of its tax liabilities, repeatedly offering Sibneft shares as a partial payment or as security for proposed future payment, even though Russian law did not allow payment in kind, Yukos' title to the proffered shares had been challenged by a third-party, and an injunction had been issued (at the request of the third-party) prohibiting their sale or encumbrance.

48. During this entire period, nothing prevented Yukos from selling its assets subject to the bailiffs' approval and using the proceeds to pay its tax obligations.

49. Thus, the authorities found themselves confronted by a company that was fiercely resisting the payment of its overdue taxes, that had previously obstructed its tax audit, lied to the tax authorities and courts, and attempted to make itself and its subsidiaries judgment proof, and that was now burdening the tax authorities' principal security -- YNG -- with new liabilities. In these circumstances, the bailiffs understandably decided to sell a majority of YNG's shares -- the only

realistic way to timely collect Yukos' unpaid taxes. Despite criticizing the bailiffs for not adequately documenting their decision-making process, the ECtHR concluded that the bailiffs' actions were not unreasonable. It is commonplace in other countries too for tax collection authorities to sell first the assets that best ensure payment.

50. The sale of the YNG shares was carried out in accordance with Russian law and consistent with international practice. The authorities could have sold the shares to a designated purchaser in a directly negotiated transaction, but instead granted Yukos' request that the shares be auctioned. A formal and careful appraisal was conducted by DKW, and the starting price for the auction was set at a level consistent with DKW's appraisal, taking account of the fact that only 76.79% of the company's shares were sold and that YNG had its own outstanding tax liabilities. All bidders, foreign or domestic, were welcome to participate.

51. Claimants and Yukos did all they could to prevent the auction from succeeding, threatening a "lifetime of litigation" against anyone who participated in or facilitated the sale. Yukos also initiated sham bankruptcy proceedings in Houston, obtaining a temporary restraining order ("TRO") that prevented all the previously announced bidders and all of their banks from participating in the auction. If the price achieved was lower than it might otherwise have been, the fault lies solely with Claimants and Yukos.

52. The YNG auction achieved a price of approximately US$ 9.4 billion, US$ 500 million more than the starting price. This result was consistent with the shares' appraised value and contemporaneous fair market value estimates.

53. The evidence does not support Claimants' contention that the winning bidder, Baikal Finance, conspired with Rosneft. Rather, Baikal Finance found itself unable to finance its winning bid because of the Houston court's TRO, and thus at risk of losing its US$ 1.7 billion deposit unless a substitute purchaser, not dependent on immediate bank financing, could be found on very short notice. Rosneft simply seized a commercial opportunity that presented itself as a result of Claimants' misconduct.

54. The net proceeds of the YNG sale were not sufficient to meet all of Yukos' tax obligations. The Russian authorities nonetheless gave Yukos ample time to pay the remaining balance, but it declined to do so, making clear that its priority was to place assets behind the shield of the Dutch *stichtings.*

V. The Russian Federation Acted Properly In Connection With Yukos' Bankruptcy, Which Was Precipitated By Yukos' Failure To Pay Its Debts To The SocGen Syndicate, And Is Not Attributable To The Russian Federation

55. Claimants' bankruptcy-related claims fail because critical conduct essential to these claims was taken by actors for which the Russian Federation is not responsible, including the SocGen syndicate, YNG, Rosneft, the Federal Tax Service acting as creditor, the meeting and committee of Yukos' creditors, Yukos' interim manager and bankruptcy receiver, the participants in Yukos' bankruptcy auctions, and the purchasers of the auctioned assets sold. In taking the actions complained of by Claimants, none of these actors was exercising sovereign authority or acting pursuant to the direction or control of sovereign authority. Claimants have provided no evidence on which the Tribunal could make a contrary finding.

56. Yukos' dilatory and obstructionist treatment of its commercial creditors paralleled closely its treatment of the tax authorities. In both instances, Yukos (a) falsely claimed it was unable to meet its obligations, (b) forced its creditors to pursue their claims in multiple court proceedings where Yukos presented unsubstantiated defenses, (c) offered to negotiate with its creditors only when they were close to collecting their claims, (d) made unrealistic settlement proposals that were

subsequently withdrawn, and (e) together with its controlling shareholders, strenuously resisted all collection efforts, prompting more aggressive action on the part of its creditors.

57. Both sides agree that Yukos' bankruptcy was initiated by the SocGen syndicate, based upon Yukos' failure to pay an outstanding English court judgment after it was recognized in Russia.

58. The SocGen syndicate simultaneously also sought payment of the same debt from Rosneft pursuant to the 2004 loan guarantee that Yukos had foisted on YNG, which Rosneft then owned. Although Rosneft disputed the validity of the guarantee, Rosneft required forbearance from the same banks on covenant breaches arising from the YNG acquisition, and Rosneft needed the banks' cooperation for its planned IPO. The convergence of the syndicate's and Rosneft's commercial interests resulted in their agreeing that Rosneft would pay the syndicate in full, but only after the syndicate had pursued all legal avenues to obtain payment from Yukos, the primary obligor. If Rosneft instead paid, the syndicate's rights under the loan agreement were to be assigned to Rosneft.

59. Claimants acknowledge that this agreement was commercially-motivated and on commercial terms, but contend that its confidentiality clause evidences a conspiracy on the part of the SocGen syndicate to act secretly on behalf of Rosneft, which Claimants improperly equate with Respondent. The confidentiality clause, however, was itself a standard commercial term necessary to preserve the possibility that Yukos would pay the SocGen syndicate before Rosneft became unconditionally obligated to do so, and remained in effect only for so long as Yukos' payment would have discharged Rosneft's own obligation to pay the syndicate.

60. Yukos satisfied the criteria for bankruptcy under Russian law due to its persistent failure to pay its commercial creditors, and was insolvent long before the proceedings were commenced. This is also undisputed.

61. The proceedings were conducted in compliance with Russian law and international practice. The courts properly allowed the Federal Tax Service's, Rosneft's and YNG's claims, and substantial amounts of YNG's claims were never disputed by Yukos. Belying Claimants' discrimination charge, the courts also allowed some Yukos related-party claims, but properly rejected other abusive claims, such as the Moravel loan, a barely disguised attempt to turn equity into debt.

62. Yukos' management, actively supported by Claimants, had the opportunity to present a rehabilitation plan to the meeting of creditors. The rough outline management submitted was, however, legally defective and did not provide any basis for creditors to prefer rehabilitation to liquidation. It was not properly presented to or approved by Yukos' shareholders, did not meet the legal requirement that the company's tax claims be satisfied within six months, and did not ensure full, let alone timely, payment of Yukos' creditors' claims.

63. Once Yukos' liquidation was properly approved, the company's assets were sold at auction in accordance with Russian law and international practice. Yukos' receiver obtained appraisals for the fair value of the assets, and used those appraisals to set minimum bids in the auctions, all of which were exceeded, some by very large margins. The auctions were open to domestic and foreign bidders, adequately noticed and advertised, and competitive. To the extent that any bidders may have been discouraged from participating, this was again the result of Claimants and Yukos having threatened potential bidders with legal action. While the aggregate results exceeded Yukos' own (and other) contemporaneous fair market value estimates, more than US$ 9 billion in creditor claims nonetheless remained unsatisfied.

VI. Claimants Have Failed To Establish *Sine Qua Non* Elements Of Their Article 13 And 10(1) ECT Claims

A. Article 21 ECT

64. First, as an initial matter, Claimants' claims must be based on measures outside the taxation carve-out of Article 21(1) ECT or, alternatively, within Article 21(1) ECT, but subject to one of the claw-backs of Article 21(2) to (5) ECT.

65. Taxation carve-outs such as this one fulfill plainly legitimate functions. They (a) preserve the Contracting Parties' sovereign power in the field of taxation, which is of critical importance to the very existence of a State, (b) delineate the extensive network of investment treaties from the even broader network of taxation treaties, (c) pay due regard to the complexity of tax matters, and, in many cases, preserve the coordination role of the competent tax authorities under double taxation treaties.

66. To fulfill these functions, taxation carve-outs are typically broad, covering all aspects of tax regimes, including tax enforcement measures.

67. Article 21(1) ECT, under its plain meaning, covers the whole range of measures taken by all branches of government in the field of taxation. Tax legislation and enforcement measures are inextricably linked, and it is not possible to meaningfully dissociate them in the context of Article 21(1) ECT.

68. The core allegations on which Claimants base their claims are squarely within the scope of Article 21(1) ECT: tax audits, tax assessments, interest and fines provoked by Yukos' failure to pay its assessed taxes, measures to ensure the effective collection of its taxes, and the sale of Yukos' assets to satisfy its tax liabilities.

69. Claimants seek to avoid Article 21 ECT on two grounds, that Article 21(7)(a) ECT limits the scope of the taxation carve-out to tax legislation and tax treaties and does not apply to *mala fide* taxation measures. These arguments are baseless.

70. Article 21(7)(a) ECT contains an illustrative list of taxation measures that does not replace the term "measures" with the term "provisions," but underscores that the term "Taxation Measures" covers all aspects of the tax regime, including international and domestic measures.

71. Claimants' position that Article 21(1) ECT is inapplicable to the taxation measures they complain about fails as a matter of fact and law. The record shows that the taxation measures at issue were a justified response to Yukos' massive tax fraud and its willful strategy to obstruct efforts to collect the taxes due. As a matter of law, Claimants mix two issues, the concept and definition of "Taxation Measures," on the one hand, and their legality, on the other. Legality is determined under Part III of the ECT, but only to the extent of the claw-backs pursuant to Article 21(2) to (5) ECT.

72. Article 21 ECT contains no claw-back for Article 10(1) ECT, and the Tribunal therefore lacks jurisdiction over core allegations of Claimants' Article 10(1) ECT claims.

73. Article 21(5) ECT contains a claw-back for Article 13 ECT claims, but is applicable only to "taxes," and is combined with a mandatory referral to the competent tax authorities, a procedure invoked by Respondent in these proceedings. The expropriation claw-back, in its ordinary meaning, supported by the *travaux préparatoires*, applies to charges imposed by the State for public purposes, excluding tax enforcement and collection measures. When compared to the varying practices with respect to clawbacks in taxation carve-outs, the deliberate choice of the ECT negotiating States to reinstate expropriatory "taxes" represents a middle ground, which must be respected.

B. Article 13(1) ECT

74. In order to establish their claim for a breach of Article 13(1) ECT, Claimants must show that, in addition to being outside the scope of the taxation carveout of Article 21(1) ECT -- or within Article 21(1) ECT, but **reinstated** by Article 21(5) ECT -- the measures complained of must be "measures having effect equivalent to nationalization or expropriation."

75. First, Claimants have failed to establish that conduct not carved-out by Article 21 ECT that is (a) attributable to Respondent, and (b) an exercise of its sovereign power caused a total or near total deprivation of Claimants' investment. Critically, the core allegations of Claimants' claims are outside the scope of Article 13(1) ECT by virtue of Article 21 ECT. Moreover, Yukos itself engaged in conduct -- by refusing to pay the assessments against it when due, while preserving its right to challenge them – that directly resulted in the company's demise and the ensuing loss of Claimants' investments. Finally, conduct that was essential to Yukos' liquidation, including in particular the filing of the bankruptcy petition by the SocGen syndicate, and the creditors' meeting decision to liquidate Yukos, is not expropriatory because it is not attributable to Respondent under the rules of State responsibility, or does not involve an exercise of sovereign power.

76. Second, Claimants have failed to establish that the measures complained of frustrated distinct, reasonable, investment-backed expectations, an important element in assessing whether regulatory measures amount to "measures having effect equivalent to nationalization or expropriation." Claimants had no right or legitimate expectation to operate Yukos in violation of Russian law, and no right or legitimate expectation that Respondent would exempt Yukos from the tax enforcement and collection measures about which Claimants complain if Yukos failed to pay its taxes and obstructed the collection of taxes due.

77. In particular, Claimants have failed to establish that Respondent at any time made a representation, based upon complete disclosure, that it would allow Yukos to operate its fraudulent tax evasion scheme or refrain from enforcing and collecting the taxes Yukos owed. Yukos' tax evasion scheme was illegal under Russian law when Claimants made their investments, and the tax enforcement and collection measures taken against Yukos were all provided for by Russian law at that time. The bad faith taxpayer anti-abuse doctrine that Respondent's tax authorities and courts applied to counter Yukos' tax evasion dates back to the mid 1990s, well before Claimants acquired their Yukos shares.

78. Third, putting aside the other elements required to establish "measures having effect equivalent to nationalization or expropriation," the executive and judicial measures at issue, in any event, constitute a legitimate exercise of Respondent's regulatory power.

79. The measures alleged to be expropriatory are well within the range of what is generally accepted as a legitimate exercise of States' police powers. First, Respondent has established that the measures complained of accord in all material respects with international and comparative standards.

80. Second, the measures challenged by Claimants conform with Russian law, which in turn accords with international standards, and have been reviewed and upheld by multiple levels of Respondent's judiciary, including the Russian Supreme Court.

81. Third, the European Court of Human Rights has found that the very same measures Claimants allege to be expropriatory were a legitimate exercise of Respondent's regulatory power.

82. Fourth, the measures complained of must be assessed in their proper context -- Yukos' massive tax evasion, compounded by its illegal and deliberate strategy to frustrate any effort by the authorities to collect the company's overdue taxes.

83. Contrary to Claimants' perception, respect for the rule of law is not a oneway-street. Foreign investors have a duty to abide by the law, pay taxes, provide required disclosures of their activities in the host State, and cooperate with the authorities.

84. Measures taken to combat illegal conduct may legitimately result in the loss of an investment. Yukos' tax evasion scheme violated Russian law, and the assessment of the evaded taxes was a legitimate measure to combat Yukos' fraud. The resulting tax enforcement and collection measures were completely justified in light of Yukos' failure to pay the assessed taxes and its willful obstruction of Respondent's collection efforts. Indeed, none of the subsequent enforcement measures, including the auction of YNG, would have occurred, and Yukos would not have been liquidated, had Yukos acted as a responsible taxpayer should have done.

C. Article 10(1) ECT

85. Claimants' Article 10(1) ECT claims fail for many of the same reasons as their expropriation claim. At the threshold, the core allegations on which Claimants base their Article 10(1) ECT claims are within the taxation carve-out of Article 21(1) ECT. The Tribunal therefore lacks jurisdiction over these claims and Article 10(1) ECT is inapplicable.

86. Again, at the threshold, critical conduct alleged to be unlawful under Article 10(1) ECT is not attributable to Respondent or not an exercise of sovereign authority. The harm attributed to Respondent's alleged breaches of Article 10(1) ECT, the loss of Claimants' Yukos shares, was caused by Yukos' own misconduct and conduct of third parties not attributable to Respondent. Claimants have failed to show that any of the irregularities they allege in the administrative and judicial proceedings at issue affected the outcome of the case, the liquidation of Yukos, and the ensuing loss of Claimants' shares.

87. In any event, Claimants have failed to establish that the challenged measures interfered with their legitimate expectations at the time they made their investment or were not taken in the proper exercise of the authorities' statutory duties. The contested measures (a) accord with international and comparative standards, (b) were reviewed and upheld by the Russian courts, and (c) have been assessed by the ECtHR to be a legitimate exercise of Respondent's taxation power.

88. Finally, but no less important, the host State's conduct under Article 10(1) ECT cannot be assessed in isolation from that of the investor or its investment. Yukos' massive tax fraud and illegal obstruction of the efforts to collect the taxes it owed provoked the measures complained of, which were justified responses to combat Yukos' illegal conduct and enforce overdue taxes. None of the measures at issue can therefore be said to be arbitrary, unfair, or inequitable for purposes of Article 10(1) ECT.

89. Nor are such measures discriminatory within the meaning of Article 10(1) ECT. Article 10(1) ECT does not establish a right of impunity based on the host State's authorities' alleged failure to enforce mandatory legal requirements, and Claimants have in any event failed to show nationality-based discrimination, or unjustified differential treatment of similar cases.

VII. The Tribunal Lacks Jurisdiction Over Claimants' Claims Concerning The Alleged Mistreatment Of Messrs. Khodorkovsky And Lebedev And Other Yukos Officials, And In Any Event, These Claims, And Claims Concerning Searches Of Yukos Records, Are Unsupported

90. The Tribunal should reject Claimants' attempt to distract its attention from the only matter that is genuinely at issue in these arbitrations -- Claimants' investments in Yukos, and the consequences for those investments of Yukos' tax evasion scheme -

- with extensive allegations concerning the arrests and prosecution of Yukos officials and searches and seizures of the company's records.

91. First, the Tribunal cannot assert jurisdiction under Article 26 ECT to address alleged violations of the rights of Yukos officials, because Claimants have not proven that any such violations directly impaired Claimants' management or control of their investments. To the contrary, Yukos expressly confirmed after Mr. Khodorkovsky's arrest and subsequent resignation that they had "no impact whatsoever on [its] operations," and Mr. Lebedev did not even hold a position with Yukos at that time. The prosecutions of Messrs. Khodorkovsky and Lebedev likewise did not impair Yukos' performance, which the company informed its investors in 2005 "was extremely healthy."

92. Claimants have also failed to establish that the prosecutions of any Yukos officials reflect a systemic failure of the Russian judicial system or, at a minimum, were fundamentally unjustified or groundless. To the contrary, all were reviewed by the Russian courts at multiple levels, and by the ECtHR (with respect to the initiation of Mr. Khodorkovsky's prosecution), and were found to be in accord with Russian law and international standards. Tellingly, Claimants have never disputed that Mr. Khodorkovsky, Mr. Lebedev, or any of the other Yukos officials who were convicted of crimes related to their management of Yukos, actually committed those crimes, relying instead on conclusory complaints about various procedural matters, based on mischaracterizations of the pertinent facts.

93. Finally, Claimants have not established that the searches of certain of Yukos' offices and the seizure of certain of its records pursuant to the official investigations of its misconduct were expropriatory, evidence a systemic judicial failure, or were otherwise fundamentally unjustified or groundless. This allegation is at best ironic, in light of Yukos' unrelenting obstruction of those investigations. It is also unsustainable. All of these procedures conformed to Russian law, and Yukos' own contemporaneous public statements and internal documents confirm that Yukos itself did not believe they had any significant impact on the company.

VIII. The Tribunal Lacks Jurisdiction Over Claimants' Claims, Or Must Dismiss Them, Because They Are Based On Illegal Conduct By Claimants And The Yukos Managers They Installed And Controlled

94. The Oligarchs who controlled Claimants acquired and consolidated their investments in Yukos through illegal acts and bad faith conduct, and thereafter perpetrated -- either directly or through the Yukos managers they installed and controlled -- a long series of illegal acts, including the tax evasion that is at the heart of these arbitrations.

95. Claimants contend that these illegalities are "collateral" or "unrelated to" their investments, even though they relate to the acquisition or enhancement of the value of Yukos, or to Claimants' own unlawful abuse of the Russia-Cyprus Tax Treaty. Through that abuse, Claimants themselves fraudulently evaded -- in violation of both Russian and Cypriot criminal laws -- more than US$ 230 million in Russian withholding taxes, and more than triple that amount in Russian profit taxes.

96. This history of repeated illegal conduct by Claimants -- culminating in the diversion of assets worth billions of dollars to the illegally-created Dutch *stichtings*, placing those assets beyond the reach of the Russian tax authorities -- deprives the Tribunal of jurisdiction over Claimants' claims, because ECT protection does not extend to illegal investments, or requires that the Tribunal dismiss those claims under the principle of unclean hands. The Tribunal should reject Claimants' attack on the existence of the principle of unclean hands in international law, as well as their baseless charge that Respondent is estopped from raising Claimants' illegalities.

IX. Claimants Have Failed To Establish Any Entitlement To Damages

97. Claimants are not entitled to any compensation, in light of (a) their own illegal conduct, including their and the Oligarchs' illegal acquisition and consolidation of their ownership and control of Yukos, their abuse of the Russia-Cyprus Tax Treaty, and their implementation of Yukos' tax evasion scheme, and (b) Yukos' failure to mitigate its tax liability, and Yukos' and Claimants' actions to prevent the collection of Yukos' overdue taxes.

98. Claimants are not entitled to any compensation for acts of the Russian Federation that are within the carve-out of Article 21(1) ECT and not within the clawback of Article 21(5) ECT.

99. Claimants also are not entitled to any compensation based on Yukos' claimed value at any given point in time, because they have failed to demonstrate any causal link between any diminution in Yukos' then-supposed value and specific violations of the ECT. Claimants' "all-or-nothing" approach does not provide a means by which the Tribunal can (a) assess whether the Russian Federation's actions constituted an "expropriation," or (b) quantify the damages, if any, arising in the event some, but not all, of the measures Claimants complain about are found to violate the ECT. This is the inevitable result of Claimants' failure to present a damages measure, but instead a static valuation, devoid of any causation analysis.

100. Claimants' valuations also fail on their own terms, because they are entirely dependent on Claimants' unsustainable valuation date of November 21, 2007.

101. Claimants and their expert concede that the valuations presented in their opening submissions are infected by numerous material errors. These errors fatally undermine Claimants' core assertions and render Claimants' evidence unreliable for any purpose. The revised valuations submitted in Claimants' Reply are likewise riddled with errors and are manifestly result-driven, leaving Claimants with no competent evidence of damages at all. This is true, too, of their "method of collection" scenarios, which are unsupportable and fail of their own terms.

102. Once Yukos chose not to mitigate its tax liability during the first quarter of 2004 -- by paying no more than US$ 9.8 billion, capping its tax exposure at that amount and avoiding all of the subsequent enforcement measures -- there was no realistic means by which Yukos could have paid all of its liabilities, let alone continued in business as a going concern. Claimants' failure to mitigate is a further reason why their damages model, based on the claimed value of Yukos as of a given date, does not provide a meaningful measure of damages. Thus, even if the Tribunal were to conclude that an award of damages is warranted, it must be capped at Claimants' proportionate interest in the amount, if any, of Yukos' unavoidable liabilities -- not more than US$ 9.8 billion -- that the Tribunal concludes were improperly assessed.

103. Claimants' damages claim represents a 58% compound annual rate of return on their investment in Yukos. Claimants' requested rate of return fails to take account of Claimants', the Oligarchs', and Yukos' unlawful misconduct and is well beyond that which any legitimate investor would have earned.

104. Measured against a reasonable return on investment, and after taking account of the returns on their investment in Yukos that Claimants have already received (not to mention the fruits of their ill-gotten gains and assets secreted offshore), Claimants have not incurred any damages at all.

IV. PARTIES' REQUESTS FOR RELIEF

A. RELIEF REQUESTED BY CLAIMANTS

110. Claimants request that the Tribunal render an Award:

(1) Declaring that the Respondent has breached its obligations under Article 10(1) of the Energy Charter Treaty;

(2) Declaring that the Respondent has breached its obligations under Article 13(1) of the Energy Charter Treaty;

(3) Ordering the Respondent to pay to the Claimants, in full reparation of their damages, an amount to be determined by the Arbitral Tribunal, estimated by the Claimants at no less than US$ 114.174 billion, to be shared between the Claimants in the following proportions:

- Hulley Enterprises Limited US$ 93.229 billion
- Yukos Universal Limited US$ 4.666 billion
- Veteran Petroleum Limited US$ 16.279 billion

(4) Ordering the Respondent to pay post-award interest on the above sums to the Claimants at the rate of Libor + 4% compounded annually from the date of the Award until the date of full payment;

(5) Ordering the Respondent to pay to the Claimants the full costs of these arbitrations, including, without limitation, arbitrators' fees, administrative costs of the PCA, counsel fees, expert fees and all other costs associated with these proceedings;

(6) Dismissing all of the Respondent's defenses;

(7) Ordering any such further relief as it may deem appropriate.[7]

B. RELIEF REQUESTED BY RESPONDENT

111. Respondent requests that the Tribunal render an Award:

(a) Dismissing Claimants' claims on the ground that the Tribunal lacks jurisdiction to entertain them;

(b) In the alternative, dismissing Claimants' claims on the ground that they are inadmissible;

(c) In the alternative, dismissing Claimants' claims on the merits in their entirety;

(d) In the alternative, declaring that Claimants are not entitled to the damages they seek, or to any damages;

(e) Ordering Claimants to pay the Russian Federation's costs, expenses, and attorney's fees;

[7] Reply ¶ 1199. *See also* Claimants' Memorial on the Merits, 15 September 2010 (hereinafter "Memorial") ¶ 1056; Claimants' Post-Hearing Brief, 21 December 2012 (hereinafter "Claimants' Post-Hearing Brief") ¶ 302.

(f) Granting such further relief against the Claimants as the Tribunal deems fit and proper.[8]

V. APPLICABLE LAW

A. PROCEDURAL LAW

112. The procedural law to be applied by the Tribunal consists of the procedural provisions of the ECT (particularly Article 26), the UNCITRAL Rules of 1976, and, because The Hague is the place of arbitration, any mandatory provisions of Dutch arbitration law. The Final Awards are made pursuant to Article 1049 of the *Netherlands Arbitration Act 1986.*

B. SUBSTANTIVE LAW

113. The substantive law to be applied by the Tribunal consists of the substantive provisions of the ECT, the Vienna Convention on the Law of Treaties ("**VCLT**"),[9] and applicable rules and principles of international law, including those authoritatively set out in the Articles on Responsibility of States for Internationally Wrongful Acts of the International Law Commission of the United Nations ("**ILC Articles on State Responsibility**").[10] In addition to the foregoing sources, the national law of the Russian Federation is relevant with regard to certain issues.

1. Energy Charter Treaty

114. Throughout this Award, the Tribunal refers to and analyzes specific provisions of the ECT. For ease of reference, the key relevant provisions are also collected and reproduced below, in the order in which they appear in the Treaty:

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8 Counter-Memorial ¶ 1654; Respondent's Rejoinder on the Merits, 16 August 2012 (hereinafter "Rejoinder") ¶ 1748; Respondent's Post-Hearing Brief, 21 December 2012 (hereinafter "Respondent's Post-Hearing Brief") ¶ 263.

9 Vienna Convention on the Law of Treaties, Vienna, 23 May 1969, 1155 UNTS 331.

10 Draft Articles on Responsibility of States for Internationally Wrongful Acts with commentaries (Text adopted by the International Law Commission at its fifty-third session, in 2001), Arts. 1–11 and 28–39, Exh. C-1042; Arts. 49–54, Exh. C-1681 (hereinafter "ILC Articles on State Responsibility"). The full text of the ILC Articles, along with parts of the official commentary, was also submitted submitted by Respondent. *See* Exhs. R-1031 and R-4235. The Tribunal is aware that Part II of the ILC Articles on State Responsibility, which sets out the consequences of internationally wrongful acts, is concerned with claims between States and may not directly apply to cases involving persons or entities other than States. That being said, the ILC Articles reflect customary international law in the matter of state responsibility, and to the extent that a matter is not ruled by the ECT and there are no circumstances commanding otherwise, the Tribunal will turn to the ILC Articles on State Responsibility for guidance. The Tribunal further notes that both Parties have cited to and relied on Parts I and II of the ILC Articles on State Responsibility in their submissions.

Article 10

PROMOTION, PROTECTION AND TREATMENT OF INVESTMENTS

(1) Each Contracting Party shall, in accordance with the provisions of this Treaty, encourage and create stable, equitable, favourable and transparent conditions for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include a commitment to accord at all times to Investments of Investors of other Contracting Parties fair and equitable treatment. Such Investments shall also enjoy the most constant protection and security and no Contracting Party shall in any way impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal. In no case shall such Investments be accorded treatment less favourable than that required by international law, including treaty obligations.

[. . .]

Article 13

EXPROPRIATION

(1) Investments of Investors of a Contracting Party in the Area of any other Contracting Party shall not be nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "Expropriation") except where such Expropriation is:

(a) for a purpose which is in the public interest;

(b) not discriminatory;

(c) carried out under due process of law; and

(d) accompanied by the payment of prompt, adequate and effective compensation.

Such compensation shall amount to the fair market value of the Investment expropriated at the time immediately before the Expropriation or impending Expropriation became known in such a way as to affect the value of the Investment (hereinafter referred to as the "Valuation Date").

Such fair market value shall at the request of the Investor be expressed in a Freely Convertible Currency on the basis of the market rate of exchange existing for that currency on the Valuation Date. Compensation shall also include interest at a commercial rate established on a market basis from the date of Expropriation until the date of payment.

[. . .]

Article 21

TAXATION

(1) Except as otherwise provided in this Article, nothing in this Treaty shall create rights or impose obligations with respect to Taxation Measures of the Contracting Parties. In the event of any inconsistency between this Article and any other provision of the Treaty, this Article shall prevail to the extent of the inconsistency.

[. . .]

(5) (a) Article 13 shall apply to taxes.

(b) Whenever an issue arises under Article 13, to the extent it pertains to whether a tax constitutes an expropriation or whether a tax alleged to constitute an expropriation is discriminatory, the following provisions shall apply:

(i) The Investor or the Contracting Party alleging expropriation shall refer the issue of whether the tax is an expropriation or whether the tax is discriminatory to the relevant Competent Tax Authority. Failing such referral by the Investor or the Contracting Party, bodies called upon to settle disputes pursuant to Article 26(2)(c) or 27(2) shall make a referral to the relevant Competent Tax Authorities;

(ii) The Competent Tax Authorities shall, within a period of six months of such referral, strive to resolve the issues so referred. Where nondiscrimination issues are concerned, the Competent Tax Authorities shall apply the non-discrimination provisions of the relevant tax convention or, if there is no non-discrimination provision in the relevant tax convention applicable to the tax or no such tax convention is in force between the Contracting Parties concerned, they shall apply the non-discrimination principles under the Model Tax Convention on Income and Capital of the Organisation for Economic Co-operation and Development;

(iii) Bodies called upon to settle disputes pursuant to Article 26(2)(c) or 27(2) may take into account any conclusions arrived at by the Competent Tax Authorities regarding whether the tax is an expropriation. Such bodies shall take into account any conclusions arrived at within the six-month period prescribed in subparagraph (b)(ii) by the Competent Tax Authorities regarding whether the tax is discriminatory. Such bodies may also take into account any conclusions arrived at by the Competent Tax Authorities after the expiry of the six-month period;

(iv) Under no circumstances shall involvement of the Competent Tax Authorities, beyond the end of the six-month period referred to in subparagraph (b)(ii), lead to a delay of proceedings under Articles 26 and 27.

[. . .]

(7) For the purposes of this Article:

(a) The term “Taxation Measure” includes:

(i) any provision relating to taxes of the domestic law of the Contracting Party or of a political subdivision thereof or a local authority therein; and

(ii) any provision relating to taxes of any convention for the avoidance of double taxation or of any other international agreement or arrangement by which the Contracting Party is bound.

(b) There shall be regarded as taxes on income or on capital all taxes imposed on total income, on total capital or on elements of income or of capital, including taxes on gains from the alienation of property, taxes on estates, inheritances and gifts, or substantially similar taxes, taxes on the total amounts of wages or salaries paid by enterprises, as

well as taxes on capital appreciation.

(c) A "Competent Tax Authority" means the competent authority pursuant to a double taxation agreement in force between the Contracting Parties or, when no such agreement is in force, the minister or ministry responsible for taxes or their authorized representatives.

(d) For the avoidance of doubt, the terms "tax provisions" and "taxes" do not include customs duties.

[. . .]

Article 26

SETTLEMENT OF DISPUTES BETWEEN AN INVESTOR AND A CONTRACTING PARTY

(1) Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III shall, if possible, be settled amicably.

(2) If such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the Investor party to the dispute may choose to submit it for resolution:

[. . .]

(c) in accordance with the following paragraphs of this Article.

(3) (a) Subject only to subparagraphs (b) and (c), each Contracting Party hereby gives its unconditional consent to the submission of a dispute to international arbitration or conciliation in accordance with the provisions of this Article.

[. . .]

(4) In the event that an Investor chooses to submit the dispute for resolution under subparagraph (2)(c), the Investor shall further provide its consent in writing for the dispute to be submitted to:

[. . .]

(b) a sole arbitrator or ad hoc arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter referred to as "UNCITRAL");

[. . .]

(6) A tribunal established under paragraph (4) shall decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law.

[. . .]

(8) The awards of arbitration, which may include an award of interest, shall be final and binding upon the parties to the dispute. An award of arbitration concerning a measure of a sub-national government or authority of the disputing Contracting Party shall provide that the Contracting Party may pay monetary damages in lieu of any other remedy granted. Each Contracting Party shall carry out without delay any such award and shall make provision for the effective enforcement in its Area of such awards.

2. Vienna Convention on the Law of Treaties

115. Relevant provisions of the VCLT are as follows:

Article 31
General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

   (c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32
Supplementary means of interpretation

1. Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

   (a) leaves the meaning ambiguous or obscure; or

   (b) leads to a result which is manifestly absurd or unreasonable.

Article 33
Interpretation of treaties authenticated in two or more langauges

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which

> the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

116. Where appropriate, provisions of the ILC Articles on State Responsibility and Russian law are set out in relevant parts of the Award. Additionally, where appropriate, the Tribunal cites to decisions of other international courts and tribunals and legal commentaries which the Parties have submitted as relevant sources to consider in deciding the arbitrations.

VI. SUMMARY OF WITNESS TESTIMONY

117. In the merits phase of these proceedings, Claimants and Respondent each submitted statements or opinions from 11 witnesses.[11] In all, the Tribunal has reviewed over 1,400 pages of written testimony, as well as thousands of exhibits to the witness statements and opinions.

118. The purpose of the present part of the Award is to provide an overview of the witnesses' evidence. It is not meant to be exhaustive. Rather, it serves as a summary of the vast evidentiary foundation on which the Tribunal has reached its conclusions. Additional references to witness testimony, including specific extracts of their oral examinations, are set out in the relevant portions of the Tribunal's analysis of the evidentiary record.[12]

119. The Tribunal has considered the evidence of those witnesses that were cross-examined, as well as those witnesses who submitted written statements but were not called to the Hearing. With respect to this latter category, the Tribunal has kept in mind that these witnesses were not

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[11] Having initially submitted statements or opinions from 12 witnesses, on 4 October 2012, shortly before the Hearing on the Merits, Claimants notified the Tribunal that one of their witnesses, the former Prime Minister of the Russian Federation, Mr. Mikhail Kasyanov, had informed them that he would not appear at the Hearing and that, in the circumstances, Claimants would withdraw his witness statement. Mr. Kasyanov's witness statement has been filed on 3 September 2010 and consisted of a two-paragraph confirmation of the contents of the following documents: Transcript of Mr. Kasyanov's Testimony before the Khamovnichesky Court of Moscow in the second criminal case against Messrs. Khodorkovsky and Lebedev, 24 May 2010, Exh. C-440; *Mikhail Borisovich Khodorkovskiy v. The Russian Federation*, ECtHR, Appls. Nos. 5829/04, 11082/06 and 51111/07, Witness Statement of Mr. Kasyanov, 8 July 2009, Exh. C-446; Mikhail Kasyanov, *Without Putin: Political Dialogues with Evgeny Kiselev*, Novaya Gazeta. 2009 (excerpts), Exh. C-574; Video recording and transcript of interview of Mr. Kasyanov on 24 May 2010 after his testimony in the Khamovnichesky Court of Moscow; Video recording and transcript of interview of Mr. Kasyanov on 24 May 2010 at the Press Center, Exh. C-591; Alexander Bekker & Vladimir Fedorin, *Interview: Mikhail Kasyanov, Prime Minister of the Russian Federation*, Vedomosti, 12 January 2004, Exh. C-677. These documents were submitted as independently-numbered exhibits with the Memorial. Respondent's position at the Hearing was that the documents annexed to Mr. Kasyanov's witness statement could not be considered by the Tribunal (Transcript, Day 18 at 19–21). Claimants maintained that the exhibits stood on their own as part of the record in these arbitrations. The Tribunal has decided that while Mr. Kasyanov's witness statement itself was withdrawn and thus no longer forms part of the record, the documents annexed to the statement, which have come into the record as independent exhibits to the Memorial, and include statements made by Mr. Kasyanov prior to these proceedings, continue to form part of the record of these arbitrations.

[12] *See* Part VIII below.

subject to cross-examination.

A. CLAIMANTS' WITNESSES

120. At the Hearing on the Merits, Respondent called 8 of Claimants' 11 witnesses for examination. They were, in the order in which they testified:

1) Mr. Jacques Kosciusko-Morizet;
2) Mr. Vladimir Dubov;
3) Mr. Frank Rieger;
4) Dr. Andrei Illarionov;
5) Mr. Leonid Nevzlin;
6) Mr. Bruce Misamore;
7) Mr. Steven Theede; and
8) Mr. Brent Kaczmarek CFA.

121. Claimants' other witnesses, who did not appear for cross-examination, were:

9) Mr. Philip Baker QC;
10) Mr. Yuri Schmidt; and
11) Dr. Sergei Kovalev.

122. The following summary first addresses the testimony of Claimants' eight witnesses who appeared before the Tribunal, in order of appearance. It then reviews the evidence from Claimants' three witnesses whom Respondent chose not to cross-examine.

1. Mr. Jacques Kosciusko-Morizet

123. Mr. Jacques Kosciusko-Morizet[13] was a Member of the Board of Directors of Yukos and the Chairman of the Board's Audit Committee from June 2000 to December 2004. In his witness statement, Mr. Kosciusko-Morizet describes Mr. Khodorkovsky's plans in the late 1990s "to modernize Yukos and to break the company's ties with the Soviet traditions" through a Western board and consolidation of Yukos' accounts. According to Mr. Kosciusko-Morizet, the reforms brought success: Yukos' shares increased in value by 50 percent after it published U.S. Generally Accepted Account Principles ("**U.S. GAAP**") consolidated financial statements in July 2000, and its leadership in transparency and corporate governance brought the verb

[13] Witness Statement of Jacques Kosciusko-Morizet, 3 September 2010 (hereinafter "Kosciusko-Morizet WS") (original in French, translated into English) submitted with Memorial. Mr. Kosciusko-Morizet appeared for examination (testifying in English) on 15 October 2012, Transcript, Day 4 at 4–235. References to Mr. Kosciusko-Morizet's testimony appear in Chapters VIII.C (Harrassment, Intimidation and Arrests), VIII.D (The Unwinding of the Yukos–Sibneft Merger) and VIII.H (The Withdrawal of PwC Audit Opinions).

"to Yukosize" into common parlance in Russian business circles.

124. Mr. Kosciusko-Morizet's statement also deals with the relationship with PwC, which he describes as "cordial and close" while he was Chairman of the Audit Committee. Yukos was one of PwC's major clients; PwC conducted Yukos' external audits and assisted with training Yukos' in-house accountants and with designing and implementing procedures. Thus, he testifies, "from 1997 to 2004, PwC was given access to the entire documentation of the whole of Yukos without restriction and had a very detailed and global view of the financial situation and the procedures of Yukos and its subsidiaries."[14]

125. After the arrest of Mr. Platon Lebedev in July 2003, Mr. Kosciusko-Morizet chaired a temporary ad hoc committee set up to assess the situation through interviews with individual managers at Yukos and PwC. He states that Mr. Michael Kubena, a PwC partner, assured the committee that Yukos had always complied with Russian law, including in its tax optimization structure, and that "PwC did not consider that there was any possibility for the Russian authorities to attack Yukos on these issues."[15] Mr.Kosciusko-Morizet referred to this advice several times during his oral testimony. Thus, according to Mr. Kosciusko-Morizet, the "late and spectacular volte-face of PwC," including the withdrawal of the certification of Yukos' accounts that took place on 15 June 2007, was "in blatant contradiction" to his relationship with PwC, was "questionable and damaging to [PwC's] reputation," and can only be explained by Respondent's pressure on PwC's Moscow office from December 2006 onwards.

126. Mr. Kosciusko-Morizet appeared before the Tribunal on 15 October 2012. He was cross-examined about, *inter alia*: (a) his responsibilities as the Chairman of Yukos' Audit Committee; (b) the relationship between Yukos and PwC including as to disclosures about Behles Petroleum S.A., Baltic Petroleum Trading Limited and South Petroleum Limited (known collectively as the "**BBS Companies**"); (c) the Yukos consolidation perimeter for purposes of U.S. GAAP; (d) the abandoned plans to list Yukos on the New York Stock Exchange ("**NYSE**") due to the Yukos–Sibneft merger; and (e) his knowledge of Yukos' tax optimization structures and the tax assessments against regional Yukos trading entities (in which context he remarked that "[t]rying to minimise tax is good management . . . within the

14 Kosciusko-Morizet WS ¶ 17.

15 Kosciusko-Morizet WS ¶ 24.

legislation applicable.")[16]

127. Mr. Kosciusko-Morizet was also given the opportunity to recount to the Tribunal a story that Mr. Khodorkovsky had conveyed to him in August 2003 about threats from the Russian authorities and their potential impact on Yukos.[17]

2. Mr. Vladimir Dubov

128. Mr. Vladimir Dubov[18] held various senior positions in Bank Menatep and Yukos entities, including on the Yukos Board from 1998 to 1999. He was elected as a State Duma Deputy in December 1999 (representing a region encompassing Mordovia) and was Chairman of the Tax Sub-Committee of the State Duma from February 2000 to October 2003. From 1997 he was a shareholder, and then a beneficiary of trusts holding shares in GML Limited ("**GML**") (the parent company of YUL). He first met Mr. Khodorkovsky in the late 1980s. In his witness statement, Mr. Dubov makes three key assertions: (a) Respondent was aware of, and approved Yukos' trading structure and tax optimization scheme; (b) Yukos' trading companies significantly contributed to the social and economic development of the regions in which they operated; and (c) Respondent's tax claims were aimed at appropriating Yukos' assets and removing Mr. Khodorkovsky as a "potential political threat".

129. Mr. Dubov explains in his statement that, given that Yukos' tax payments accounted for approximately four percent of the country's 2003 budget, the company was under "constant supervision and control of the Russian tax authorities."[19] Before 2003 there was never "any suggestion that Yukos' trading structure was other than in compliance with legal requirements and appropriate."[20] The authorities were extensively consulted and approved Yukos' practice of operating through trading companies in low-tax regions like the Republic of Mordovia. Yukos' trading companies significantly contributed to the local economy. Yukos' trading companies' VAT refunds were also closely monitored. According to Mr. Dubov, all four major

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16 Transcript, Day 4 at 65.

17 *See* paragraph 775 below.

18 Witness Statement of Mr. Vladimir Dubov, 8 September 2010 (hereinafter "Dubov WS") (original in Russian, translated into English), submitted with Memorial. Mr. Dubov appeared for examination (testifying in Russian through English interpretation) on 16 October 2012, Transcript, Day 5 at 2–191. References to Mr. Dubov's testimony appear in Chapters VIII.A (The Tax Optimization Scheme), VIII.B (The Tax Assessments Starting in December 2003) and VIII.C (Harrassment, Intimidation and Arrests).

19 Dubov WS ¶ 11.

20 *Ibid.* ¶ 54.

Russian oil companies (Lukoil, Sibneft, TNK, Yukos) engaged in tax optimization. Their taxes were closely supervised. Access to pipelines was conditioned on payment of taxes. This involved liaising with officials and opening up records to inspection.[21]

130. Mr. Dubov describes how he and Mr. Khodorkovsky became increasingly involved in social and political activities to build a civil society based on "liberal, open and democratic values" and in 2001 co-founded Open Russia to manage and fund projects to foster a "social and liberal ethos."[22] Mr. Khodorkovsky's funding of political parties openly and legally "put pressure on other political parties to be more transparent." These efforts "sent shockwaves through the entire Russian political system."[23]

131. Mr. Dubov expresses "no doubt that the alleged tax claims and the other trumped-up charges brought against Yukos, Khodorkovsky and his associates, were merely a pretext to remove Khodorkovsky as a potential political threat and to destroy Yukos with a view to taking its assets."[24] According to Mr. Dubov's statement, as the 2004 presidential elections approached, the Administration shifted attention to seizing Yukos' assets. At a meeting of the Russian Union of Industrialists and Entrepreneurs with President Putin at the Kremlin in February 2003, Mr. Khodorkovsky raised questions about official corruption. President Putin rebuked him and suggested that Yukos be scrutinized. At an April 2003 meeting, President Putin approved the Sibneft merger but warned that Mr. Khodorkovsky should restrict his political activities and not finance the Communist Party. In October 2003, Mr. Khodorkovsky was arrested just before a planned meeting with opposition parties.[25]

132. Mr. Dubov testifies that, on 27 October 2003, he learned his name had been removed as a Duma candidate. He was advised to leave Russia and was told by a Kremlin official that President Putin "had gone absolutely berserk over Khodorkovsky."[26] He left that night and has not returned since. In January 2004, the financial support of Messrs. Dubov and Nevzlin to an opposition presidential candidate was announced. The next day, international arrest warrants

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21 *Ibid.* ¶ 42–53.

22 *Ibid.* ¶¶ 55, 61.

23 *Ibid.* ¶ 64.

24 *Ibid.* ¶ 58.

25 *Ibid.* ¶¶ 55–64.

26 *Ibid.* ¶ 80.

were issued against both men on "entirely unfounded and politically motivated" charges. They were both found guilty *in absentia*.[27]

133. Mr. Dubov appeared before the Tribunal for examination on 16 October 2012. He was cross-examined about his financial interest in the case, being the beneficiary of the Draco Trust, in which had made an initial investment of around USD 10,000 and which now has a seven percent interest in GML.[28] He was also extensively cross-examined about the extent of disclosures he made to Russian government officials about Yukos' tax scheme in Mordovia and his knowledge and understanding about the Yukos trading entities in the ZATOs and the tax assessments leveled against them.[29]

134. Mr. Dubov stated his belief, held since he heard about the tax assessments against Yukos in 2004 from media reports, that the tax claims were being used by Respondent as an instrument of confiscation.[30] When asked by the Tribunal to elaborate on what information at the time led him to that conclusion, he testified:

> I had a personal relationship with the Deputy Head of Staff of the President, Mr. Vladislav Surkov . . . . [O]n the first business day following Khodorkovsky's arrest, Surkov asked me to come see him in the Kremlin . . . . He told me that he was asking for my forgiveness . . . . I had been struck from the list upon petition from the Prosecutor General by the council of the party without leveling any charges against me. . . . And I remember asking, "What will happen to Yukos?" And he said—and I am quoting him verbatim; I remember it very well—he said, "Yukos will be taken away from . . . you gentlemen." . . . And I also had a longstanding good relationship with yet another Deputy Head of the Staff of the President who, in late November of that year, told us . . . there would be criminal claims against every single shareholder. He said that an instruction had been issued to commence criminal cases against us and to take Yukos from us.[31]

3. Mr. Frank Rieger

135. Mr. Frank Rieger[32] is the former Acting CFO of Yukos, and held various positions with Yukos and its subsidiaries from 2000 until 2006. He resigned on 26 March 2006, due to the

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27 *Ibid*. ¶¶ 65–72.

28 Transcript, Day 5 at 29–36.

29 Transcript, Day 5 at 81–84, 101–102, 149–50, 152–54.

30 Transcript, Day 5 at 52.

31 *Ibid.* at 181–82.

32 Witness Statement of Mr. Frank Rieger, 9 September 2010 (hereinafter "Rieger WS") submitted with Memorial. Mr. Rieger appeared for examination on 17 October 2012, Transcript, Day 6 at 1–235. References to Mr. Rieger's testimony appear in Chapters VIII.A (The Tax Optimization Scheme), VIII.B (The Tax Assessments Starting in December 2003), VIII.C (Harrassment, Intimidation and Arrests), VIII.E (Attempts to Settle), VIII.G (The Bankruptcy of Yukos) and VIII.H (The Withdrawal of the PwC Audit Opinions).

"deepening crisis surrounding the company and the persecution of its management." In his witness statement, Mr. Rieger recounts that under Mr. Khodorkovsky's leadership, Yukos acted as a "trail-blazer" in corporate governance in Russia. When Mr. Rieger joined Yukos in 2000 from Roland Berger Consulting, he was directed by Mr. Khodorkovsky to "apply the same benchmark of Western corporate accountability and responsibility." Yukos modernized its production process, disclosed the company's shareholding details, and implemented international accounting and reporting procedures. Mr. Rieger states that Yukos "set a new standard for corporate social responsibility in Russia" but its achievements provoked concern amongst competitors.

136. According to Mr. Rieger, the Russian authorities targeted and harassed Yukos' auditor, PwC. Yukos engaged PwC as its external auditor and gave it "unrestricted access" to its "personnel, management, the Board of Directors, books and accounts." Mr. Rieger's "personal involvement with PwC was extensive." After PwC employees began to be questioned by the Prosecutor General's Office, PwC ceased to have further contact with Yukos. Mr. Rieger learned about PwC's withdrawal of its Yukos audits from 1995 to 2004 from the media. The suggestion that PwC did not have full access to information or that Yukos deliberately withheld information "defies credibility"; PwC raised no such concerns until its June 2007 withdrawal letter ("**PwC's Withdrawal Letter**").

137. According to Mr. Rieger, Yukos made numerous attempts to settle the alleged tax claims against it, including through negotiations and significant payments. However, the Russian authorities did not respond to Yukos' various proposals, and refused to provide written confirmation of the payments. It became clear to Mr. Rieger that "this was a political case, not a tax case, aimed at the destruction and expropriation of the company itself."

138. Mr. Rieger claims that Respondent conducted a campaign of harassment against Yukos, including illegal raids by armed masked men, searches and seizures of up to 70 percent of the Accounting Department's documents. In addition, numerous Yukos employees were questioned by the Prosecutor General's Office. Mr. Rieger himself was detained and interrogated at Moscow's airport in May 2006.

139. Mr. Rieger appeared before the Tribunal for examination on 17 October 2012. He was cross-examined about, *inter alia*: (a) his role at Yukos and understanding of its related entities; (b) Yukos' accounting structure including the extent to which it was designed by PwC; (c) the timing and process of Yukos' identification of assets for payment of taxes; (d) Yukos'

settlement offers, the responses from the Russian authorities and the legal limits within which the authorities were operating; (e) the repayment of the SocGen and Moravel Investments Limited ("**Moravel**") loans, relevant to the bankruptcy; (f) dividend payments via the "Laurel" group of Yukos companies; and (g) his awareness and understanding of tax assessment of Yukos entities in the ZATOs.

140. Mr. Rieger was also given an opportunity to describe to the Tribunal how in 2006 he was asked a series of questions at the General Prosecutor Office for which the investigator had already prepared his answers, a situation he said he "couldn't believe" had he not experienced it himself. He refused to sign the pre-prepared answers and gave his own version instead.[33]

4. Dr. Andrei Illarionov

141. Dr. Andrei Illarionov[34] served as Chief Economic Advisor to President Putin from April 2000 until his resignation in December 2005. He was also President Putin's personal representative ("sherpa") to the G-8. He is currently a Senior Fellow at the Cato Institute's Center for Global Liberty and Prosperity in Washington, D.C., as well as the President of the Institute of Economic Analysis in Moscow, which he founded. Dr. Ilarionov maintains a residence in Moscow and visits approximately five times a year.[35] In his witness statement, Dr. Illarionov recounts the evolution of Yukos since its establishment by government decree in 1993 following the dissolution of the USSR and the restructuring of the oil industry. Yukos saw remarkable growth and improvements in performance after its privatization in 1995–96, as a result of substantial investment, the employment of foreign engineers and managers, and the use of Western technology. Some officials viewed such reforms negatively. Yukos' public revelation, in 2002, of details of its shareholding, including the structure of GML, "had the effect of an earthquake on the Russian business community." It contrasted with the traditionally secretive manner of doing business and was viewed as setting a "harmful"

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33 Transcript, Day 6 at 69–70.

34 Witness Statement of Dr. Andrei Illarionov, 11 September 2010 (hereinafter "Illarionov WS") submitted with Memorial. Dr. Illarionov appeared for examination on 18 October 2012, Transcript, Day 7 at 3–176. References to Dr. Illarionov's testimony appear in Chapters VIII.B (The Tax Assessments Starting in December 2003), VIII.C (Harassment, Intimidation and Arrests) and VIII.F (The Auction of YNG).

35 Transcript, Day 7 at 5.

precedent. In Dr. Illarionov's words, Yukos was "one of the most dangerous enemies for those who did not want to see Russia a free country."[36]

142. According to Dr. Illarionov, the arrests of Messrs. Khodorkovsky and Lebedev and the dismantlement of Yukos were politically and economically motivated. Yukos' intended merger with Western oil majors was seen as a national betrayal and a hurdle to expropriation. Dr. Illarionov describes the 19 February 2003 meeting at the Kremlin between President Putin and business leaders, at which Mr. Khodorkovsky made a presentation on corruption, to which President Putin responded that everyone knew how various assets, including Yukos, were acquired, and told Mr. Khodorkovsky: "I return the ball in your corner." The tone of the meeting became "steely and menacing" as if something had gone "really wrong." It signaled the "gloves [had come] off," and that Mr. Khodorkovsky was no longer tolerated. From then on, according to Dr. Illarionov, "a case needed to be fabricated to launch the Government attack under the guise of 'legitimate' court proceedings" and a special unit was set up to fabricate evidence against Yukos. In October 2003, the "dramatic arrest" of Mr. Khodorkovsky at the airport signaled Yukos could be attacked. Few dared to voice support, and Prime Minister Mikhail Kasyanov, among others, was dismissed for doing so.[37]

143. Dr. Illarionov's statement further recounts that the campaign against Yukos culminated in the confiscation of YNG. While it was independently valued at USD 14.7–17.3 billion, the Russian authorities sold YNG for USD 9.3 billion—"a price well below even the most conservative estimates prepared by experts"—on a Sunday, at a forced auction attended by two participants, to an unknown company (Baikal) which was registered at an address above a local bar and had a charter capital of USD 350. President Putin said he knew the individuals behind the company and they were "well-established in the oil business." Four days later, Rosneft purchased Baikal with funds from State banks. According to Dr. Illarionov, the auction "sent shockwaves" and was internationally condemned. This "scam" was "one of the low points in Russia's recent history." The dismantling of Yukos was contrary to "basic principles of due process," and led Dr. Illarionov to resign as sherpa in 2004 and as the President's Chief Economic Advisor in December 2005.[38]

144. Dr. Illarionov appeared before the Tribunal for examination on 18 October 2012. Respondent

[36] Illarionov WS ¶¶ 5–16.

[37] Illarionov WS ¶¶ 17–41.

[38] Illarionov WS ¶¶ 42–52.

sought to undermine his credibility by showing he is now a vocal critic of the Russian Government, and that he has taken extreme positions against climate change regulation.[39] Respondent also challenged his assertion that Yukos' financial statements had complied with U.S. GAAP, on the basis that Dr. Illarionov lacked an understanding of GAAP and had not read Yukos' financial statements in full. Dr. Illarionov was cross-examined mostly about his claimed knowledge and understanding of the valuation of YNG and the auction process.[40]

145. The Tribunal asked Dr. Illarionov whether he had ever felt able to discuss with President Putin the arrest of Mr. Khodorkovsky and the measures of the Russian Government in respect of Yukos.[41] He replied:

> the most important conversation that I had with Mr. Putin was several days after Mr. Khodorkovsky had been arrested . . . . Mr. Putin has said that Mr. Khodorkovsky has made mistakes and behaved pretty badly . . . . And for a long time Mr. Putin himself was protecting Mr. Khodorkovsky from these attacks of his friends, of Mr. Putin's friends, but unfortunately Mr. Khodorkovsky continued to behave badly, and not cooperatively... One thing, he said that Mr. Khodorkovsky lied to us because he was in negotiations with American oil company about possible merger. Another issue he has mentioned: that Mr. Khodorkovsky joined Communist Party in preparation to the parliamentary election of year 2003... That is not something that "mi dogovarivalis"—I will try, "we had an agreement on." So he said . . .
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> So he said that after protecting Mr Khodorkovsky for some time—now it's almost a quotation—"I decided and I stepped aside to allow Mr Khodorkovsky to solve his problems with the boys by himself." . . . ."so Mr Khodorkovsky has chosen to fight. Okay," said Mr Putin, "if he has chosen to fight, let him to fight and we'll see what will happen."[42]

146. The Tribunal also asked Dr. Illarionov about the 50-person special unit that, according to paragraph 35 of his statement, was set up at the Russian General Prosecutor's office to work exclusively on "fabricating" evidence against Mr. Khodorkovsky and Yukos and, in particular, whether he could identify the sources on which he relied for that statement. He could not disclose the identity of his source—due to that individual still residing in Moscow and thus facing "serious risks" but his source was a "very high-placed official in the Russian administration at the time" and was very reliable.[43] Dr. Illarionov testified that the official had told him that the targeting of Yukos was "a big mistake … but it is a mistake that would be

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39 Transcript, Day 7 at 12–50.

40 For further specific references to the transcript, see discussion in Chapter VIII.F at paragraphs 1013 and 1019.

41 Transcript, Day 7 at 153 (referring to Illarionov WS ¶¶ 39–41).

42 *Ibid*. at 153–56.

43 *Ibid*. at 156–57. Upon further cross-examination, Dr. Illarionov said he had only ever discussed this special unit with his source and with Claimants' lawyers in these arbitrations. *Ibid.* at 164–65.

impossible to stop . . . . This unit has been created to 'zanyatsa' Khodorkovsky, [meaning to] 'take care of' Khodorkovsky . . . which means one day . . . security services and officers did receive an order so-called to solve the problem."[44]

147. Dr. Illarionov elaborated on his assertion, at paragraph 41 of his statement, that Russian Prime Minister Mikhail Kasyanov had "expressed his disapproval of Mr. Khodorkovsky's arrest and the mounting attack on Yukos", and explained that after Mr. Khodorkovsky's arrest:

> there was public outrage in mass media . . . . From the Government ranks, I cannot recall any person who would express disapproval of the arrest . . . with the exception of Mr. Kasyanov . . . . And after making such a statement, Mr. Putin publicly made a very rude statement that you can find recorded in video . . . that, "I would ask everybody in the Government to shut up on Mr. Khodorkovsky's arrest." And it was very clear that this comment was addressed to Mr. Kasyanov, and later Mr. Kasyanov . . . [was] removed from his position.'[45]

5. Mr. Leonid Nevzlin

148. Mr. Leonid Nevzlin[46] is a long-standing friend and close business colleague of Mr. Khodorkovsky. They first met at a research centre in 1987. Mr. Nevzlin held various high level positions in Bank Menatep and Yukos, including as Vice-President of Yukos responsible for public relations, and as First Deputy Chairman of the Yukos Board of Directors. Mr Nevzlin helped found Open Russia in 2001. He also later served as a senator representing Mordovia until March 2003. He is a beneficiary of three of the trusts that hold ownership shares in GML. He now resides in Israel, working in philanthropy.

149. In his witness statement of 15 September 2010, Mr. Nevzlin testifies that his support for democratic causes led the Russian authorities to target him for persecution. For example, after he announced his financial support for an opposition presidential candidate in January 2004, the Prosecutor General's Office brought "entirely unfounded and politically motivated" charges against him for tax evasion and embezzlement. "Ludicrous" murder charges were added in

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44 *Ibid*. at 158.

45 *Ibid*. at 159–60.

46 Witness Statement of Mr. Leonid Nevzlin, 29 August 2010 (hereinafter "Nevzlin WS") (original in Russian, translated into English), submitted with Memorial. Mr. Nevzlin appeared for examination on 18 and 19 October 2012 (testifying in Russian, through English interpretation), Transcript, Day 7 at 176–224 and Day 8 at 1–43. References to Mr. Nevzlin's testimony appear in Chapters VIII.C (Harassment, Intimidation and Arrests) and VIII.D (The Unwinding of the Yukos–Sibneft Merger).

2004 and 2005. Israel refused to extradite him to Russia but after a "show trial" in 2008, he was sentenced *in absentia* to life imprisonment.[47]

150. Mr. Nevzlin explains that Mr. Khodorkovsky was perceived by the Kremlin as a political threat and a potential presidential candidate. According to Mr. Nevzlin, the attacks on Yukos were motivated by the objectives "to remove Mr. Khodorkovsky as a potential political threat," "to punish and make an example of" Yukos leaders, and to "expropriate Yukos without compensation." Mr. Nevzlin received warnings of the attacks on Yukos, including at a meeting with the Media Minister in Spring 2003, who told him that Mr. Khodorkovsky risked losing everything, including his liberty, if he did not immediately stop criticism of President Putin. He was told that President Putin was "furious" about Mr. Khodorkovsky's media coverage.[48]

151. With regard to the Yukos–Sibneft merger, Mr. Nevzlin testifies that he understood that "everything that happened with Sibneft was approved by President Putin." At a meeting with Mr. Khodorkovsky, President Putin cautioned against a U.S. oil major acquiring more than 25 percent of YukosSibneft. The merger was completed in October 2003, but Mr. Abramovich "abruptly changed his mind and sought to unwind the merger" after it "became apparent that Khodorkovsky was being targeted by the Kremlin." Mr. Nevzlin testifies that shortly after Mr. Khodorkovsky's arrest in October 2003, Mr. Abramovich approached Mr. Nevzlin in Tel Aviv to convey that the Yukos–Sibneft merger could only be preserved if Sibneft was given management of the merged company. The companies were not integrated and eventually de-merged.[49]

152. Mr. Nevzlin appeared before the Tribunal for examination on 18 and 19 October 2012. Respondent highlighted his lack of banking experience when he rose to the top of Bank Menatep. Mr. Nevzlin pointed out that "there had not been any commercial banks in the Soviet Union, and not a single person in the Soviet Union worked in a commercial bank prior to 1988;" and further that "the position of bank president did not mean that [he] in fact was responsible for banking operations; it was a position that was established specifically for someone who engaged in public relations."[50]

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47 Nevzlin WS ¶¶ 14, 22.

48 *Ibid.* ¶¶ 22, 28–36.

49 *Ibid.* ¶¶ 24–27.

50 Transcript, Day 7 at 180–82.

153. Mr. Nevzlin was cross-examined on his interest in GML, his motives for testifying in these arbitrations, and a recent UK court case relating to individuals involved in the Yukos–Sibneft merger. He acknowledged that the trusts in which he has beneficial interests (the Pictor Trust, the Southern Cross Trust and the Palmus Trust) hold a total of approximately 67 percent of GML, and thus that he would benefit financially if the outcome of these arbitrations was favourable to Claimants.[51] Mr. Nevzlin testified that he had not paid anything for his interests in the trusts and confirmed also that Messrs. Brudno, Lebedev and Shakhnovsky had not paid any consideration for their beneficial interests in the Palmus Trust. Amidst this line of questioning, Mr. Nevzlin pointed out:

> everything I own, just like my partners used to own, was earned through extremely hard work, starting, as you will know from . . . in 1987 . . . . [V]irtually all the business revenue, except for what was paid to charity or used for personal needs, was reinvested in the business . . . . So all the money, all the shares that we owned we earned through our titanic—if you will—efforts that had spread over a long period of time.[52]

154. Mr. Nevzlin confirmed that he knew about the 2004 tax assessments soon after they were issued, but by that point he had "already realised that Putin will not stop, and will take away the company anyway. So I was not surprised by tax claims in this size and consequent actions by the Russian Federation." He also confirmed his long-held belief that the tax assessments were improper, as were the Russian authorities' enforcement actions, claiming:

> Yukos was led into bankruptcy . . . They [the Russian authorities] did everything in order to prevent Yukos from paying off its debts. The company was in perfect shape, with a lot of cash, with the best rating in the country, with a good market capitalisation, but it took about two years for Putin and Sechin . . . to destroy this company completely.[53]

When asked whether he had hoped Yukos would prevail and defeat the assessments, he replied that "[t]hose proceedings took place in the Russian Federation, and the outcomes, the decisions were made in the Kremlin. The decisions were not made in the courtroom . . . . We are not talking about a democratic country; we are talking about a dictatorship."[54]

155. Mr. Nevzlin was questioned about why he had waited until 2010, when providing his witness statement in these proceedings, to disclose that in 2003 Mr. Abramovich told him that

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51 *Ibid.* at 187–92, 207.

52 *Ibid.* at 196–99.

53 *Ibid.* at 209–13.

54 *Ibid.* at 217–18.

Mr. Khodorkovsky "had been targeted because of his involvement in politics."[55] He was also asked why he had not included this evidence in his 6 August 2006 witness statement in the ECtHR proceedings, nor in any of the Russian criminal cases against Mr. Khodorkovsky. He explained:

> if I had spread the information about Abramovich and Putin fairly broadly, and if it had become available to the public, then from the perspective of Khodorkovsky, who is in Russian prison, I would have damaged him.
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> . . . I would have caused him tremendous amounts of harm . . . in the other corner facing him were Putin, Sechin and others; but I also would have turned Abramovich into an enemy of Khodorkovsky's by disclosing this information.
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> . . . [A]fter . . . things moved to a second absurd set of charges and a second trial, Khodorkovsky's position changed radically. He was no longer wary of a political . . . confrontation with Putin's regime because he realised that he was not going to be able to find truth in a Russian court if he tried to defend himself based on the laws.
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> . . . Russian courts have no interest in my position: it would be either ignored or rejected by them . . . .Because it's not a judge who makes decision on Khodorkovsky and Lebedev; the judge just rubber-stamps decisions that are made by investigative committee and Prosecutor's Office . . . .The fact that I trust this court and tell this court a lot more than I've ever said on the matter, this is a typical position for me, because . . . if we're able to defend our interests, that would be either in courts in free countries or international courts.[56]

156. Mr. Nevzlin was cross-examined about his May 2011 witness statement to the High Court of Justice in England in a case brought by Mr. Berezovsky against Mr. Abramovich. Mr. Nevzlin was shown the English judge's decision, in which the judge declined to attach significant weight to Mr. Nevzlin's evidence, as she found him to be "tendentious," that he "expressed opinions about matters in respect of which he had no knowledge," and that she had "the impression that Mr. Nevzlin had crafted his evidence to suit Mr. Berezovsky's case." Mr. Nevzlin observed the judge was "entitled to her opinion" and he "only told her the truth."[57]

6. Mr. Bruce Misamore

157. Mr. Bruce Misamore[58] was Chief Financial Officer of Yukos and a Member of its Management

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55 Transcript, Day 8 at 4–5, referencing Nevzlin WS ¶ 35.

56 *Ibid.* at 17–25

57 *Ibid.* at 34, 37, 39–40. Extract from *Berezovsky v. Abramovich*, 31 August 2012 ¶¶ 485–86, Exh. R-4654.

58 Witness Statement of Mr. Bruce Misamore, 28 July 2010 (hereinafter "Misamore WS") submitted with Memorial. Mr. Misamore appeared for examination on 22 October 2012, Transcript, Day 9 at 1–268. References to Mr. Misamore's testimony appear in Chapters VIII.A (The Tax Optimization Scheme), VIII.B (The Tax Assessments Starting in December 2003), VIII.C (Harrassment, Intimidation and Arrests), VIII.D (The Unwinding of the Yukos–Sibneft Merger), VIII.E (Attempts to Settle) and VIII.H (The Withdrawal of PwC's Audit Opinions).

Committee from April 2001 to December 2005. He was a Member of the Executive Committee of the Yukos Board commencing in 2005. He has 38 years experience in financial and executive roles in the oil industry. In his witness statement, Mr. Misamore explains that as CFO, he was to ensure that Yukos met international best practices in financial management. He describes how, by 2003, Yukos had become an industry leader in transparency, corporate governance and production and that, "[c]ontemplating significant expansion and growth" Yukos closed its merger with Sibneft on 3 October 2003 and was in talks with Western oil majors.[59]

158. Mr. Misamore testifies that PwC played an "integral role" in developing Yukos' financial reporting system and was given full access to Yukos' books, accounts, and employees, and was "very knowledgeable about and had full access to Yukos' principal subsidiaries." He considers PwC's withdrawal of the Yukos audit reports as having been "motivated by the continuing attack . . . on Yukos and persons associated with the company" and that it was "highly questionable professionally."[60]

159. According to Mr. Misamore, the campaign by the Russian authorities to dismantle Yukos began in earnest in the summer of 2003 with arrests, raids, searches, and seizures. In July 2003, Russian authorities raided Yukos' Moscow offices "in an incredible scene full of armed, masked officers" and "trawled through [the company's] computer records for approximately 17 hours." Large volumes of documents and electronic files were seized, with no copies or record left." In August 2006, "baseless, politically motivated" criminal investigations were announced against Mr. Misamore and others.[61]

160. According to Mr. Misamore, Russian authorities also interfered with the Yukos–Sibneft merger; Sibneft put the merger "on hold," and refused to negotiate the demerger.[62] Russian authorities then imposed a series of "huge fabricated tax reassessments" on Yukos "designed to financially cripple the company" and to "serve as a pretext under which the Government broke up the company and expropriated its assets." Yukos made numerous efforts to negotiate and to pay its tax bills; these were rejected, "stifle[d]," or went unanswered.[63] He described how on

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59 Misamore WS ¶¶ 22–24.

60 *Ibid.* ¶¶ 26–29.

61 *Ibid.* ¶¶ 30–33.

62 *Ibid.* ¶¶ 36–37.

63 *Ibid.* ¶¶ 38–51.

19 December 2004, the Russian authorities held an auction for YNG. As one of only two bidders, Baikal won the auction, in ten minutes, for USD 9.35 billion. Baikal was immediately sold to State-owned Rosneft. In 2007, the court-appointed receiver in the bankruptcy proceedings, Mr. Eduard Rebgun, liquidated the remaining 40 percent of the company in auctions won by State-owned entities at prices well below market value.[64]

161. Mr. Misamore appeared for examination on 22 October 2012. He was cross-examined on a wide range of issues encompassing, *inter alia*: (a) the Yukos–Sibneft merger including the dividend payment and the unwinding of the merger; (b) PwC and its role in developing the concepts of golden shares and call options which allowed Yukos to consolidate the financial performance of companies that it did not own, but for which it had call options; (c) Mr. Misamore's knowledge and understanding of Yukos' domestic offshore trading entities and the tax assessments levied against some of them; (d) the responses to the tax assessments and use of proceeds from the sale of Yukos assets; and (e) the creation of two Dutch foundations, namely Stichting Administratiekantoor Yukos International ("**Stichting 1**") and Stichting Administratiekantoor Small World Telecommunication Holdings B.V. ("**Stichting 2**," together with Stichting 1, the "**Stichtings**").

162. The Tribunal also asked Mr. Misamore whether he was aware of any written legal opinion that concluded that Yukos' tax optimization scheme was lawful under Russian law. He replied that upon receiving the tax assessment in December 2003, Yukos requested opinions from Mr. Sergey Pepeliaev, a tax expert and regular advisor to Yukos, and PwC. Mr. Misamore stated that "[b]oth of those opinions basically said what Yukos was doing was completely legal," but he could not recall if Yukos' tax structure had received the blessing of a lawyer or an accounting firm in writing prior to December 2003. He added that he "was informed consistently, throughout the entire time [he] was at Yukos, that everything Yukos did with respect to these things was entirely in accordance with Russian law."[65]

7. Mr. Steven Theede

163. Mr. Steven Theede[66] joined Yukos as its Chief Operating Officer in August 2003, after a

64 *Ibid.* ¶¶ 51–60.

65 Transcript, Day 9 at 250–52.

66 Witness Statement of Mr. Steven Theede, 26 August 2010 (hereinafter "Theede WS") submitted with Memorial. Mr. Theede appeared for examination on 23 and 24 October 2012, Transcript, Day 10 at 1–133, Day 11 at 1–59. References to Mr. Theede's testimony appear in Chapters VIII.A (The Tax Optimization Scheme), VIII.B (The Tax

30 year career with ConocoPhilips. From June 2004 until February 2005, he served as CEO of Yukos. Upon the advice of the U.S. State Department, in November 2004 he decided not to return to Russia. From May 2005 until resigning in August 2006, Mr. Theede was President of Yukos. In his witness statement, Mr. Theede testifies that within a few years he saw "one of the largest oil companies in the world . . . managed in accordance with the highest international standards" be "brought to its knees through the orchestrated attacks of the Russian authorities."[67]

164. Mr. Theede states that he was involved in many attempts by Yukos to discharge or settle its alleged tax liabilities. While Yukos did not accept the validity of the tax claims, it nonetheless tried to discharge or settle them, only to be prevented from doing so by Respondent. For instance, in April 2004, Yukos was told to pay USD 3.4 billion within two days, but the next day was prohibited by the Moscow Arbitrazh Court from alienating assets. This "impossible situation" of demanding that Yukos pay but depriving it of any means to pay, became a pattern that led to "a state of paralysis."[68]

165. According to Mr. Theede's statement, Yukos made about 80 proposals and communications to various Russian authorities but "all our efforts were in vain." For example, he states that in July 2004, an offer by Yukos to relinquish its stake in Sibneft to satisfy the alleged debt was ignored. Yukos retained former Canadian Prime Minister Jean Chrétien to seek a global settlement, but his proposals went unanswered. Meanwhile, the tax bill kept increasing and Yukos paid taxes nearly equal to its total revenue. In October 2004, Mr. Theede testifies that Yukos submitted a "full settlement proposal" in the range of USD 21 billion, but negotiations "came to an abrupt end" when Yukos' principal negotiator, Yukos Vice-President Alexander Temerko was advised to leave Russia to avoid arrest. In December 2004, YNG, Yukos' core asset, was sold for a "grossly undervalued price" of USD 9.35 billion in a "sham auction" to an "unknown company." After that, there were no more settlement discussions. Mr. Theede stated that the undervaluation of YNG became obvious when in 2006 Rosneft valued it at approximately USD 80 billion.[69]

Assessments Starting in December 2003), VIII.C (Harrassment, Intimidation and Arrests), VIII.D (The Unwinding of the Yukos–Sibneft Merger), VIII.E (Attempts to Settle), VIII.G (The Bankruptcy of Yukos) and VIII.H (The Withdrawal of PwC's Audit Opinions).

67 Theede WS ¶¶ 1–9, 36.

68 *Ibid*. ¶¶ 10–11, 28.

69 *Ibid*. ¶¶ 9, 24–26.

166. According to Mr. Theede's statement, in March 2006, a consortium of Western banks that had obtained a judgment in England against Yukos filed a bankruptcy petition with the Moscow Arbitrazh Court. Mr. Theede states that his urgent letter to the Chief Bailiff, requesting that assets be released to satisfy the debt, went unanswered. He further describes how, in a confidential agreement, Rosneft agreed to purchase Yukos' debt to the consortium upon the initiation of bankruptcy proceedings, which began in March 2006. Respondent was thus the only creditor of significance. Mr. Theede testifies that in July 2006, Mr. Rebgun produced a report concluding that Yukos was insolvent, and at the 20 July 2006 creditors' meeting, he recommended Yukos be declared bankrupt. By contrast, Yukos had submitted a rehabilitation plan in June 2006 (the "**Rehabilitation Plan**"), which valued the company at USD 31 billion, and would have seen Yukos pay its creditors in two years. The Rehabilitation Plan was not mentioned in Mr. Regbun's report. Not wanting to lend credibility to a "charade", Mr. Theede did not attend the 20 July 2006 creditors' meeting and, feeling there was nothing more to do to protect the company's assets, he resigned with effect from 1 August 2006.[70]

167. Mr. Theede appeared before the Tribunal for examination on 23 and 24 October 2012. Mr. Theede was cross-examined about, *inter alia*: (a) the 15 April 2004 injunction ("**April 2004 Injunction**") and its effect on Yukos' control over certain assets; (b) Yukos' perception of the tax assessments as politically motivated; (c) the nature, adequacy and legitimacy of various settlement proposals offered by Yukos to pay off its tax debts; (d) the bankruptcy proceedings and proceeds from asset sales; and (e) the establishment of the Stichtings.

168. Upon cross-examination, Mr. Theede confirmed that, in light of Yukos' strong performance in 2004, "[d]espite the ongoing external pressure," Yukos' Board approved approximately USD 50 million in bonuses. Mr. Theede himself received a USD 5 million bonus. The decision to issue bonuses was motivated by Yukos' acute concerns about employee retention and "hiring others was going to be almost impossible, because . . . it was a scary place to be."[71] He recalled the exceptional hire of Mr. Aleksanyan as executive vice-president of Yukos because the bankruptcy administrator, Mr. Rebgun, wanted a Yukos executive in Moscow with whom he could work directly. Mr. Theede recounted that Mr. Aleksanyan "went and met with Mr. Rebgun and explained to him that we were in a difficult situation but we wanted to cooperate, and we really felt that we could find a way to survive." Within three days, police

70 *Ibid.* ¶¶ 29–34.

71 Transcript, Day 11 at 14–16, 21–23.

stormed Mr. Aleksanyan's house and he was held in jail without a hearing for three years and only released as a result of a ECtHR ruling.[72] He died a year later from an illness contracted in jail.

169. In response to a Tribunal question, Mr. Theede testified that he met with PwC at least quarterly, but he did not recall that the trading companies ever came up in their discussions. He never asked PwC for a written opinion on the structure of the trading companies, and he "was told that PwC's consulting arm was actually the architect of those structures." He did not discuss any of the tax reassessments with either Messrs. Kubena or Miller of PwC.[73]

8. Mr. Brent Kaczmarek

170. Mr. Brent C. Kaczmarek CFA[74] is Managing Director of Navigant Consulting, Inc. and has served as a financial, valuation and damages expert in more than 40 international investment arbitrations. Mr. Kaczmarek was retained by Claimants as a damages expert to calculate Claimants' losses result from a "series of acts which resulted in the demerger of Yukos Sibneft, the piece-by-piece sale of Yukos' assets, and eventually the destruction of Yukos," which he defines as "the Actions."

171. Mr. Kaczmarek's two expert reports and oral testimony are summarized in Part XII of the Award. In essence he concludes that, assuming the underlying tax assessments and all subsequent Actions were violations of the ECT, Claimants should be compensated for the value of their shareholding in a hypothetical Yukos entity (as merged with Sibneft and listed on the NYSE) as at the date of 21 November 2007, as well as any dividends that would have been paid to them up to that point in time, plus interest. The total amount of damages calculated on this basis would be USD 114.174 billion. Mr. Kaczmarek relies on a number of techniques in support of this figure, including valuations of Yukos' assets, a Discounted Cash Flow ("**DCF**") analysis, a comparable companies approach and a comparable transactions approach. Mr. Kaczmarek also offers valuations in scenarios where there is no merger with Sibneft and no listing on the NYSE. He additionally makes assessments of the damages which would be due

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72 *Ibid.* at 38–39. *See also* Theede WS ¶ 30.

73 *Ibid.* at 50–51, 54.

74 First Expert Report of Mr. Brent C. Kaczmarek, CFA, 15 September 2010, filed with Memorial (hereinafter "First Kaczmarek Report"); Second Expert Report of Mr. Brent C. Kaczmarek, 15 March 2012, filed with Reply (hereinafter "Second Kaczmarek Report"). Mr. Kaczmarek appeared for examination on 24 October 2012, Transcript, Day 11 at 60–196. References to Mr. Kaczmarek's testimony appear in Part XII of the Award (The Quantification of Claimants' Damages).

to compensate Yukos were the Tribunal to find that the original tax assessments did not breach the ECT but that the subsequent enforcement of the tax claims did. His damages calculations for the latter scenario range between USD 33 billion and USD 67 billion.

172. Mr. Kaczmarek was cross-examined about (a) revisions he made between his first and second reports; (b) errors made with respect to the crude oil export tariff rate, the mineral extraction tax rate, inflation rates, the use of the U.S. Consumer Price Index, an erroneous conversion of tons to barrels, (c) assumptions about Yukos' borrowing capacity, and (d) various reasonableness tests. The Tribunal also questioned him about the choice of valuation dates.[75]

9. Mr. Philip Baker QC

173. Mr. Philip Baker QC[76] practices at Gray's Inn Tax Chambers in London and is presently a senior research fellow at the University of London. Claimants presented him as an expert on international tax law to counter claims made by Respondent's expert Professor Rosenbloom, regarding the benefits claimed by Hulley and VPL under the Agreement between Cyprus and the Russian Federation for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital, signed on 5 December 1998 ("**Cyprus-Russia DTA**"). For reasons explained in more detail in Chapter IX.B of this Award (on "Unclean Hands"), Mr. Baker disagrees with Professor Rosenbloom's conclusion that the claims to benefit from the Cyprus-Russia DTA were not appropriate, were vitiated by tax treaty abuse and were not justified by the provisions of the DTA.

174. In essence, Mr. Baker firstly maintains that the benefits that Hulley and VPL received under the Cyprus-Russia DTA are consistent with its purpose. Secondly, Mr. Baker opines that the abuse of law doctrine is found in the domestic law of certain countries, but is not universal and, where it applies, it is for that domestic jurisdiction to resolve whether the doctrine applies to international obligations such as double taxation conventions. Thirdly, Mr. Baker maintains that Hulley and VPL were the beneficial owners of the dividends received from Yukos in the sense of Article 10 of the Cyprus-Russia DTA. Hulley and VPL were acknowledged investment companies holding shares in Russian companies and did not have a permanent

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75 Transcript, Day 11at 192–93.

76 Expert Report of Mr. Philip Baker QC, 14 March 2012, filed with Reply. Initially Mr. Baker was expected to appear before the Tribunal, but on 4 October 2012, Respondent informed the Tribunal it no longer wished to cross-examine him. References to his report appear in Chapter IX.B (Unclean Hands).

establishment in Russia under Article 10(4).

10. Mr. Yuri Schmidt

175. Mr. Yuri Schmidt[77] was Mr. Khodorkovsky's defense lawyer in his 2004 and 2007 criminal trials, prior to which Mr. Schmidt had no previous dealings with Mr. Khodorkovsky or with Yukos. In his witness statement, Mr. Schmidt recounts that Russian authorities systematically intimidated and harassed Yukos' lawyers and personnel. Illegal and aggressive raids and seizures were "meticulously calculated to correspond to the critical stages in the dismantlement of Yukos." Russian authorities also engaged in physical attacks and other provocation, including long and abusive interrogations and beatings. In February 2007, defense lawyers were illegally and invasively searched at the airport while en route to visit Mr. Khodorkovsky in Siberia. Russian authorities also (unsuccessfully) brought libel proceedings against and attempted to disbar Mr. Schmidt. Respondent chose not to call him for cross-examination.

176. Mr. Schmidt testifies that in the criminal cases against Messrs. Khodorkovsky and Lebedev, Russian authorities violated basic standards of due process and fair trial. In 50 years of legal practice in Russia, Mr. Schmidt had "never seen breaches of due process so flagrant and so egregious," nor had he ever, even in the "darkest hours of the Soviet regime," "seen the Russian State undertake such coordinated, systematic and intense efforts, and deploy such huge resources, against a person accused of an alleged economic offense." The raids resulted in the "massive confiscation" of documents that were not returned. In December 2006, the defendants were transferred to a "pre-trial detention isolator" in Chita and Siberia. Mr. Schmidt recounts that during the trials, seized documents were presented out of context; the defendants sat in metal and glass cages that were equipped with hidden microphones; criminal charges were brought against defense witnesses; and prosecution motions were systematically granted, while defense motions were refused.

177. According to Mr. Schmidt, the goal of destroying Yukos and confiscating its assets was carried out by the coordinated actions of all branches of the Russian State. The judiciary blocked Mr. Khodorkovsky's registration of candidacy for the 2005 parliamentary elections by accelerating his appeal. The administration transferred Messrs. Khodorkovsky and Lebedev to

[77] Witness Statement of Mr. Yuri Schmidt, 6 September 2010 (hereinafter "Schmidt WS") (original in Russian, translated into English), submitted with Memorial. References to Mr. Schmidt's testimony appear in Chapter VIII.C (Harassment, Intimidation and Arrests).

the "most inaccessible penal colonies in Russia," "in blatant violation of Russian law." The legislature amended legislation to permit the transfer and amended the law on NGOs to force the closure of Open Russia.

11. Dr. Sergei Kovalev

178. Dr. Sergei Kovalev[78] is a Russian human rights activist, former politician, Soviet dissident and political prisoner. From 1993 to 2003 he served as an elected State Duma Deputy. He has been nominated for the Nobel Peace Prize. Dr. Kovalev's expert opinion is on the independence of the Russian judiciary in cases with a political element or representing a particular interest to Russian authorities. Dr. Kovalev concludes that the Russian judicial system was not, and is still not, independent. According to Dr. Kovalev, where cases implicate the interests of the State, trials are political and decisions dictated by extralegal motives. There exists "absolute submission of the Russian judiciary to the executive power." Respondent did not call him for cross-examination.

179. Dr. Kovalev opines that the normative regulation of the Russian judiciary ensures its dependence, including through the role of the executive branch of government in the appointment of judges. Court Presidents have "excessive powers," courts are under-funded, judges earn bonuses for "exemplary behavior" (as defined by the regime), and disciplinary action is taken against disobedient judges.

180. Dr. Kovalev's answer to the question of whether the Russian judiciary was independent of the executive branch in the Yukos and Khodorkovsky/Lebedev cases, is "unequivocal and definitely negative," because of the "clearly political nature" of the cases. The political motive was "to dispose of Mikhail Khodorkovsky," whom the Putin administration saw as an "unmistakable political opponent." According to Dr. Kovalev, the attacks on Yukos also had economic motives, as evidenced by President Putin's vouching for the unknown last minute purchasers of YNG. Pressure (including the imprisonment of Yukos lawyer Vasiliy Aleksanyan) was exerted on other Yukos associates to obtain testimony. Dr. Kovalev lists "egregious due process violations" against Messrs. Khodorkovsky and Lebedev, including: (a) a pretrial investigation that was conducted without the defendants' participation; (b) the

[78] Expert Report of Dr. Sergei Kovalev, 2 September 2010 (hereinafter "Kovalev Report") (original in Russian, translated into English), submitted with Memorial. References to Dr. Kovalev's testimony appear in Chapter VIII.C (Harassment, Intimidation and Arrests).

dismissal by the Court of every defense petition; and (c) the refusal by the Court to allow the defense attorneys to question Prosecution expert witnesses.

B. RESPONDENT'S WITNESSES

181. Respondent submitted no testimony from fact witnesses. Respondent submitted 11 expert opinions. At the Hearing on the Merits, Claimants chose to cross-examine only:[79]

1) Professor James Dow PhD; and
2) Mr. Oleg Y. Konnov

182. Respondent's other witnesses, who did not appear for cross-examination, were:

3) Professor Reinier Kraakman;
4) Professor H. David Rosenbloom;
5) Professor Thomas Z. Lys PhD;
6) Ms. Felicity Cullen QC;
7) Mr. Dale Hart;
8) Mr. Polyvios G. Polyviou;
9) Mr. John Ellison FCA;
10) Mr. Raymond Gross CPA; and
11) Professor Dr. Albert Jan van den Berg

183. The following summary first addresses the testimony of Respondent's two witnesses who appeared before the Tribunal, in order of appearance. It then reviews the evidence from Respondent's nine witnesses whom Claimants chose not to cross-examine as well as the evidence provided by Professor Stef van Weeghel during the jurisdictional phase of this case.

1. Professor James Dow

184. Professor James Dow[80] is Professor of Finance at London Business School, where he has taught valuation since 1989. He has a PhD from Princeton University and economics degrees from Cambridge University. Professor Dow was retained by Respondent as a damages expert to respond to the reports of Claimants' expert, Mr. Kaczmarek.

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79 Initially, Claimants intended to also cross-examine Professor H. David Rosenbloom. However, they decided not to after Respondent, shortly before the Hearing on the Merits, advised that it did not wish to cross-examine Claimants' international tax law expert, Mr. Philip Baker QC.

80 First Expert Report of Professor James Dow, 1 April 2011, filed with Respondent's Counter Memorial, Second Expert Report of Professor James Dow, 15 August 2012, filed with Rejoinder. Professor Dow appeared for examination on 25 October 2012, Transcript, Day 12 at 1–202. References to Professor Dow's testimony appear in Part XII (The Quantification of Claimants' Damages).

185. Professor Dow's two expert reports and oral testimony are summarized in Part XII of the Award. Professor Dow acknowledges focusing on "explaining why the Kaczmarek Report is not useful for calculating damages in this matter." His reports contain no alternative valuation of his own. He basically describes a series of flaws in the analysis of Mr. Kaczmarek, highlighting his choice of a valuation date which, he says, is arbitrary and unjustifiably inflates damages. He also criticizes Mr. Kaczmarek for ignoring causation and the extent to which Yukos' own actions might have contributed to the loss. Professor Dow identifies a number of errors in Claimants' DCF analysis and questions the way in which Mr. Kaczmarek sought to correct them without impacting the ultimate valuation. He also articulates problems with Claimants' comparable companies method and the assumptions underlying the "alternative collection scenarios" whereby Claimants would have been given an opportunity to make arrangements to pay off legitimate tax assessments. He identifies some "obvious and significant errors" relating to the application of the inflation rate, the export duty rate and the mineral extract tax rate. He also criticizes any valuation based on an American Depository Receipt ("**ADR**") listing on the NYSE as too speculative. Professor Dow was cross-examined about these issues.

186. At the Hearing, Professor Dow testified that he would be prepared to put some weight on Mr. Kaczmarek's analysis for YNG with corrections (USD 17.1 billion for the comparable companies approach and USD 17.2 billion for the comparable transactions approach); which represented a "reasonable stab".[81] Professor Dow was asked if his corrected figures for Yukos and YukosSibneft valuations resulting from the comparable companies analysis (of USD 67.8 billion and US 93.7 billion respectively) could provide "a valid result in terms of valuation in the same manner as for YNG," to which he answered that: "They are not presented in that context, but I think I'd have to agree that they could be a useful valuation, yes."[82] He qualified this answer by noting he had not done enough analysis, for example by accounting for changes in oil prices. Claimants' counsel also challenged Professor Dow on his criticisms of Claimants' comparable companies approach. With respect to the proper valuation date, from an economic standpoint, he considered that the end of 2004 was the appropriate valuation date, since that is when the loss of value in Yukos had taken place and the market thought, based on the share price, that the company's fortunes had no chance of being reversed. Professor Dow opined that

81 Transcript, Day 12 at 47.

82 Transcript, Day 12 at 47–48.

"it's indisputable that there was no value by the end of 2004.[83] By the end of 2004, Yukos' share price had plummeted, it was a penny stock, and in the three years that followed there was no recovery in the share price."[84]

2. Mr. Oleg Y. Konnov

187. Mr. Oleg Y. Konnov[85] is a partner at Herbert Smith LLP and head of its Russian tax group based in Moscow. He has practiced tax law for 17 years and taught at the Law Faculty of Moscow State University. Respondent retained him as an expert on Russian tax law. Mr. Konnov was the only Russian tax lawyer who appeared as a witness before the Tribunal. Extensive extracts from his testimony are set out in the Analysis portion of the Award, especially the chapters dealing with Yukos' tax optimization scheme and the tax assessments. Accordingly, his testimony is not reproduced here in any detail.

188. His first expert report describes the tax optimization scheme adopted by Yukos using domestic offshore companies and sets out some basic principles of the Russian federal tax legislation at the relevant times. He then addresses seven specific questions.

189. The first question is whether the tax authorities acted in accordance with applicable law and practice when assessing profit tax on Yukos with respect to sales by the domestic offshore companies. Mr. Konnov answers affirmatively and opines that the actions of the Russian tax authorities against Yukos were consistent with pronouncements by Russian courts on the "anti-abuse doctrine", which according to Mr. Konnov, was "accepted and consistently applied" by Russian courts before and after the Yukos tax cases.[86]

190. The second question is whether Yukos was automatically entitled to a zero percent VAT rate in connection with exports declared by domestic offshore companies. Mr. Konnov answers no, because the application of a zero percent VAT rate was "strictly conditioned" on the taxpayer's

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83 *Ibid.* at 176.

84 *Ibid.* at 47.

85 Mr. Konnov submitted two expert reports for these proceedings. First Expert Report of Mr. Oleg Konnov, 4 April 2011 (hereinafter "First Konnov Report"); Second Expert Report of Mr. Oleg Konnov, 15 August 2012 (hereinafter "Second Konnov Report"). Mr. Konnov appeared for examination on 29–31 October 2012; Transcript, Day 13 at 1–257; Day 14 at 1–261; Day 15 at 1–256. References to Mr. Konnov's testimony appear Chapters VIII.A (The Tax Optimization Scheme), VIII.B (The Tax Assessments Starting in December 2003), VIII.E (Attempts to Settle) and VIII.F (The Auction of YNG).

86 First Konnov Report ¶¶ 31–52.

filing of a "special" zero percent monthly VAT return. According to Mr. Konnov, Yukos should have complied with the specific procedures because the courts and the tax authorities established that Yukos was "the actual owner and exporter of goods."[87]

191. The third question is whether Yukos had disclosed to the Russian tax authorities prior to the commencement of the 2003 tax audit its tax minimization practices involving the use of domestic offshore companies registered in domestic low-tax jurisdictions. Mr. Konnov saw nothing in the record indicating that Yukos "made any significant disclosure of its tax scheme," but even so, illegal tax practices may not be legitimized through a tax offender's disclosure.[88]

192. The fourth question is whether the Russian Tax Ministry complied with applicable law in appointing and conducting a tax audit of Yukos in December 2003. Mr. Konnov answers affirmatively.[89]

193. The fifth question is whether the Russian tax authorities and courts complied with applicable law in imposing fines on Yukos. Mr. Konnov explains that the base fine under Russian tax law is 20 percent, which can be increased to 40 percent if non-payment results from the willful acts of a taxpayer, which in turn may be doubled for repeat offenders. Mr. Konnov concludes that the imposition of fines on Yukos was justified and accorded with prevailing court practice.[90]

194. The sixth question concerns actions that Yukos could have taken after receiving the 2000 Tax Audit Report in December 2003 to reduce its tax liability. Mr. Konnov explains that Yukos could have: (a) voluntarily paid all tax arrears and accrued interest and reserved cash for fines; (b) filed amended tax returns, and paid tax and interest due for 2001–2003; (c) complied with the legal requirements for claiming the zero percent VAT rate; and (d) discontinued as of 1 January 2004 the use of domestic offshore companies.[91]

195. The seventh question is whether the tax treatment of YNG changed after its sale to Rosneft. Mr. Konnov concludes that the treatment of YNG before and after its sale to Rosneft "was

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87 *Ibid*. ¶ 53–59.

88 *Ibid*. ¶¶ 59–64.

89 *Ibid*. ¶¶ 65–70.

90 *Ibid*. ¶¶ 71–82.

91 *Ibid*. ¶¶ 83–85.

consistent with then current practice of the Russian tax authorities and courts, and does not suggest any irregularity."[92]

196. Mr. Konnov's second report responds to alleged misstatements of Russian tax law found in the Reply, including with respect to the "anti-abuse doctrine" under Russian tax law,[93] "re-attribution," and the "bad-faith taxpayer" doctrine.[94] Mr. Konnov also addresses Claimants' arguments about proportionality between tax benefits claimed and investments made in the low-tax regions, Yukos' awareness that its tax optimization scheme was not fully compliant with the law, the application of the Law of the Russian Federation governing Value Added Tax ("**VAT Law**"), and fines on Yukos.[95]

197. Mr. Konnov appeared before the Tribunal for examination on 29, 30 and 31 October 2012. He was cross-examined on a range of documents from the record, legal authorities and their application to Yukos and its domestic offshore companies. Issues canvassed in the cross-examination included, *inter alia*: (a) the factual record underlying his views expressed about alleged improprieties in Yukos' domestic offshore companies; (b) whether oil products must be physically stored or moved from the premises of trading companies; (c) the re-attribution theory applied to Yukos and the existence of legal precedents for the theory at the relevant time; (d) provisions in the regional tax legislation in Mordovia and elsewhere; (e) the investment agreements concluded between the domestic offshore trading companies and Mordovian authorities; (f) the existence of the anti-abuse doctrine at relevant times; (g) fines and penalties; (h) prior audits conducted by local and regional authorities on Yukos' domestic offshore trading companies and the extent to which they demonstrate familiarity with and tolerance of the tax optimization scheme; (i) audit inspection practices; (j) the meaning of "interrelatedness" in the context of Russian tax legislation; (k) the consequences of the reattribution theory on entitlement to VAT refunds and the formalities required to enjoy VAT exemption; (l) the evolution of the ZATO tax laws and certain internal memoranda within ZATO tax inspectorates; and (m) timing for enforcement of tax assessments.[96]

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92 *Ibid*. ¶¶ 89–92.

93 Second Konnov Report, ¶¶ 7–17.

94 *Ibid*. ¶ 26–41.

95 *Ibid*. ¶¶ 84–121.

96 Transcript, Day 13 at 49–52, 70–80, 114–20, 151–52; Transcript, Day 14 at 61–68.

198. Mr. Konnov also answered questions from the Tribunal, including about the principle of resolving doubts in favor of the taxpayer.[97] He was asked why, in the interests of justice the Russian courts did not treat the filings for VAT by the trading companies as filings by Yukos.[98] When he emphasized the formalities required for filing for VAT, he was further asked whether the trustee in bankruptcy (Mr Rebgun), who was charged with maximizing the resources available for creditors, himself could have filed the monthly forms for VAT return. Mr. Konnov answered that he could have done so, subject to the three-year limitation period, *i.e.*, he could have re-filed for the three years preceding his appointment as trustee.[99] The Tribunal also asked Mr. Konnov how the tax authorities determine the motivation of a taxpayer in making use of a low-tax region and about his experience in advising clients with respect to tax minimization.[100]

199. Mr. Konnov was asked about a comment made by him as an expert witness in the *RosInvestCo UK Ltd. v. The Russian Federation* arbitration ("***RosInvestCo***"), to the effect that "sometimes Russian courts [do not] have an excellent reputation." Mr. Konnov responded that he had not come across corruption or irregularities in tax cases.[101] He was invited to share his views on the tax evasion aspects of the convictions of Messrs. Khodorkovsky and Lebedev. The parts of the judgment dealing with tax elements of the ZATOs and issues of personal income tax avoidance seemed to him to make sense, but he could not comment on other parts of the judgment.[102]

3. Professor Reinier Kraakman

200. Professor Reinier Kraakman[103] is a Harvard law professor specializing in comparative corporate law and governance. Claimants chose not to call him for cross-examination. His expert report concerns the activities of Bank Menatep, Mikhail Khodorkovsky and his "tight-knit group of confederates" (the "**Khodorkovsky Group**"), Yukos Oil Company, and Yukos' subsidiaries

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97 Transcript, Day 15 at 37–42 (Dr. Poncet referring to the principle *in dubio contra fiscum*).

98 *Ibid*. at 232.

99 *Ibid*. at 234–35.

100 *Ibid*. at 237–41

101 *Ibid*. at 251–56. Referring to the case of *RosInvestCo UK Ltd. v. The Russian Federation*, SCC Arbitration V (079/2005), Final Award, 12 September 2010, Exh. C-1049 (hereinafter "*RosInvestCo*").

102 *Ibid*. at 249–55.

103 Expert Report of Professor Reinier Kraakman, 1 April 2011, filed with Counter-Memorial. References to his expert report appear in Chapter IX.B (Unlean Hands).

from the period 1995–1999. He addresses provisions of the Russian Civil Law, Joint Stock Company Law ("**JSC Law**") and privatization law.

201. Professor Kraakman maintains that Mr. Khodorkovsky, his Group, and Bank Menatep acted in bad faith and "probably illegally" in violation of the spirit and letter of Presidential Decree No. 889, which was the legal foundation of the Loans-For-Shares ("**LFS**") Program. At stake in the initial auction of Yukos shares in December 1996 were (i) the right to lend funds to the Russian Federation secured by a pledge of 45 percent of Yukos stock, and (ii) the right to purchase a block of 33 percent of Yukos Stock in a so-called "Investment Tender". Bank Menatep held shares pledged by the State and sold those shares to their close affiliates, a "tactic" that "allowed the Khodorkovsky Group to gain title to the pledged shares while avoiding Bank Menatep's agency duty to maximize their value," thus violating "the intent of Decree 889, while making a gesture toward formal compliance."

202. According to Professor Kraakman, secondary sources, and some primary documentation, support "a reasonable inference" that, prior to the Russian Federation's sovereign debt crisis in late 1998, the Khodorkovsky Group systematically skimmed revenue from Yukos' partially-held operating subsidiaries—YNG, Samarneftegaz, and Tomskneft—in bad faith and in violation of the JSC Law's regulations on self-dealing transactions. Circumstantial evidence indicates that the Khodorkovsky Group skimmed revenue directly from Yukos from mid-1996 until 1999, and transferred it to offshore companies around the world that were controlled or beneficially owned by members of the Khodorkovsky Group.

203. He testifies that following the Russian sovereign debt crisis, Yukos and the Khodorkovsky Group largely succeeded in squeezing out minority shareholders from Yukos' operating subsidiaries. Yukos managed this by committing serious violations of the provisions in the JSC Law intended to protect minority shareholders. Yukos exhibited egregious bad faith by blocking minority shareholders from participating in extraordinary shareholders meetings called in March 1999. He claims: "As a professor of corporate law with a particular interest in the JSC Law, I have never read—or read about—anything more chilling in a professional sense than the documents and manipulative behavior surrounding the March 1999 EGMs [Extraordinary General Meetings] held for YNG, Samareneftegaz, and Tomskneft." In Professor Kraakman's opinion, Yukos and the Khodorkovsky Group opportunistically devalued Yukos shares, which Bank Menatep—the Group's financial arm—had previously pledged to Western banks in order to finance Yukos' efforts to gain control of Tomskneft.

4. Professor H. David Rosenbloom

204. Professor H. David Rosenbloom[104] is a practicing attorney, a consultant and NYU law professor specializing in international taxation. He has worked for the U.S. Government on international tax matters. Respondent retained him as an international tax law expert. He opines on the appropriateness of the actions from 2000–2003 by four Cypriot entities—Hulley, VPL, Dunsley Limited, and Nassaubridge Management Limited—in claiming a reduced Russian Federation tax on dividends paid by Yukos and affiliates, under the Cyprus-Russia DTA.

205. Professor Rosenbloom concludes that each of the four entities is a "paper entity", with "total control" and "ultimate ownership" exercised by Russian individuals operating solely within Russia and enjoying all economic benefits. According to Professor Rosenbloom, the invocation of the Cyprus-Russia DTA under these circumstances was a "blatant example of tax treaty abuse." Professor Rosenbloom refers to pervasive recognition of the international "abuse of law" doctrine, to the OECD Commentaries (the DTA follows the OECD Model), and to the VCLT to assert that: (a) taxpayers must act in good faith to benefit from an income tax treaty; and (b) the employment of entities in one State party to a tax treaty exclusively to reduce taxes otherwise applicable under the laws of the other State party constitutes tax treaty abuse.

206. For reasons described in more detail in Chapter IX.B (on "Unclean Hands"), Professor Rosenbloom concludes that the benefits claimed were not justified by Article 10 of the Cyprus-Russia DTA, which limits the tax charged by one State on dividends paid from a company in that State to beneficial owners of the stock resident in the other State, provided they do not operate through a "permanent establishment" in the first State, to which the dividends are attributable. Firstly, he opines, the Cypriot entities were not beneficial owners of the dividends received on Yukos shares, and the beneficial owners were not residents of Cyprus. Secondly, in his view, the entities were not eligible for the claimed benefits because they operated through permanent establishments in the Russian Federation, to which the dividends were attributable. In sum, according to Professor Rosenbloom, the claims under the Cyprus-Russia DTA on behalf of the Cypriot entities were unjustified. They were not only abusive, but without merit.

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[104] First Expert Report of Professor H. David Rosenbloom, 1 April 2011, filed with Counter-Memorial, Second Expert Report of Professor H. David Rosenbloom, 15 August 2012, filed with Rejoinder. Initially Claimants intended to cross-examine Professor Rosenbloom, but decided not to after Respondent advised it would not be cross-examining Mr. Philip Baker QC. References to Professor Rosenbloom's reports appear in Chapter IX.B (Unclean Hands).

207. In his second expert report, Professor Rosenbloom replies to the opinion of Claimants' tax law expert, Mr. Baker, which he describes as "long on law and history" but "short, very short, on the facts." The facts here, according to Professor Rosenbloom, involve Russian nationals and residents earning Russian source income and claiming a treaty-based reduction of normal Russian tax by reason of a "wafer-thin Cypriot corporate veneer managed from Russian soil." Neither the DTA nor any other income tax treaty would condone such a structure and no rational country would endorse it as sound policy. Professor Rosenbloom then sets out in further detail facts pertaining to several Yukos-related entities which inappropriately claimed benefits under the Cyprus-Russia DTA.

208. Professor Rosenbloom opines that the primary purpose of a tax treaty is to eliminate or at least mitigate international double taxation and none of the authorities in Mr. Baker's report deal with a country using treaties to reduce tax on its own residents but rather discuss third-country investors. Interpreting the Cyprus-Russia DTA as an instrument to attract foreign direct investment into Russia without regard to tax revenue loss exceeds the limited scope of OECD-based treaties and undermines the purpose of tax avoidance and evasion. Professor Rosenbloom also accuses Mr. Baker of failing to differentiate between treaty shopping and "round tripping". Russia's inaction to insist on strict limitation on benefit or its failure to terminate the Cyprus-Russia DTA does not establish Russia's endorsement of round tripping.

209. Finally, Professor Rosenbloom refers to documents provided after the filing of his first report, which he says confirm that neither Hulley nor VPL beneficially owned dividends received from Yukos. Even if Hulley and VPL were considered beneficial owners of the Yukos dividends on the transferred shares, the related-party "repos" or stock-lending agreements, which had no purpose other than to enable claims of treaty benefits, are an improper use of the DTA.

210. According to Professor Rosenbloom, even if the Yukos structure and transactions with the Cypriot entities were not abusive, dividend distributions by Yukos and its affiliates to Hulley, VPL and the other Cypriot entities did not qualify under the DTA for reduced tax in Russia since they should have been taxed as "business profits" under Article 10(4) of the DTA. The facts also confirm that all the Laurel subsidiaries had permanent establishments in Russia to which the dividends received from their Russian subsidiaries were attributable. According to Professor Rosenbloom, it is not necessary to adopt a complicated "economic substance" or "substance-over-form" analysis to see that the Yukos structure cannot be defended as within the scope of the Cyprus-Russia DTA or legitimate tax planning. Had Mr. Baker and Claimants "focused on the facts presented" they could not reasonably have come to any other conclusion.

5. Professor Thomas Z. Lys

211. Professor Thomas Lys[105] is a professor of accounting at Kellogg School of Management, Northwestern University in Chicago. He has a PhD in accounting and finance from the University of Rochester and an economics degree from the University of Berne, Switzerland. He has served as a consultant to several companies. He was retained by Respondent to expound in detail various financial transactions and operations of Yukos. Claimants chose not to call him for cross-examination. The appendices attached to Professor Lys' Reports were used at various times throughout the Hearing to help illustrate Yukos' structure and activities.

212. Professor Lys recounts Yukos' incorporation in 1993, privatization in 1995 and public sale of shares in 1996. He describes Yukos' structure and activities and the role of the various producing subsidiaries, trading entities and off-shore entities, and the structure and flow of funds originating in the trading companies into "offshore and Yukos entities."

213. Professor Lys explains that starting in 1999, the majority of Yukos shares were owned by subsidiaries of GML, an entity whose major interest was held by Mr. Khodorkovsky, the CEO and Chairman of the Executive Committee of the Board of Directors of Yukos. Other shareholders of GML also had senior management positions in Yukos. In several instances, shares of Yukos stock were transferred between various entities under the control of GML. Many such transactions placed the Yukos shares temporarily, sometimes for less than a week, under nominal ownership of Cypriot entities on dates that established record ownership for purposes of Yukos dividend distributions, apparently in an effort to reduce Russian taxes on these dividends. YUL was a wholly-owned subsidiary of GML. Hulley was a wholly-owned subsidiary of YUL. Although VPL did not fall under the ownership structure of GML, it was a subsidiary of the Veteran Petroleum Trust (a Jersey trust), of which YUL controlled at least three quarters of the voting rights.

214. Professor Lys describes and details how there were hundreds of transactions of Yukos shares among the above-described entities and their affiliates; in some instances multiple transactions occurred on a single day. Many appear to Professor Lys to "have been structured to place Yukos shares temporarily in the hands of Hulley and a specific account held in the name of VPL, both of which are Cypriot entities, as of the record dates of Yukos dividend payments."

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[105] First Expert Report of Thomas Z. Lys, 1 April 2011, filed with Counter-Memorial, Supplemental Expert Report of Professor Thomas Z. Lys, 15 August 2012, filed with Rejoinder. References to Professor Lys' Reports appear in Chapters VIII.A (The Tax Optimization Scheme) and X.E (Contributory Fault).

He states that "they appear to have been performed to allow the Cypriot entities to claim beneficial ownership of these shares to reduce the Russian withholding taxes on the dividends Yukos paid on these shares, pursuant to the [Cyprus-Russia DTA]." Given their timing, Professor Lys sees no apparent business purpose for these transactions.

215. Professor Lys also describes Yukos' dividend flows through YUL, Hulley, VPL, and GML. He concludes that YUL, and its beneficiary GML, not only received the economic benefit of the dividends paid on the Yukos shares owned by Hulley, but also received the benefit of the gains Hulley reported from the sales of Yukos shares to YUL. In other words, the profits earned on those sales were effectively "returned" through the dividend. YUL (and GML) were also the beneficiaries of dividends paid on Yukos shares owned by VPL.

216. Professor Lys describes how from 2000 to 2003, groups of Yukos-related entities "moved funds in a common pattern from Russia's low-tax regions out of Russia, into off-shore entities." He details the flow structures of profits through the Fargoil and Ratibor structures. He sets out the Mega Alyans flow structure, showing the ultimate ownership of trading entities by Laurel, a BVI entity, and its sole shareholder, Stephen Curtis. He describes how Yukos had a call option to acquire all of Mr. Curtis' Laurel shares for one rouble.

217. He also details the flow structures in 2000–2001 of the trading companies registered in the ZATOs of Lesnoy and Trekhgorny (Business-Oil, Flander, Forest-Oil, Greis, Kolkrein, Kverkus, Mitra, Muscron, Nortkes, and Vald Oil). He explains how the Lesnoy and Trekgorny trading companies passed funds through two Russian entities—Neftetrade and Neftemarket—to a number of Cypriot companies, which in turn passed the funds on through Laurel to Halsley and Belmont, two BVI entities owned by Brill.

218. Finally, Professor Lys describes loans made by and to Yukos Capital (incorporated in Luxembourg in 2003). Yukos Capital's 2005 financial statements show that it borrowed extensively from and lent extensively to other Yukos entities. Professor Lys details loan transactions where the exact amount borrowed by Yukos Capital was then lent by Yukos Capital to other Yukos-related entities.

6. Ms. Felicity Cullen QC

219. Ms. Felicity Cullen QC[106] is a barrister specializing in United Kingdom tax law. Respondent asked Ms. Cullen to opine on rules concerning the assessment, collection, and enforcement of tax in the UK, in the context of showing that "[t]he treatment by the Russian tax authorities of Yukos' tax evasion scheme is entirely consistent with the positions that would have been taken by the tax authorities of virtually every other country [including the UK]."[107] Claimants chose not to call her for cross-examination.

220. Ms. Cullen was asked to give her opinion on the basis of a number of assumptions about a large corporate taxpayer who has entered into transactions to reduce its tax liability. She was asked to assume that the transactions are considered by tax authorities to involve avoidance and/or criminal evasion of tax, to lack genuine commerciality, and to have been carried out on non-arm's length terms. The same taxpayer is assumed to have deliberately concealed the true character of its transactions, to have been deliberately uncooperative in tax investigations and to have dissipated assets otherwise available to satisfy potential tax liabilities. In such assumed circumstances, Ms. Cullen describes the investigation and enforcement options open to an officer of Her Majesty's Revenue and Customs ("**HMRC**") during an enquiry into a tax return. For example, HMRC can amend a company's self-assessment if its suspected of understating the company's true tax liability and there is a real risk of substantial loss of tax to the government. Under a discovery process, HMRC is allowed to re-open returns for periods otherwise considered closed when there has been careless or deliberate conduct leading to loss of revenue.

221. With respect to penalities, Ms. Cullen notes that under the current UK civil tax penalty regime may vary from 30 to 100 percent of the potential lost revenue (depending on whether there was deliberate concealment). She further describes the considerable methods of enforcement available to HMRC, which include proceedings in English courts, freezing orders, and pursuit of insolvency proceedings. Criminal action may, according to Ms. Cullen, be pursued where appropriate, in which case HMRC will often conduct a form of "dawn raid", require production of documents, seize items like computers and make arrests.

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106 Expert Report of Ms. Felicity Cullen QC, 4 April 2011.

107 Counter-Memorial ¶ 1135.

222. Ms Cullen observes that traditionally, tax legislation in the UK was construed literally but today, it is construed purposively, which has facilitated challenging and countering tax avoidance schemes.

7. Mr. Dale Hart

223. Mr. Dale Hart[108] is a retired executive of the U.S. Internal Revenue Service ("**IRS**"). Respondent retained Mr. Hart to describe the U.S. legal framework against tax abuse and evasion and enforcement powers of the IRS, in the context of Respondent's claim that "tax administrations around the world [including the U.S.] would have been at least as firm as the Russian Federation in dealing with abuses of the kind perpetrated by Yukos."[109] Claimants chose not to call him for cross-examination.

224. Mr. Hart testifies that under U.S. law, abusive or fraudulent tax shelters are broadly defined to include investment schemes that reduce tax income without changing the value of the business. To combat them, the IRS relies on a legal framework that provides the authority to reallocate income and deductions to properly reflect income. The framework includes the judicial doctrines of economic substance, business purpose, sham transactions, substance over form and step transactions. The IRS has extensive civil and criminal enforcement powers, which according to Mr. Hart, it uses "aggressively". It has broad discretion in determining which tax returns and taxpayers to select for audit and it tailors the scope of its audit to the taxpayer's financial and tax situation. If evidence of fraud is revealed, the civil audit is discontinued and a criminal investigation may be launched. Mr. Hart notes that the typical three-year limitation period may be extended for fraud or other misconduct.

225. With respect to penalties, Mr. Hart describes how U.S. law imposes "heavy" penalties on fraudulently underpaid tax, including failure to pay and failure to file penalties, accuracy-related penalties on underpayments and a civil fraud penalty of 75 percent. The collection process begins with a formal notice of assessment requesting payment. According to Mr. Hart, a deferred payment arrangement is only ever considered when the taxpayer is unable to pay in full. Mr. Hart describes the "strong arsenal" of administrative enforcement collection tools at the disposal of the IRS, including a federal tax lien, a notice of levy and the sale of property by

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[108] Expert Report of Mr. Dale Hart, 4 April 2011.

[109] Counter-Memorial ¶ 1135.

public auction or public sale after determination a minimum bid price that need not be based on fair market value.

8. Mr. Polyvios Polyviou

226. Mr. Polyvios Polyviou[110] of Chryssafinis & Polyviou LLC in Nicosia is a lawyer practicing Cypriot law. Respondent retained him as an expert to show that Claimants' alleged abuses of the Cyprus-Russia DTA also violated the criminal laws of Cyprus. Claimants chose not to call him for cross-examination.

227. Mr. Polyviou's report is based on the following assumptions: (a) that for purposes of the Cyprus-Russia DTA, Hulley and Veteran were "residents" of Cyprus and Yukos was a "resident" of Russia; (b) that in reliance on the Cyprus-Russia DTA, Hulley and Veteran paid a reduced five percent withholding tax to Russia on dividends received from Yukos; (c) that Hulley and Veteran had no right to take the benefit of the Cyprus-Russia DTA because the relevant dividends *were* connected with activities carried out in Russia and/or because Hulley and Veteran were not the beneficial owners of the relevant dividends; (d) that the natural persons who declared/confirmed on forms submitted by Hulley and Veteran to Cypriot tax authorities that the relevant dividends received from Yukos were *not* connected with activities carried out in Russia and that Hulley/Veteran was the beneficial owner of the relevant dividends were authorized to do so on Hulley/Veteran's behalf; and (e) that at the time of making the declarations/confirmations, these natural persons *knew* that the dividends from Yukos *were* connected with activities carried out in Russia or that Hulley/Veteran was *not* the beneficial owner and intended for the forms to be submitted to the Cypriot authorities so as to obtain completion, dating, signing and stamping of Box 4 (the "Note of the foreign Tax authority") on the forms. On the basis of these assumptions, Mr. Polyviou was asked to address two questions, as described below.

228. The first question was: "Did the circumstances under which Hulley and Veteran obtained the completion, dating, signing and stamping of certain tax forms by the Cypriot tax authorities give rise to criminal offences under the Criminal Code of Cyprus?" Mr. Polyviou answers "Yes" under sections 297 (false pretences), 305 (willfully obtaining a "certificate" by false pretences) and 341 (willfully procuring execution of documents by false pretences) of Cap. 154

[110] Expert Report of Mr. Polyvios G. Polyviou, 1 April 2011 (hereinafter "Polyviou Report"). References to Mr. Polyviou's report appear in Chapters IX.B (Unclean Hands) and X.E (Contributory Fault).

of the Criminal Code. According to Mr. Polyviou, but for the false pretence, Cypriot tax authorities would have rejected the request to complete, date, sign and stamp the forms as it would have been pointless and tantamount to assisting an abuse of the Cyprus-Russia DTA.

229. The second question was: "Were criminal offences committed under the Criminal Code and/or the Companies Law of Cyprus?", assuming that during the period 1 January 2000 to 28 October 2003: (a) in reliance upon the Cyprus-Russia DTA Hulley and Veteran paid a reduced five percent withholding tax to Russia on dividends received from Yukos; (b) neither Hulley nor Veteran had the right to take the benefit of the Cyprus-Russia DTA, at least vis-à-vis Yukos' above-mentioned dividends; and (c) neither Hulley nor Veteran disclosed point (b) in their annual accounts for financial years 2000–2002? Mr. Polyviou answered "Yes" under section 311(b)(iii) (directors and officers of corporations keeping fraudulent accounts or falsifying books or accounts) of Cap. 154 and section 143(6) (contents and forms of accounts) of Cap. 113 of the Criminal Code.

9. Mr. John Ellison

230. Mr. John Ellison[111] is a consultant at KPMG in London, having retired as a senior partner in 2010. His report concerns the withdrawal by PwC of its audit opinions on Yukos' financial statements for the years 1995–2004. Claimants chose not to cross-examine him.[112]

231. Mr. Ellison opines that for a reputable international firm such as KPMG to withdraw an audit opinion is an "unusual and serious" event, of which he knows of only a handful of cases. At KPMG, whether in the UK, the U.S., or Russia, such decision would necessarily be preceded by extensive consultations with several senior partners of the firm together with its technical departments and legal counsel. According to Mr. Ellison, PwC's procedures were similar, as shown by a declaration (appended to the Ellison Report) from Ms. Laurie Endsley, PwC's in-house counsel who worked on the Yukos matter at the time of withdrawing the audits.

232. Mr. Ellison analyzes PwC's letter of 15 June 2007,[113] in which PwC announced the withdrawal of its audit opinions of Yukos' financial statements, explaining that it had acquired new information that caused it to question the reliability of the representations made by Yukos'

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111 Expert Accountant's Report to the Tribunal by John Ellison, FCA, 14 August 2012 (hereinafter "Ellison Report"). References to Mr. Ellison's expert report appear in Chapter VIII.H (The Withdrawal of PwC's Audit Opinions).

112 *See* Chapter VI.C (The So-Called "Empty Chairs").

113 Letters from ZAO PwC Audit to Mr. Rebgun, 15 June 2007, Exh. C-611 (hereinafter "PwC's Withdrawal Letter").

management during the audits. Assuming the veracity of the contents of the letter, Mr. Ellison concludes that in withdrawing its audit opinions, PwC acted in accordance with the auditing standards generally accepted in the U.S., Russia and internationally.

233. Mr. Ellison notes that under U.S. Statement of Auditing Standards No. 1, Section 333, when an auditor after issuing its report becomes aware of facts that existed at the time the report was being compiled, believes there are persons relying or likely to rely on his report and considers that the new facts are material to his report, or shake his confidence in the overall veracity of representations made by management, the auditor must advise his client to disclose the new facts and possibly revise its financial statements. Mr. Ellison refers to PwC's claim that in light of the bankruptcy of Yukos, PwC "was unable to access the information required that could lead to revision of the financial statements and was also unable to discuss the matter with management, as recommended by [U.S. Auditing standards] AU Section 561." Mr. Ellison accepts that in those circumstances, PwC "had no option but to withdraw its audit reports."

234. Under International Standard on Auditing 560 and Russian Federal Auditing Rule 10, when new material facts become known to the auditor after issuance of the audit report, the auditor should consider revising the company's financial statements, discuss the matter with the company's management and "take the action appropriate in the circumstances" or "take steps necessary in the circumstances." In Mr. Ellison's view, PwC did take the appropriate steps.

10. Mr. Raymond Gross

235. Mr. Raymond Gross[114] is a partner of KPMG's U.S. Accounting & Reporting Group in London. Claimants chose not to cross-examine him. Respondent asked Mr. Gross to review what Yukos' consolidated financial statements prepared under U.S. GAAP revealed with respect to: (a) Yukos' tax optimization scheme, including its use of trading companies in low-tax regions of Russia to buy oil and oil products from production subsidiaries and transfer the proceeds to offshore companies established or controlled by Yukos; (b) the Jurby Lake structure, a group of offshore trading companies controlled by Yukos or its former Russian majority shareholders and comprising Jurby Lake Limited (Ireland) and the BBS Companies; and (c) the taxes assessed against Yukos' trading companies in the ZATO of Lesnoy for tax years 1999 and 2000.

[114] Expert Accountant's Report to the Tribunal by Raymond Gross, CPA, 14 August 2012.

236. Mr. Gross was instructed to assume that the statements would have "put a reader on notice of facts relevant to the nature and legality of Yukos' use of the Tax Optimization Scheme" if they had included: (a) identification of the involved trading and offshore companies (listed in the exhibits to the Report); (b) the monetary value of the investments made and tax savings achieved by Yukos through the scheme; (c) details of the extent of the trading companies' investments in Russia's low-tax regions; (d) details the extent of Yukos' direction of and control over the trading companies; (e) details of the flow of funds from the trading companies to Yukos; (f) details about the taxes assessed against Yukos' trading companies in the ZATO of Lesnoy in 1999 and 2000 and the Republic of Kalmykia in 2001 due to improperly received tax benefits; and (g) disclosure of the possible financial impact on Yukos if the tax optimization scheme was disallowed by the Russian authorities.

237. Mr. Gross concludes that the statements for the years 2000–2002 and the first three quarters of 2003 were not transparent with regard to Yukos' tax optimization scheme, as they disclosed none of the above-listed information necessary to put a reader on notice. While the statements showed that Yukos' effective tax level was lower than the statutory tax level, they failed to explain the nature of the difference. The statements also failed, according to Mr. Gross, to identify the companies composing the Jurby Lake structure.

238. Mr. Gross also concludes that the 2001–2002 statements were not transparent and not consistent with the U.S. GAAP in that they failed to disclose as contingent liabilities the taxes assessed against the trading companies of the ZATO of Lesnoy for 1999 and 2000, despite the fact that these tax assessments were material to the statements. Under the U.S. GAAP, Yukos could omit these assessments from the statements if it determined that the probability of loss was remote; however, the written support of outside legal counsel or another competent authority which would usually be required for such a determination was not obtained in this case. Mr. Gross opines that Yukos should have disclosed that the validity of the tax optimization scheme had been called into question and discussed the risk involved in continuing with the scheme.

11. Professor Dr. Albert Jan van den Berg

239. Professor Dr. Albert Jan van den Berg[115] of Hanotiau & van den Berg in Brussels, specializes in international arbitration. He was previously in private practice in the Netherlands and is a professor at Erasmus University in Rotterdam. Respondent retained Professor Van den Berg to provide an expert opinion addressing the legality under Dutch law of the 2005 transfer of Yukos' foreign assets into the Stichtings. Claimants chose not to cross-examine Professor Van den Berg.

240. Professor Van den Berg was provided with a 12-page Statement of Assumed Facts on which to base his opinion. These assumed facts may be summarized as follows. Before the auction of YNG in December 2004, Yukos' assets outside the Russian Federation (the "**Foreign Assets**") were held by two wholly-owned subsidiaries of Yukos, Yukos Finance B.V. ("**Yukos Finance**") and Yukos CIS Investment Limited ("**Yukos CIS**"). After the auction, Yukos management transferred the Foreign Assets to the two Stichtings, which issued depositary receipts in return to Yukos Finance and Wincanton Holding BV ("**Wincanton**"), a Dutch subsidiary of Yukos CIS. This restructuring had the "stated purpose . . . to prevent the non-Russian assets of Yukos Oil from being used to satisfy the tax debts that Russian courts had found Yukos Oil to owe, and, more broadly, to prevent the non-Russian assets from being available to satisfy claims of Yukos' Russian creditors."

241. Under the Articles of Association of the Stichtings (amended in 2008), the management board, including former Yukos managers David Godfrey, Bruce Misamore and Steven Theede, manages the Foreign Assets in the interests of Yukos, its subsidiaries, shareholders, employees and "legitimate" creditors. As a result of the restructuring: (a) even after Yukos CIS and Yukos Finance were sold in Yukos' bankruptcy auction, the former Yukos managers have continued to manage and control the Foreign Assets; (b) the lending group under a USD 1 billion loan was unable to enforce an English judgment against Yukos Finance's assets; and (c) Moravel, whose loan had been held to be unenforceable by Russian courts because of its status as a subsidiary of Yukos, was able to negotiate the repayment of its loan from one of the Stichtings.

242. Based on the above-described assumed facts, Professor Van den Berg opines that the restructuring of Yukos Finance and Yukos CIS was illegal, as Dutch law does not permit a

[115] Legal Opinion on the Validity of Restructuring Devices under Dutch Law by Professor Dr. Albert Jan van den Berg, 14 August 2012 (hereinafter "Van den Berg Report"). References to Professor Van den Berg's legal opinion appear in Chapter VIII.G (The Bankruptcy of Yukos).

company to transfer its assets for the purpose of making it more difficult for a creditor to satisfy its claims, or for the new ultimate parent company to exercise control. This is so even when a company believes the claims against it are illegitimate. The company is not entitled to exercise self-help.

243. According to Professor Van den Berg, this illegality gave rise to the directors' "internal liability" (liability of the directors to the company itself) pursuant to Articles 2:8 and 2:9 of the Dutch Civil Code (the "**DCC**") and to the directors' "external liability" (liability of the directors to creditors) as well as "company liability" (liability of the company to creditors) pursuant to Article 6:162 of the DCC. Further, this illegality renders the board decisions regarding the restructuring voidable pursuant to Articles 2:8 and 2:15(1)(b) of the DCC (as contrary to the principles of reasonableness and fairness) and pursuant to Article 3:40(1) of the DCC (as contrary to "good morals"). Professor Van den Berg opines that the Stichtings are also disallowed as invalid permanent protective devices; even if they are treated as temporary protective devices, the requirements to uphold such temporary devices are not met in this case.

12. Professor Stef van Weeghel

244. The Tribunal recalls that Respondent had raised the question of "unclean hands" in the jurisdictional phase of the case, an issue which the Tribunal decided to defer for consideration until the merits phase of the arbitration.[116] During the jurisdictional phase of the case, Respondent had adduced expert testimony from Professor Stef van Weeghel,[117] a professor of international tax law at the University of Amsterdam and a tax law partner at Stibbe. In his expert report, Professor Van Weeghel reached three main conclusions about Claimants and taxation law, as summarized in the Interim Awards.[118] The Parties did not reference his report in their pleadings in the merits phase of the case and he was not cross-examined at the Hearing on the Merits. The Tribunal has decided to include in the Final Awards the summary of Professor Van Weeghel's expert evidence.

245. According to Professor Van Weeghel, Hulley was not entitled to obtain the taxation benefits contained in the Cyprus-Russia DTA in respect of the Yukos dividends because: (a) Hulley

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116 Interim Award, Hulley ¶ 435. *See also* Procedural Orders Nos. 2 and 3 of 8 September and 31 October 2006.

117 Expert Report of Professor Stef van Weeghel, 29 January 2007, filed with Counter-Memorial on Jurisdiction. References to Professor Van Weeghel's Expert Report appear in Part X.E (Contributory Fault).

118 Interim Awards, Hulley ¶¶ 191–97.

had a permanent establishment in Russia under Article 10(4) of the Cyprus-Russia DTA) as it either had a place of management in Russia, or it had an agent in Russia; and (b) those dividends were attributable to the permanent establishment in Russia. He also opines that VPL was similarly not entitled to obtain the taxation benefits contained in the Cyprus-Russia DTA because it was not the beneficial owner of the Yukos dividends within the meaning of Article 10(2) of the Cyprus-Russia DTA.

246. According to Professor Van Weeghel, the Yukos holding structure is a sham or otherwise abusive under general principles of international tax law and designed specifically to avoid taxation obligations. Therefore rights to tax benefits under the Cyprus-Russia DTA should be denied. Tax authorities do not always have to accept artificial legal constructions. Anti-abuse doctrines to counter artificial legal constructions have developed in and are common to many countries including the Russian Federation and Cyprus. Professor Van Weeghel refers to the example of the Swiss Federal Court denying the benefits of a double taxation treaty to a Danish company in circumstances analogous to the Yukos holding structure. He refers to international efforts to control the use of tax havens and notes that the OECD Forum on Harmful Tax Practices in its 2000 Progress Report identified 35 tax havens which included the Isle of Man, Gibraltar, Jersey and the British Virgin Islands. Professor Van Weeghel examines the Yukos holding structure, and notes that at the bottom of the structure is the successful and profitable Russian oil company developing and exploiting natural energy resources in Russia, while at the top of the structure are a small number of Russian individual shareholders. He concludes that it is "hardly perceivable" that the Russian individual shareholders, in setting up the Yukos holding structure, had any other goal in mind than low taxation and lack of transparency in respect of the ownership of Yukos shares. Such a structure would normally fall within the scope of international efforts to counter the harmful use of tax havens.

C. THE SO-CALLED "EMPTY CHAIRS"

247. At the Hearing on the Merits, each side accused the other of leaving conspicuous "empty chairs" in its presentation of witness evidence. Each side asked the Tribunal to draw adverse inferences against the other from the absence of the persons who should have filled the empty chairs.[119]

[119] *See e.g.*, Transcript Day 2 at 98 (Claimants' opening); Respondent's Rebuttal Slides, p. 650 & ff; *see also* Respondent's Post-Hearing Brief ¶ 135.

1. Individuals that Claimants Wished were Available for Examination

248. At the Hearing, Claimants submitted that the following individuals should have been called as witnesses by Respondent as they could have been cross-examined in respect of the knowledge of Yukos' tax structure by high-ranking Russian officials:

- Aleksei Kudrin, First Deputy Minister of Finance, including in particular on the January 2000 meeting with Mr. Dubov at which the establishment of Yukos' trading companies in Mordovia was discussed;
- Vladimir Gusev, First Deputy Minister in charge of VAT, including in particular on the meeting with Mr. Dubov at which Yukos' VAT refunds in Mordovia were discussed;
- Alexander Pochinok, Tax Minister, including in particular on the December 1999 meeting with Mr. Dubov at which Yukos' plan to use trading companies in Mordovia was discussed;
- Alexander Smirnov, First Deputy Minister of Tax, including in particular on the December 1999 meeting with Mr. Dubov; and
- Nicolai Merkushkin, Head of the Republic of Mordovia, including in particular on the December 1999 meeting.[120]

249. Claimants also argued that they should have had the opportunity to hear from and examine the following individuals in respect of their knowledge of Yukos' tax structure derived from the audits of Yukos' trading companies:

- P. A. Puschin, Senior Tax Inspector of Russian Tax Ministry's Interregional Inspectorate for major Taxpayer No. 1; and
- A.V. Ivushkina, Senior Tax Inspector of Russian Tax Ministry's Interregional Inspectorate for major Taxpayer No. 1.[121]

250. In addition, Claimants complained that they did not have the opportunity to hear from and examine Sergei Bogdanchikov, the President of Rosneft, on the circumstances of Rosneft's acquisition of Baikal in December 2004 and Rosneft's agreement with a syndicate of Western banks led by Société Générale S.A. (the "**Western Banks**") regarding the initiation of Yukos' bankruptcy.[122]

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120 Claimants' Opening Slides, p. 300; Claimants' Closing Slides, p. 14.

121 *Ibid.*

122 *Ibid.*

251. Finally, Claimants argued that they should have had the opportunity to hear from and examine the following individuals in respect of PwC's audit of Yukos and the circumstances of the withdrawal of PwC's audit reports:

- Douglas Miller, Director, ZAO PwC Audit, including in particular regarding the work conducted for the purposes of the certification of Yukos' accounts for years 1998–2003 and the circumstances of the withdrawal of the reports in 2007; and
- Michael Kubena, General Director, ZAO PwC Audit, including in particular regarding the establishment of Yukos' tax optimization structure and its legality.[123]

2. Individuals that Respondent Wished were Available for Examination

252. At the Hearing, Respondent argued that the following individuals should have been made available for questioning with respect to: (a) the establishment and history of Yukos' "tax optimization" schemes and Yukos' understanding of their legality; (b) Yukos' relationship with its Lesnoy, Mordovian, and other "sham" trading shells; and (c) Yukos' reaction to the assessments against and criminal investigation of the Lesnoy and Trekhgorniy trading shells, including the restructurings and liquidations, the instructions to destroy documents, and other apparent attempts at obstruction:

- Dmitry Gololobov, Yukos' former Deputy General Counsel;
- Irina Golub, Yukos' former Chief Accountant;
- Dmitry Maruev, former head of the Financial Engineering Section of Yukos Treasury Department (Deputy Chief Accountant);
- Alexey Smirnov, former head of Yukos' Tax Department;
- Vasily Shakhnovsky, GML shareholder/beneficiary and former President of Yukos-Moscow; and
- Mikhail Brudno, GML shareholder/beneficiary.[124]

253. According to Respondent, Mr. Golobolov, together with Mr. Sergey Pepeliaev, Yukos' tax counsel, could also have addressed the following issues: (a) Yukos' unsuccessful attempts to obtain a legal opinion approving its "tax optimization" schemes, including why Mr. Pepeliaev did not provide a legal opinion to Yukos on the schemes prior to the 29 December 2003 tax

123 *Ibid.*

124 Respondent's Rebuttal Slides, pp. 655–56; *see also* Respondent's Post-Hearing Brief ¶ 136.

audit report; (b) the bases for Yukos' responses and reactions to the 29 December 2003 tax audit report, and the bases on which outside counsel prepared its post-hoc opinions for Yukos on the "tax optimization" schemes; and (c) the reasons why Yukos tried to file "annual" amended VAT returns, and did not submit proper amended monthly VAT returns after the "annual" ones were rejected.[125]

254. Respondent also argued that on the issue of Yukos' consideration of an enhanced ADR listing, including warnings that were provided to Yukos' senior management concerning the substantial risks of disclosing Yukos' "tax optimization" schemes in connection with such a listing, the failure to disclose Messrs. Khodorkovsky's and Lebedev's relationship to the BBS Companies, and Mr. Khodorkovsky's concerns for his own personal liability if he signed Yukos' F-1 Registration Statement, Claimants should have made available for testimony:

- Pavel Malyi, former Deputy Head of Yukos' Corporate Finance Department; and
- Oleg Sheiko, former Vice President/Director of Yukos' Corporate Finance Department.[126]

255. On issues relating to the understanding by Yukos' Russian management of the legality of Yukos' "tax optimization" scheme, Respondent complained about the absence of:

- Yury Beilin, Yukos' former Deputy CEO; and
- Simon Kukes, Yukos' former CEO.[127]

256. Finally, with respect to GML's "sustained and aggressive threats that deterred broader participation in the YNG and bankruptcy auctions," Respondent wished they could have heard from and examined Mr. Tim Osborne, GML Director and member of the Stichtings' boards.[128]

VII. ISSUES FOR ANALYSIS

257. In this second phase of the present arbitrations, the Parties presented their arguments and evidence on the many substantive issues related directly to the merits of the case under Articles 10 and 13 of the ECT. In addition, the Parties presented extensive argument on the

125 Respondent's Rebuttal Slides, pp. 656–57; *see also* Respondent's Post-Hearing Brief ¶ 136.

126 Respondent's Rebuttal Slides, pp. 658; *see also* Respondent's Post-Hearing Brief ¶ 136.

127 *Ibid.*

128 Respondent's Rebuttal Slides, pp. 659; *see also* Respondent's Post-Hearing Brief ¶ 136.

two preliminary objections that the Tribunal had decided to defer to the merits phase, namely the objection based on Claimants' alleged "unclean hands" and the objection based on Article 21 of the ECT.

258. The deferred preliminary objections—like the merits issues—require the Tribunal to untangle the complex factual matrix underlying Claimant's claims. Indeed, the Tribunal had decided to defer the preliminary objections relating to alleged "unclean hands" and Article 21 to avoid making findings on these important questions in a vacuum.

259. This Award therefore begins, in Part VIII, with the Tribunal's analysis of the factual issues. Guided in large measure by the Parties' presentations of the issues, the Tribunal considers it convenient to analyze the evidentiary record under the following eight headings

A. Yukos' Tax Optimization Scheme

B. The Russian Federation's Tax Assessments

C. Harassment, Intimidation and Arrests

D. Unwinding of the Yukos–Sibneft Merger

E. Yukos' Attempts to Settle its Tax Liabilities

F. Auction of YNG

G. The Bankruptcy of Yukos

H. The Withdrawal of PwC's Audit Opinions

260. As mentioned previously, the Tribunal, in Part VIII, makes determinations in respect of the many highly contested issues of fact and observations on the significance of various facts and findings.

261. Next, in Part IX of this Award, the Tribunal turns to Respondent's preliminary objections. Specifically, the Tribunal considers:

A. whether all or some of Claimants' claims are barred by the "fork-in-the-road" provision in Article 26(3)(b)(i) of the ECT (the Tribunal dismissed this objection in the Interim Awards, but Respondent has renewed the objection in this merits phase);

B. whether Claimants' conduct—their alleged "unclean hands"—deprives Claimants of protection under the ECT (in the Interim Awards, the Tribunal confirmed the deferral of its decision on this objection to the merits phase of this arbitration, consistent with Procedural Order No. 3); and/or

C. whether Article 21 of the ECT, which contains a "carve out" for "Taxation Measures", bars the Claimants' claims either as a matter of jurisdiction or admissibility (in the Interim Awards, the Tribunal decided to defer these issues to the merits phase, to avoid ruling on them in a vacuum).

262. Since the Tribunal dismisses each of Respondent's preliminary objections, thereby confirming that it has jurisdiction over Claimants' claims under the ECT, it next addresses Respondent's liability under the ECT. This analysis is undertaken in Part X of the Award.

263. Claimants allege that Respondent, by conducting investigations and legal proceedings against Yukos, its subsidiaries, and their management, has failed to accord Claimants' investments fair and equitable treatment. In particular, Claimants allege Respondent failed to refrain from impairing the management, maintenance, use, enjoyment and disposal of Claimants' investments by unreasonable or discriminatory measures, in contravention of Article 10 of the ECT. Claimants maintain that the treatment of Yukos was discriminatory as compared to other Russian oil companies.

264. Claimants further submit that Respondent's actions amount to an expropriation of the Claimants' investments, in breach of Article 13 of the ECT. According to Claimants, the alleged interventions of Respondent, and other entities directed and controlled by it—including in the Sibneft demerger, the sale of YNG at a cost alleged to be much lower than its real value to Baikal (a special purpose company that was quickly bought by the State-owned oil company Rosneft) and the pursuit of Yukos' bankruptcy proceedings—resulted in the total loss of value of Claimants' investments.

265. Claimants contend that Respondent's actions were politically and economically motivated, rather than aimed at legitimate tax enforcement. In that regard, Claimants purport to establish that Respondent acted through almost all its organs, at all levels, in seeking the destruction of Yukos.

266. In response, Respondent contends that Claimants have failed to establish a violation under either Articles 10 or 13 of the ECT. For Respondent, this case is about Yukos' tax evasion,[129] and therefore about Yukos' self-inflicted demise: Respondent contends that any losses suffered by Claimants are attributable to their own actions, those of the Yukos managers they installed and allegedly controlled, and of Messrs. Khodorkovsky, Lebedev, Nevzlin, Dubov, Brudno, Shakhnovsky and Golubovitch (the so-called "**Oligarchs**"). It follows, argues Respondent, that Claimants had no legitimate expectation that Russian tax law would not be applied to them and their investment when Yukos breached its tax obligations.

267. In addition to lacking the factual predicate for an expropriation claim under Article 13 of the ECT, Respondent also contends that Claimants' claims fail because the assessment and collection of taxes is in the public interest, as to which States are afforded a wide margin of discretion. Respondent maintains that its conduct in this regard did not radically depart from either Russian law or international norms.

268. To the extent that Claimants allege discriminatory taxation compared to other Russian oil companies—in contravention of the fair and equitable treatment in Article 10 of the ECT, as well as one of Article 13's four conditions for a lawful expropriation—Respondent answers that these claims fail because Claimants do not contend that their investment was subjected to discrimination based on foreign ownership. Respondent also disputes the facts presented by Claimants in support of their allegations of discrimination.

269. Respondent further contends that Claimants' allegations of due process violations with respect to tax, tax enforcement, the sale of YNG and Yukos' bankruptcy proceedings are equally meritless, and, in any event, did not affect the management and operations of Yukos.

270. The Tribunal's conclusions on these liability issues, in Part X, follow necessarily as the legal consequences of its factual conclusions in Part VIII. The Tribunal includes in Part X its decision on the attribution of the conduct of various actors to the Russian Federation, and its findings in relation to Claimant's contributory fault.

271. Finally, in Parts XI, XII and XIII of this Award, respectively, the Tribunal decides the issues relating to interest, the quantification of damages, and the allocation of costs.

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[129] Rejoinder ¶ 1.

VIII. ANALYSIS OF THE EVIDENTIARY RECORD

A. THE TAX OPTIMIZATION SCHEME

1. Introduction

272. In the latter years of the twentieth century and in the early years of the twenty first, oil companies in the Russian Federation were growing, consolidating and becoming large corporate entities. By the end of 2000, there were nine major oil companies in Russia. Yukos was the largest, followed by Lukoil. During that period, all nine major oil companies operated in a similar fashion. The key features of their operations were firstly vertical integration; secondly transfer pricing; and thirdly the use of low-tax regions to mitigate tax burdens.[130] In relation to the third element, one-time Prime Minister of Russia, Mikhail Kasyanov stated that "the tax havens in the ZATOs had been used by every oil company."[131] In fact,

> [t]housands of companies took advantage of the low-tax regimes available in Russian tax havens zones, including businesses engaged in construction, services, the sale of oil products, investments, as well as holding companies and groups of companies involved in financing and taxation arrangements. This activity was well known to the Russian government, including the Federal Tax Ministry.[132]

273. Respondent acknowledges that the majority of large Russian oil companies operated in a way similar to Yukos and did "use low-tax regions to evade taxes." At the same time, Respondent alleges that those companies did so "on a much more modest scale in comparison to Yukos."[133]

274. In this sense, Yukos was a typical Russian oil company, as it also used the low-tax regions as part of its tax optimization strategy. A central disputed issue in this arbitration concerns the legality, under Russian law, of the modalities of Yukos' use of the low-tax regions. Was Yukos merely taking advantage of the legislative arrangements in place to minimize its taxes, or was there an element of abuse in its scheme? A related disputed issue concerns the legitimacy of

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130 Transcript of Mikhail Kasyanov before the Khamovnichesky Court of Moscow in the Second Criminal Case Brought Against Mikhail Khodorkovsky and Platon Lebedev, 24 May 2010, p. 3, Exh. C-440. *See also* Statement of Prime Minister Mikhail Mikhailovich Kasyanov to the ECtHR, 8 July 2009, in *Khodorkovskiy v. Russia* (Application Nos. 5829/05, 11082/06 and 51111/07) ¶¶ 10–12, Exh. C-446. As noted earlier in paragraph 47 and n.11 above, Claimants withdrew Mr. Kasyanov's witness statement in these arbitrations because he did not appear at the Hearing and was not subject to cross examination. However, the Tribunal has taken notice of his testimony in other proceedings, which forms part of the record in the present proceedings.

131 Statement of Prime Minister Mikhail Mikhailovich Kasyanov to the ECtHR, 8 July 2009, in *Khodorkovskiy v. Russia* (Application Nos. 5829/05, 11082/06 and 51111/07) ¶ 34, Exh. C-446.

132 Vladimir Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*, Publication of International Tax & Investment Center, December 2003, p.1, Exh. C-577.

133 Counter-Memorial ¶ 12.

the tax assessments against Yukos that began in December 2003. Was the Russian Federation merely enforcing its tax laws, or rather was it carrying out a punitive campaign against Yukos and its principal beneficial owners? Were the other Russian oil companies subjected to the same tax enforcement actions by the Russian Federation, or was Yukos discriminated against and specifically targeted by the Russian Federation? Before turning to the question of the legitimacy of those tax assessments, which the Tribunal does in the next chapter of the Award, the Tribunal considers it important to address the first question: were Yukos' practices in the low-tax regions, and specifically the practices of Yukos' trading companies in those regions, lawful?

275. In sections 2 and 3 of this chapter, the Tribunal summarizes the evidence that was presented by the Parties regarding the structure and legal framework of Yukos' tax optimization scheme. In section 4, the Tribunal distills, as best it can from the massive documentary record, the complex and extensive background relating to the activities and audits of the Yukos trading entities before December 2003. Finally, in section 5, the Tribunal reviews, on the basis of this complex record, the legality of Yukos' tax optimization scheme under Russian law.

276. The Tribunal observes that it considers the question of the legality of the tax optimization scheme to be a matter of fact in the present arbitration. It is not the role of the Tribunal in the present proceedings to review and determine, as if it were a Russian court of appeal, the decisions made pursuant to Russian law in respect of the legality of this scheme. However, even in considering the issue as a matter of fact, the Tribunal's observations on the legality of Yukos' tax optimization scheme based on what the record reveals will inform its decision on the principal legal questions facing the Tribunal under the ECT.

2. The Structure of the Tax Optimization Scheme

277. The Tribunal has been presented with an enormous volume of material relating to Yukos' structure and tax optimization scheme. In short, Yukos' tax optimization scheme consisted of using "trading companies" located in the low-tax regions as intermediaries in the chain of transactions between Yukos' core oil-producing entities YNG, Samaraneftegaz and Tomskneft at one end, and its customers at the other. The trading companies at issue were established in three types of low-tax regions. The first type was closed administrative territories, or ZATOs (Lesnoy, Trekhgorny, Sarov). ZATOs are territories established in the former Soviet Union as defense and nuclear sites, or as sites with sensitive military, scientific or industrial significance which faced economic catastrophe at the end of the Cold War. For this reason, special tax

regimes were instituted in those territories aimed at boosting economic activity.[134] The second type was "domestic-offshore territories", regions that faced significant economic challenges and where the Russian Federation wanted to facilitate investment (Mordovia, Evenkia, Kalmykia).[135] The third low-tax region was Baikonur, a former spaceport, which was treated as a ZATO but is on the territory of Kazakhstan.[136]

278. The names of the trading entities of particular relevance in this arbitration and the regions or ZATOs in which they were located are set out in the following table:

Region or ZATO	Company
Mordovia	Alta-Trade Fargoil Macro-Trade Mars-XII (Energotrage) Ratmir Yukos-M Yu-Mordovia
Evenkia	Evoil Interneft Petroleum-Trading Ratibor Yukos Vostok Trade
Kalmykia	Siberian Transportation Company
Baikonur	Mega-Alliance
ZATO Lesnoy	Business-Oil Mitra Vald-Oil Forest Oil
ZATO Sarov	Yuksar
ZATO Trekhgorny	Grace Muskron

134 Counter-Memorial ¶ 226, n.274. *Law of the Russian Federation No. 3297–1* of July 14, 1992, "On Closed Administrative Territorial Entity," Exh. C-404.

135 Counter-Memorial ¶ 226, n.274. Article 1, *Law of the Republic of Mordovia No. 9-Z on the Conditions of the Efficient Use of the Social and Economic Potential of the Republic of Mordovia*, 9 March 1999, Exh. C-414 (hereinafter "*Law 9-Z*"); Article 1, *Law of the Republic of Kalmykia No. 197-II-3* of 12 March 1999, "On Tax Benefits Granted to Enterprises Making Investments in the Economy of the Republic of Kalmykia," Exh. C-413; Article 1, *Law of the Evenkiysky Autonomous District No. 108* of 24 September 1998, "On the Particularities of the Tax System in Evenkiysky Autonomous District," Exh. C-412.

136 During his cross-examination, Mr. Konnov clarified the position of Baikonur as having "a special status, [it] is leased by the Russian Federation . . . . So there are three categories [of low-tax region]." Transcript, Day 14 at 54. *See also*, Decision of the Government of the Russian Federation No. 747, 25 October 2001, Exh. C-411.

Region or ZATO	Company
	Norteks Kverkus Colrain Virtus

279. In 2000, sales were conducted by at least 16 of these companies. From 2001 to 2003, Yukos employed at least eight such companies, and in 2004 at least three of them. Through this structure, Yukos was able to capture much of the profit from the sale of crude oil to its customers on the books of the entities in the low-tax regions, thus benefiting from substantial tax savings. Some of these after-tax profits, in turn, left the Russian Federation through dividends to the off-shore holding companies that Yukos controlled (for U.S. GAAP consolidation purposes) through trusts and call options.[137]

3. The Legal Framework of the Tax Optimization Scheme

(a) The Low-Tax Region Program

280. The low-tax region program was established in the 1990s to foster economic development in impoverished areas of the Russian Federation. The Russian low-tax regions were allowed to exempt taxpayers from federal corporate profit taxfor the purpose of encouraging taxpayers' investments in their regions, provided the taxpayers complied with certain requirements. There is no dispute between the Parties as to the source of the formal requirements; it is agreed that they are to be found in the low-tax regions' legislation, any applicable tax investment agreements, and the applicable federal legislation, including the Russian Tax Code. More controversial, and contested by Claimants, is the existence and significance of various so-called "anti-abuse" doctrines which, according to Respondent, have been established and applied in decisions of Russia's federal courts. The Tribunal addresses these doctrines and the relevant jurisprudence in the next subsection.

281. The benefits provided in the low-tax regions were related to profit tax, which was described by Mr. Konnov in his first report as follows:

> 29. Profit tax is a federal tax, however tax revenues are shared between the federal, regional and (in certain years) local budgets. Through the end of 2001, profit tax was governed by the Law of the Russian Federation No. 2116-1 "On Tax on Profit

[137] *See* Lys Reports.

of Enterprises and Organisations" dated December 27, 1991 (the "Profit Tax Law") and subsequently by Chapter 25 of the Tax Code. In 1999-2006, profit tax rates applicable to Russian entities and foreign entities having a permanent establishment in Russia (with respect to income attributable to such permanent establishments) were as follows:

Year	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Rate of profit tax total, including:	35% (30% after April 1)	30%	35%	24%	24%	24%	24%	24%
Rate of profit tax to the federal budget	13% (11% after April 1)	11%	11%	7.5%	6%	5%	6.5%	6.5%
Rate of profit tax to the regional budget	22% (19% after April 1)	19%	19%	14.5%	16%	17%	17.5%	17.5%
Rate of profit tax to the local budget	–	–	5%	2%	2%	2%	–	–

282. With respect to the tax benefits available in the ZATOs (*e.g.*, Lesnoy and Trekhgorny), in 1999, the ZATOs were allowed to fully exempt taxpayers from federal corporate profit tax. In 2000, most ZATOs were allowed to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget (*i.e.*, up to 19 percent). In 2001, all ZATOs were permitted to exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget (*i.e.*, also up to 19 percent). In 2002, however, these exemptions were revoked.

283. With respect to the tax benefits available in other low-tax regions (*e.g.*, Mordovia, Kalmykia and Evenkia), in 2000 and 2001, such regions were allowed to fully exempt taxpayers from the portion of the federal corporate profit tax that was payable to their budget (*i.e.*, up to 19 percent). From 1 July 2002 until 31 December 2003, low-tax regions were allowed to exempt taxpayers from the portion of the federal corporate profit tax payable to their budget, but only up to four percent. An exception existed for "grandfathered" tax investment agreements entered into prior to 1 July 2001, and these taxpayers could still receive a zero percent tax rate on the relevant portion of the profit tax if they fulfilled certain other conditions. As of 1 January 2004, the existing tax investment agreements were terminated, but the Russian Tax Code still allowed low-tax regions to reduce the federal corporate profit tax payable to their budget up to four percent.

(b) Anti-Abuse Decisions and Doctrines Promulgated by Russia's Federal Courts

284. Before considering the individual court decisions in which the anti-abuse doctrines are said to have been developed and applied, the Tribunal will describe the different courts within the judicial system of the Russian Federation.[138]

285. The Russian court system is based on four types of distinct judicial procedures—constitutional, civil, administrative and criminal.[139] Each area has created its own court structure. For its civil procedure, Russia created a system of commercial, or "arbitrazh" courts. The arbitrazh courts have jurisdiction over general commercial disputes and disputes directly relating to commercial matters, such as tax disputes. At the first instance, there are 81 arbitrazh courts, located in and for the constituent entities of the Russian Federation.[140] At the next level, the appellate instance, there are 20 appellate arbitrazh courts. Then, at the "cassation instance," there are ten federal arbitrazh courts.[141] At the apex of the Russian commercial courts system is the Supreme Arbitrazh Court of the Russian Federation.[142]

286. The Constitutional Court of the Russian Federation and the local constitutional courts of its constituent entities are the courts created for Russia's constitutional procedure. Among its other functions, the Constitutional Court plays a supervisory role over all four Russian judicial procedures at the federal level; the local constitutional courts play the same role at the level of the constituent entities. The task of the Constitutional Court is to ensure compliance of the judiciary with the Constitution of the Russian Federation ("**Russian Constitution**").[143] In this

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138 This information is derived from the Constitution of the Russian Federation, Exh. C-1698 (hereinafter "Russian Constitution") and other particulars in the public domain of interest to narration of the many decisions of the courts of the Russian Federation which the Tribunal reviews.

139 Russian Constitution, Article 118(2), Exh. C-1698.

140 Russia as a federation consists of 83 "constituent entities"—relatively autonomous territorial and political units. Most of them have their own constitutions, local laws, presidents, governments, parliaments, and court systems. Mordovia, for example, is a "constituent entity". The judicial districts usually match up with these autonomous territorial and political units, but there are several "mismatches": there are 83 "constituent entities" and only 81 first-instance arbitrazh courts.

141 In 2000, the Russian Federation created "federal districts", which are administrative units that group several "constituent entities." Currently there are eight federal districts. Since there are ten federal arbitrazh courts but only eight federal districts, there is a "mismatch" there too. For example, the Siberian Federal District has two federal arbitrazh courts, which are the Federal Arbitrazh Court of the East Siberian District and the Federal Arbitrazh Court of the West Siberian District.

142 In late 2013, the Ministry of Justice of the Russian Federation announced a judicial reform which would result in merging the Supreme Arbitrazh Court of the Russian Federation with the Supreme Court, which is the apex of the general jurisdiction courts. The reform has not yet been finalized.

143 Exh. C-1698. The Russian Constitution defines the level of autonomy of the "constituent entities" by assigning certain governance matters of federal importance to the federal bodies while allowing the remaining matters to be

capacity, the Constitutional Court is the court of last resort, which decides whether a particular law applied by the courts of lower instance is constitutional. For example, an individual or a company may apply to the Constitutional Court in a tax matter when the individual or company considers that a particular provision of the Russian Tax Code applied by an arbitrazh court is not incompliance with the Russian Constitution. The decisions of the Constitutional Court are not subject to appeal.

287. The Tribunal turns now to the anti-abuse principle under Russian law.

288. Respondent's expert on Russian law, Mr. Oleg Konnov, introduced the anti-abuse principle as follows:

> It is essential to distinguish clearly between the legitimate use of the tax benefits and abuse of tax law. Russian law generally prohibits abuse of law. The constitutional anti-abuse principle has been incorporated in some branches of law (e.g. civil law). However, it has been consistently applied even in branches of law where no explicit provisions have been included in the text of the law, e.g. labour law and tax law. In these instances, Russian courts have themselves developed anti-abuse doctrines. In the tax area, anti-abuse doctrines have been used to combat aggressive tax planning and abuse.
>
> One should not be misled by the terminology. Even though the term "substance over form" is not commonly used in Russia, the terms "bad faith," "abuse of rights," "proportionality" and "business substance" are used to achieve the same result as the "substance over form" notion in other countries.
>
> Courts (including the highest courts of Russia) accepted and consistently applied anti-abuse measures both before and after the YUKOS tax cases. The anti-abuse doctrines have been evolving over the time. In some cases, the tax authorities challenged the abusive transactions based on the application of civil law principles ("sham" and "fictitious" transactions and transactions "deliberately contrary to fundamentals of civil law and morality"), and in others they applied the notions of "bad faith" and "unjustified tax benefit" developed by court practice. There were also cases in which the tax authorities used a combination of legal principles to challenge tax avoidance misconduct.[144]

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decided by the "entities". At the same time, the Russian Constitution does not allow the "entities" to act contrary to the Russian Federation even within the "entity'" assigned autonomy. For example, one of the tasks of the Constitutional Court is to ensure that the local laws of the "entities" are in compliance with the Russian Constitution and the federal laws.

144 First Konnov Report ¶¶ 45–47. Mr. Konnov cites: Article 17(3) of the Russian Constitution, Exh. R-2211; Resolution of the Constitutional Court of the Russian Federation No. 3-P, 15 March 2005, section 4.3, Exh. R-2217 (as support for the proposition that the Constitutional Court describes non-abuse of law as a general legal principle); an assistant professor of the faculty of law of the Higher School of Economics Mr. Kurbatov, who writes: "In general terms, anti-abuse principle is set forth in Article 17 (3) of the Russian Constitution according to which exercise of rights and freedoms by citizens and individuals may not violate rights and freedoms of other persons. This principle is set forth in Chapter 2 of the Russian Constitution governing rights and freedoms of citizens and individuals. However these rights and freedoms may be applied to legal persons to the extent their nature permits so (see, for instance, para. 1 Section 4 of dicta of the Constitutional Court Ruling No. 20-P dated December 17, 1996, para. 4 Section 2 of dicta of the Constitutional Court Ruling No. 24-P dated October 12, 1998)." (A. Ya, Kurbatov, ABUSE OF LAW: THEORY AND COURT PRACTICE (Consultant Plus, 2009), Exh. R-2214). Mr. Kurbatov also writes: "It would be fundamentally wrong to consider anti-abuse as only civil law (branch) principle. It may, however, be set in provisions of specific branches of law"); Resolution of the Plenum of the Supreme Court of the Russian Federation No. 2, 17 March 2004, at

289. In support of his assertion that the various anti-abuse doctrines are part of Russian law, Mr. Konnov relies on a series of decisions issued by various Russian courts, starting with the decision of the Supreme Arbitrazh Court No. 367/96 on 17 September 1996 ("***Sibservice***") and including recent cases such as the 2010 *Novozlatoustovskoye* decision of the same court. Between these bookends, particular reliance is placed on Constitutional Court Ruling 138-0 of 25 July 2001 (which introduced the concept of "bad-faith taxpayer") and on Resolution No. 53 dated 12 October 2006 of the Plenum of the Russian Supreme Arbitrazh Court ("**Resolution No. 53**")(which linked the concepts of "unjustified tax benefit", "actual economic substance" of a transaction and the "business purpose" of a taxpayer's actions).

290. According to Mr. Konnov, the cases upholding the tax assessments against Yukos (*i.e.*, confirming the tax authorities' position that Yukos' tax optimization scheme was abusive) were "an integral part of the evolution of the 'business substance' doctrine which eventually resulted in adoption by the Russian Supreme Arbitrazh Court on 12 October 2006 of Resolution No. 53."[145]

291. Claimants argue that the "business purpose" doctrine could not possibly have played any role in the tax assessments against Yukos, since "it did not exist in Russian law at the time, having only been introduced into Russian law in 2006"[146] (in Resolution No. 53 of the Plenum of the Russian Supreme Arbitrazh Court). Indeed, Claimants note, "the notion of business purpose was never mentioned in the December 29, 2003 Audit Report and played no role in the tax assessments against Yukos."[147]

292. The Tribunal's task in evaluating the Parties' arguments is a difficult one. As with many aspects of this case, the record is voluminous and, in certain respects, contradictory. Moreover, regarding issues of Russian tax law, the Tribunal heard only from Mr. Konnov; Claimants put forward no testimony challenging Mr. Konnov's interpretation of the relevant cases from an

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clause 27, Exh. R-2213 ("If a court establishes the fact that the employee abused his rights, the court can dismiss his claim on reinstatement in a job ... since in the specified case the employer should not be responsible for the adverse consequences resulting from the employee' bad faith actions."). *See also* V.V. Arkhipov, *Abuse of Rights in Labor Relations: Wilful Hoax or Honest Mistake?*, Zakonodatelstvo i Ekonomika, No. 2, 2008, Exh. R-2215; Civil Code of the Russian Federation, entered into force on 1 January 1995, Articles 10, 169, 170, Exh. R-909 (hereinafter "Russian Civil Code"). Mr. Konnov notes that in a number of cases Article 170 of the Civil Code was applied jointly with Article 169 of the Russian Civil Code.

145 First Konnov Report ¶ 49(p).

146 Claimants' Post-Hearing Brief ¶ 29.

147 *Ibid*.

expert on the subject. And, as discussed further below, Claimants' counsel chose not to cross-examine Mr. Konnov on the existence or evolution of the anti-abuse doctrines. At the same time, in argument, Claimants have challenged almost every aspect of Mr. Konnov's testimony, including on the existence and evolution of the anti-abuse doctrine.

293. Therefore the Tribunal has had to delve into the voluminous record, including the translations of dozens of Russian court decisions and commentaries thereon, to come to its own view on what anti-abuse principles may have existed during the period relevant for an analysis of Yukos' tax optimization scheme.

294. The earliest cases relied upon by Respondent, from the mid-1990s, appear to rely on a "substance over form" doctrine. These cases include *Sibservice* and the Resolution of the Presidium of the Supreme Arbitrazh Court No. 3661/96 on 21 January 1997 ("***Yekaterinburg Telephone***").

295. Mr. Konnov summarizes these cases as follows:

a. As early as in 1996, the Russian Supreme Arbitrazh Court reviewed a case involving the Russia-Austrian joint venture Sibservice. Sibservice was assembling and selling computers. Its sales of computers were subject to VAT. In order to defer or avoid VAT payment, Sibservice entered into loan agreements with customers under which the customers purportedly loaned funds to Sibservice, and Sibservice purportedly repaid the loans by transferring computers to the customers. Based on the letter of the law, the making of the loan and the repayment of the loan (unlike sale of computers) were exempt from VAT. The Supreme Arbitrazh Court focused on substance of the transactions between Sibservice and its customers and ruled that the sale of computers had been artificially structured using the loan agreements, thereby supporting the position of the tax authorities. Specifically, the Supreme Arbitrazh Court noted that:

> "The conclusion of the state tax inspectorate that Joint Venture Sibservice supplied the goods on the condition of the prepayment of their price [is justified] since the relations with the customers (buyers) were actually developed that way (supply, contractor relationships) regardless of the name of the agreement."

b. One year later, in 1997, the Russian Supreme Arbitrazh Court reviewed a case involving the state-owned enterprise *Yekaterinburg City Telephone Network.* In 1994, the state-owned enterprise had concluded what they claimed to be several joint venture agreements with private persons and legal entities according to which the participants allegedly agreed to cooperate for the purposes of developing the telephone network of the city of Yekaterinburg. The private persons and legal entities made what purported to be joint venture financing contributions to the state enterprise which they claimed were exempt from VAT and VAT surtax under the then applicable law. The tax authorities conducted a tax audit of the state enterprise and concluded that in practice no true joint venture activity had been conducted and, therefore, VAT and VAT surtax had to apply. The Presidium of the Russian Supreme Arbitrazh Court supported this conclusion:

> "In fact, those transactions have been made in order to raise financing from the relevant entities and individuals in order to finance the claimant's business."

With reference to this case, a group of prominent Russian scholars noted later that Russian tax law required that the tax consequences of a transaction or other arrangement be determined according to its substance rather than its form:

> ". . . Therefore, the arbitrazh courts as well as the tax authorities currently follow the principle of "substance of contract over its name (form)". Thus, any attempts to conceal the real substance of an agreement by using a name of a different contract will most likely be fruitless."[148]

296. Respondent also refers to Constitutional Court Resolution No. 14-P, 28 October 1999 ("***Energomashbank***"), which, according to Respondent, "reiterated the notion that when looking at the tax aspects of a particular transaction, Russian courts should be mindful of its substance, and not merely its form." Mr. Konnov describes the case as follows in his First Expert Report:

> d. Likewise in 1999 the Russian Constitutional Court in the *Energomashbank* case advised Russian courts to analyze the substance of transactions rather than their form:
>
> ". . . in instances when the courts while examining a case fail to investigate in essence actual facts thereof but limit themselves to the establishment of formal conditions of the application of the law only, the right to judicial defence envisaged by Part 1 of Article 46 of the Constitution of the Russian Federation is found to be substantially infringed."[149]

297. In their Reply, Claimants write that the *Sibservice* and *Yekaterinburg Telephone* cases:

> involved the application of the principles enshrined in Article 170 of the Russian Civil Code, which allows the tax authorities, in certain well-defined circumstances, to disregard the form of a particular transaction and to impose taxes based on the actual facts (*i.e.*, based on the actual transaction which occurred, or the fact that no such transaction occurred). Such cases can obviously offer no support to the Respondent's re-attribution theory. Neither at the time nor in these arbitrations has the Respondent sought to rely on Article 170. Moreover, as the Accounts Chamber emphasized in its 2002 report on Sibneft, apart from the transfer pricing rules under Articles 20 and 40 of the Russian Tax Code (which were also not used against Yukos), Article 170 is the only basis under Russian law to challenge relations or transactions between companies as being "shams" or

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148 First Konnov Report ¶49(a)-(b) (citing Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation No. 367/96, 17 September 1996, Exh. R-288 (hereinafter "*Sibservice*"); Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation No. 3661/96, 21 January 1997, Exh. R-289 (hereinafter "*Yekaterinburg Telephone*"); for the group of Russian scholars, A.V. Bryzgalin, V.R. Bemik, A.N. Golovkin, *Collection of Economic Agreements and Documents for Companies with Legal, Arbitrazh and Tax Commentaries*, Nalogi i Finansovoe Pravo, 2004, Exh. R-290).

149 First Konnov Report ¶ 49(d) (citing Resolution of the Constitutional Court of the Russian Federation No. 14-P, 28 October 1999, Exh. R-293 (hereinafter "*Energomashbank*").

> "fictitious", refuting the Respondent's claim that such theories as the "bad faith taxpayer" concept conferred authority to re-attribute revenues between companies.[150]

298. Claimants also challenge the relevance of the *Energomashbank* ruling:

> If that case has any relevance to these arbitrations, it is as a wholesale condemnation of the tax authorities' formalistic approach to VAT, divorced from the actual facts, as in breach of Yukos' constitutional rights. The constitutional issue in the case was the taxpayer's right to a fair opportunity to defend itself against tax claims by the State before a court, and the Constitutional Court held that respect for this right meant that courts could not limit their inquiry to purely "formal conditions", but rather must examine the actual facts.[151]

299. Putting aside, for the moment, the *remedy* of re-attribution in the case of a finding of abuse, which the Tribunal considers in Chapter VIII.B of the present Award (in connection with the tax assessments themselves), the question here is whether the decisions cited by Respondent support the *existence* of a judicial anti-abuse doctrine in tax cases.

300. Respondent insists that they do. Focusing specifically on the *Sibservice* and *Yekaterinburg Telephone* cases, Respondent characterizes these decisions of the Supreme Arbitrazh Court as demonstrating that Russian courts have recognized and applied anti-abuse rules in the tax area to combat aggressive tax planning and abuse since at least 1996.[152] In its Rejoinder, Respondent dismisses Claimants' comments on these cases as "misleading":

> Claimants misleadingly suggest that Respondent's reliance on the 1996 *Sibservice* decision and the 1997 *Yekateringburg City Telephone Network* decision *"involve[s] the application of principles enshrined in Article 170 of the Russian Civil Code" . . . .* But nowhere in these decisions do the courts rely on, or even mention, Article 170 of the Civil Code. Rather, in both the Supreme Arbitrazh Court upheld the tax authorities' assessments by looking at the substance of the challenged transaction, as opposed to its form.[153]

301. Based on its review of these cases, the Tribunal observes that Respondent's submission appears to be well-founded. Article 170 of the Russian Civil Code provides as follows:

> Article 170. Invalidity of Mock and Sham Transactions
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> 1. A mock transaction, i.e., a transaction made only for appearances without an intent to create the legal consequences corresponding to it, is void.

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150 Reply ¶ 234 (citing Russian Civil Code, Part I, Article 170, Exh. C-1270; *Sibservice*, Exh. R-288; *Yekaterinburg Telephone*, Exh. R-289; and Accounts Chamber Report on the Results of its Audit of OAO Sibneft, December 2002, Conclusions, (finding that transactions involving Sibneft's trading companies complied with Article 170 and that "under current legislation there is no other basis for considering such interrelationships (or transactions) as fictitious and invalid.") (emphasis added), Exh. C-1282).

151 Reply ¶ 236. (Original footnote omitted.)

152 Rejoinder ¶ 648.

153 Rejoinder ¶ 648, n.987.

> 2. A sham transaction, i.e., a transaction that is made for the purpose of hiding another transaction, is void. The rules relating to the transaction that the parties actually had in mind, shall be applied, taking into account the nature of the case.

However, there is no mention of Article 170 of the Russian Civil Code in either of the *Sibservice* or *Yekaterinburg* decisions in the record of this arbitration.[154] Based on this record, it appears to the Tribunal that the Supreme Arbitrazh Court is relying in these cases on a general doctrine of substance over form. The Tribunal further observes that such a doctrine seems entirely consistent with the principles enshrined in Article 170 of the Russian Civil Code. It also seems consistent, in a general way, with the anti-abuse principle that Mr. Konnov says existed in the Russian Constitution, even though the Tribunal notes that no authority was brought to its attention in which this principle was expressly extended into the area of tax.[155]

302. On the other hand, the Tribunal is of the view that Respondent cannot draw much support from the *Energomashbank* decision. It appears to the Tribunal that, while the Constitutional Court referred to the importance of investigating the "actual facts" of a case as opposed to confirming "the establishment of formal conditions of the application of the law only," it did so in the context of highlighting substance over form as an important feature of "the right to judicial defense" of a taxpayer against the claims of the tax authorities, not as a basis for tax authorities to challenge taxpayers. At the same time, the Tribunal notes that the *Energomashbank* decision is not inconsistent with the application of the substance over form doctrine by the tax authorities against a taxpayer's scheme.

303. Another doctrine invoked by Respondent is known as the "bad-faith taxpayer" doctrine, or sometimes as the "good faith taxpayer" doctrine. This doctrine, submits Respondent, is rooted in the jurisprudence of the Russian Constitutional Court, notably Constitutional Court Ruling No. 24-P of 12 October 1998[156] and Constitutional Court Ruling 138-O of 25 July 2001.[157] In his First Expert Report, Mr. Konnov summarizes the significance of these cases as follows:

> c. In 1998, the Russian Constitutional Court introduced the concept of good/bad faith taxpayers. In 2001, the Russian Constitutional Court held that bad faith taxpayers

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154 The Tribunal observes that there appear to be at least six other decisions in the procedural history of these two cases, and that these are not in the record.

155 The authorities cited by Mr. Konnov demonstrate only that the constitutional anti-abuse principle (*i.e.*, persons should not violate other persons' rights and freedoms in exercising their own rights and freedoms) has been extended to the area of labour law. *See generally* First Konnov Report ¶ 45, n.64, 66 (authorities cited therein).

156 Ruling of the Constitutional Court of the Russian Federation No. 24-P, 12 October 1998, Exh. R-2212.

157 Ruling of the Constitutional Court of the Russian Federation No. 138-O, 25 July 2001, Exh. R-307.

would not be entitled to the same level of protection as good faith taxpayers. Mr. Savseris in his book "Bad Faith Category In Tax Law" states:

> "The criterion of bad faith taxpayer was chosen by the Constitutional Court of the Russian Federation in order to distinguish legitimate tax planning and illegal tax evasion.
> . . .
>
> Since the adoption of the Ruling of the Constitutional Court of the Russian Federation No. 138-0 the criterion of bad faith has become an independent criterion for settlement of disputes on many categories of cases."[158]

304. Claimants do not deny the existence of the "bad-faith taxpayer" doctrine,[159] but argue that its origins and subsequent application by the Russian courts suggest that it has only a "limited role" in Russian law.[160] The Tribunal considers it important to set out Claimants' position, as articulated at paragraphs 218 to 224 of their Reply, in full:

> 218. The phrase "good faith taxpayer" first appeared in the inoperative part of a decision of the Constitutional Court arising out of the 1998 financial crisis, during which many tax payments never reached the Treasury because the banks through which such payments were sent had become insolvent. When the funds did not arrive, the tax authorities simply confiscated the unreceived payments directly from the taxpayers' accounts. The Court concluded that the constitutional obligation to pay taxes is fulfilled and the tax is deemed "paid" at the moment when the funds are debited from the taxpayer's account and that it would be improper to hold the taxpayer liable for the banks' failure to retransmit those funds to the State. In these circumstances, the Court held that a second collection of these "paid" taxes would be inconsistent with constitutionally protected property rights.

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158 First Konnov Report ¶ 49(c) (citing Ruling of the Constitutional Court of the Russian Federation No. 24-P, 12 October 1998, at Exh. R-2212; Resolution of the Constitutional Court of the Russian Federation No. 138-0, 25 July 2001, Exh. R-307; S.V. Savseris, *Bad Faith Category in Tax Law*, Statut, 2007, pp. 42, 46, Exh. R-2218. He also refers to another illustration offered by Professor D.V Vinnitsky, *The Principle of Good Faith and Abuse of Right in Taxation*, Pravo i Ekonomika, No. 1, January 2003, Exh. R-2219 ("the tax legislation does not directly use the notion "good faith" as a necessary criterion for assessing activity of tax relations party. However, this is not to say that tax law is indifferent to this principle. In contrast, for this branch of law "good faith" is a fundamental principle to be used in the resolution of disputes and execution of certain tax law provisions."). Mr. Konnov notes that bad faith is one of the anti-abuse doctrines which was applied either on a stand-alone basis or together with other doctrines in the Yukos case. In many cases, the term "bad faith" was used along with other anti-abuse terms, such as "proportionality", "unjustified tax benefit" or "abuse of rights." According to Mr. Konnov, during the period in question there were a number of non-Yukos cases where the tax authorities applied the concept of bad faith to disallow tax benefits, and the courts upheld their actions. Specifically, between 2001 and 2005 the concept of bad faith was applied in the following number of court cases: (i) 2001—262 court cases; (ii) 2002—644 court cases; (iii) 2003—1.189 court cases; (iv) 2004—2.235 court cases; (v) 2005—3.737 court cases. (citing also S.V. Savseris, *Bad Faith Category in Tax Law*, Statut, 2007 p. 47, Exh. R-310). According to Mr. Konnov, another prominent Russian scholar Arkady Bryzgalin in 2001 distinguished four methods which could be applied by the state to combat tax evasion, including doctrines of "substance over form" and "business substance." (citing *Methodology of Tax optimization*, Tax and Tax Law Journal, 2001, No. 1, at p. 26, Exh. R-2283).

159 Reply ¶ 217, n.368.

160 *Ibid* at ¶ 217.

> 219. In 2001, the Tax Ministry asked the Constitutional Court to clarify its earlier decision, in particular, whether the rule (that a taxpayer's constitutional duty to pay taxes ceases when the funds are debited from its account) applied even if the taxpayer deliberately contrived, in bad faith, to use an insolvent bank in order to evade taxes. In the resulting decision, the Russian Constitutional Court held that "the conclusions which are contained in the motivational and operative parts of the [1998] Ruling do not extend to the dishonest taxpayers, and recovery by enforcement in the manner established by law from dishonest taxpayers of taxes not coming into the budget does not violate the constitutional guarantees of the right of private ownership". This decision introduced the concept of "bad faith taxpayer" into Russian law.
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> 220. Since introducing this novel doctrine, the Constitutional Court has been called on to address its proper scope on a few occasions, and has consistently imposed limits.
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> 221. In its decision of October 16, 2003, for example, the Court for the first time recognized the possibility of the doctrine's application in a context other than tax payments through failed banks, in particular, in relation to claims for VAT refunds for exports. However, the Court emphasized the limited nature of this extension, recalling that, under Article 57 of the Russian Constitution and Article 3(7) of the Tax Code, "law enforcement authorities may not construe the concept of 'good faith tax payer' as imposing on the tax payer additional obligations which are not provided for in the legislation". The Russian Constitutional Court reiterated this limiting principle in a 2005 decision and specifically criticized the Moscow Arbitrazh Court's sweeping attempt to "universalize" the concept so as to circumvent express statutory provisions in the context of the Yukos case.
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> 222. In sum, in its limited endorsement of a "bad faith taxpayer" doctrine, the Russian Constitutional Court has at all times clearly indicated that any such doctrine was subordinate to, and controlled by, relevant Constitutional and statutory provisions.
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> 223. The primacy and supremacy of Constitutional and statutory provisions over the "bad faith taxpayer" concept have since been reaffirmed by the Presidium of the Highest Arbitrazh Court in a decision wholly rejecting, in circumstances unrelated to the Yukos affair but involving tax claims against another oil company, the approach of the Moscow Arbitrazh Courts in the Yukos cases and emphasizing that "courts should assess arguments of tax authorities with respect to underpayment of taxes with consideration of specific statutory provisions rather than such subjective concepts as 'bad-faith taxpayer'".
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> 224. Accordingly, there was nothing in the "bad faith taxpayer" concept introduced by the Russian Constitutional Court that could have permitted the tax authorities to re-attribute revenues between taxpayers or otherwise disregard directly applicable statutory provisions and impose additional, unwritten obligations beyond those contained in the legislation.[161]

305. In its Rejoinder, Respondent dismisses Claimants' suggestion that the Constitutional Court has limited the application of the doctrine since it arose in 1998, notably through its decisions since 2003:

> 661. Contrary to Claimants' allegations, the Constitutional Court in 2003 was not "called on to address" the "scope" of the bad-faith taxpayer doctrine, much less to "limit[]" it, but rather to adjudicate a complaint that had been raised in connection with the

[161] Reply ¶¶ 218–24 (footnotes omitted; emphasis in original).

tax authorities' denial of a refund of input VAT based on the taxpayer's bad-faith conduct. Thus, the Constitutional Court confirmed its earlier holdings, including its 1998 ruling, reiterating that "in the sphere of fiscal relations, there shall be a presumption of good faith" in favor of taxpayers, which the authorities bear the burden of rebutting. The Court also noted that the authorities "may not construe the concept of 'good-faith taxpayer' as imposing on the taxpayer additional obligations which are not provided for in the legislation."

662. Claimants' self-serving reliance on this quotation -- which they extract from its all-important context -- is misplaced. It is clear from this ruling that the Court did not at all intend to "limit" the scope of the bad-faith taxpayer doctrine, but rather to clarify that a taxpayer's good or bad faith must be determined on a case-by-case basis, upon "review of all the circumstances of the particular case." That is exactly what the tax authorities and courts did with respect to Yukos. Specifically, the Constitutional Court explained that:

> "[t]he determination of the complainant's good or bad faith in the performance of its tax obligations and realisation of its rights to the reimbursement of amounts of tax deductions is connected with the establishment and review of the factual circumstances of the particular case and falls under the jurisdiction of the arbitrazh courts."

663. That the Court did not intend to limit the scope of the doctrine as formulated in its earlier jurisprudence is also apparent from its actual holding:

> "Based on the above […] the Constitutional Court of the Russian Federation ruled: 1. The complaint of OOO Export-Service shall not be accepted for examination because the subject matter of the application to the Constitutional Court of the Russian Federation was earlier clarified in a decision which is still in force."

664. In sum, neither in this nor in other later rulings has the "Constitutional Court […] suggested that the bad faith-taxpayer doctrine could not be used to combat abusive arrangements such as those used by YUKOS."[162]

306. The Tribunal has read and reviewed the many Constitutional Court decisions that form the backbone of the "bad faith taxpayer" doctrine in Russian law as well as papers of various Russian legal scholars. The Tribunal has formed the view that, during the period relevant for the tax assessments against Yukos from 2003 to 2004, the doctrine consisted mainly of the following principles:

- the good faith (honesty) of the taxpayer is presumed;[163]
- the tax authorities have the burden of proving the taxpayer's bad faith (dishonesty), and in doing so "may not construe the concept of 'good faith taxpayer' as imposing

[162] Rejoinder ¶¶ 661–64 (footnotes omitted; emphasis in original).

[163] Constitutional Court Ruling of the Constitutional Court of the Russian Federation No. 138-O ¶ 2 of the Motivational Part, 25 July 2001, Exh. R-307; Constitutional Court Ruling No. 329-O ¶ 2 of the Motivational Part, 16 October 2003, Exh. R-3238.

on the taxpayer additional obligations which are not provided for in the legislation";[164]

- in the case of a bad-faith (dishonest) taxpayer, the tax authorities have an "obligation . . . [to] ensure protection of the State's interests, including using mechanisms of judicial protection";[165] and

- the determination of the taxpayer's good or bad faith in the performance of its tax obligations and realization of its rights to the reimbursement of amounts of tax deductions is connected with the establishment and review of the factual circumstances of the particular case and falls under the jurisdiction of the arbitrazh courts.[166]

307. It is the Tribunal's opinion that Claimants cannot persuasively maintain that the "bad faith taxpayer" doctrine is subordinated to, and controlled by, not just the Russian Constitution (which must be the case), but also statutory provisions.[167] It seems evident that if the tax authorities establish dishonesty (bad faith) by the taxpayer in a particular case, based on specific factual circumstances, then the taxpayer may lose certain statutory benefits such as tax deductions or exemptions provided in the legislation. However, even a bad-faith taxpayer cannot be deprived of its *constitutional* rights or of statutory rights *that guarantee* the taxpayer's constitutional rights.[168]

308. Having reviewed and stated its observations on the important Constitutional Court cases, the Tribunal turns now to the Parties' arguments based on the principal arbitrazh court cases on

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164 Constitutional Court Ruling of the Constitutional Court of the Russian Federation No. 329-O ¶ 2 of the Motivational Part, 16 October 2003, Exh. R-3238.

165 Constitutional Court Ruling of the Constitutional Court of the Russian Federation No. 138-O ¶ 2 of the Operational Part, 25 July 2001, Exh. R-307

166 Constitutional Court Ruling of the Constitutional Court of the Russian Federation No. 329-O ¶ 2 of the Motivational Part, 16 October 2003, Exh. R-3238.

167 Reply ¶ 222.

168 Constitutional Court Ruling of the Constitutional Court of the Russian Federation No. 36-O of 18 January 2005 ¶ 3 of the Motivational Part, Exh. C-1140. In that case, at issue was Yukos' complaint that the Moscow Arbitrazh Court had failed to grant Yukos the benefit of the statute of limitations (contained in Article 113 of the Tax Code of the Russian Federation (hereinafter "Russian Tax Code")) on the basis that Yukos was a "bad-faith taxpayer". The Constitutional Court dismissed Yukos' complaint on jurisdictional grounds, but opined in *dicta* that Ruling No. 138-O "cannot serve as a ground for depriving the applicant of the guarantees established by Article 113 of the Tax Code of the Russian Federation." Earlier in its decision, the court had noted that Article 113 is a guarantee of a taxpayer's constitutional rights.

which Respondent relies. Although Mr. Konnov refers to dozens of other specific cases,[169] and alludes generally to "thousands of bad faith cases adjudicated in the relevant period,"[170] Respondent places particular emphasis on the *Sibirskaya* case[171] and Resolution No. 53 of the Supreme Arbitrazh Court.[172] Claimants, for their part, emphasize a Resolution of the Federal Arbitrazh Court for the North-Western District of 5 June 2002 (the "***Pribrezhnoye***" case).[173] The Tribunal considers this case in the next chapter of its Award since it relates more directly to the application of any anti-abuse doctrine to circumstances similar to those that are at issue in the present case, rather than to the existence of any anti-abuse doctrine.

309. Mr. Konnov describes the *Sibirskaya* case as follows:

> i. In May 2002, OOO *Sibirskaya Transportnaya Kompaniya* ("Sibirskaya"), which was later found to be a Domestic Offshore Company, lost a cassation appeal before the Federal Arbitrazh Court for the North-Caucasian District. Like YUKOS two years later, Sibirskaya argued that it had complied with the letter of the Kalmykian law. The tax authorities and courts, however, concluded that Sibirskaya was a bad faith taxpayer and that the tax benefits granted to it were manifestly disproportionate (0.4%) to the amount of investment made by Sibirskaya:
>
> > "Such investments neither have any effect on the economy nor cover any of the losses of the budget relating to the granting of tax incentives to taxpayers. On the contrary, those investments result in unjust enrichment (saving) of funds at the expense of budgetary funds. Therefore, being aware of a clear disproportion between the amount of investment and the amount of the tax incentives applied, the claimant has abused its right, i.e., the claimant acted in bad faith."[174]

The Tribunal notes that no further appeals appear to have been made in this case. During his cross-examination, Mr. Konnov observed that the amount at stake in *Sibirskaya* (around USD 200,000) "was peanuts."[175]

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169 First Konnov Report ¶ 49(e)–(s).

170 Second Konnov Report ¶ 13.

171 *Sibirskaya*, Federal Arbitrazh Court for the North-Caucasian District, Case No. F08-1678/2002-614A, 20 May 2002, Exh. R-311.

172 Resolution of the Plenum of the Supreme Arbitrazh Court of the Russian Federation No. 53, 12 October 2006, Exh. R-1475.

173 Resolution of the Federal Arbitrazh Court for the North-Western District No. A42-6604/00-15-8-818/01, 5 June 2002, Exh. C-1278 (hereinafter "*Pribrezhnoye*"). See also discussion at paragraph 645 below.

174 First Konnov Report ¶ 49(i) (citing Resolution of Federal Arbitrazh Court of North-Caucasian District No. F08-1678/2002-614A, 20 May 2002, at Exh. R-311).

175 Transcript, Day 14 at 214. Mr. Konnov further speculated when he testified that Yukos may have "preferred, after having the loss, [to] immediately make the payment and not to take this case forward." Transcript, Day 14 at 214.

310. Respondent argues that the *Sibirskaya* case is one of "numerous cases [in which] the courts ruled against taxpayers on the basis that disproportion between the tax benefits granted to the taxpayer and amounts of investment into the relevant low-tax region economy is an indication of an abuse of rights and evidence of the bad faith of the taxpayer."[176] Although *Sibirskaya* involved a Yukos-related entity, Sibirskaya Transportnaya Kompaniya, Respondent argues that "the tax authorities did not realize the connection of that company with Yukos at the time."[177]

311. Claimants challenge the assertion that the authorities did not know that the company was related to Yukos.[178] Furthermore, and of direct relevance to the topic at issue here, Claimants contest the validity of the "purported 'proportionality' requirement" imposed by the court on the basis of the "bad faith taxpayer" doctrine:

> Not only was the Court's reliance on the "bad faith taxpayer" doctrine improper . . . the purported "proportionality" requirement it sought to introduce was wholly arbitrary and contravened other statutory and Constitutional provisions as well as basic principles of the rule of law.[179]

312. The Tribunal cannot accept Respondent's submission that the *Sibirskaya* case is an authority for the proposition that proportionality, standing alone, is a sufficient criterion for a finding of abuse. The decision does appear indeed to stand alone and, as far as the Tribunal can tell, was not followed subsequently. Moreover, contrary to Mr. Konnov's opinion, it was not Sibirskaya Transportnaya Kompaniya that "lost" an appeal at the cassation level of the arbitrazh court, suggesting that the tax authorities had been successful at all other levels. In fact, the company had actually prevailed in the earlier decisions on this issue.[180] Those judgments are not in the record. In addition, Claimants underline that, during his expert testimony in the *Quasar de*

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176 Counter-Memorial, ¶ 997, n.1561 (citing Resolutions of Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-1682/2002–623A, 21 May 2002, Exh. R-313; Case No. F08–1674/2002–627A, 21 May 2002, Exh. R-314;, Case No. F08-1793/2002, 28 May 2002, Exh. R-316; Case No. F08–3949/2002–1374A, 22 October 2002, Exh. R-317; Resolution of Federal Arbitrazh Court of the Moscow District, Case No. KA–A41/6270–03, 10 October 2003, Exh. R-319; Decision of the Moscow Arbitrazh Court, Case No. A41-K2-10055/02, 17 November 2004, Exh. R-320).

177 *Ibid.* ¶ 291.

178 Reply ¶ 227.

179 *Ibid.* ¶ 228.

180 Resolution of the Federal Arbitrazh Court of the North-Caucasian District No. F08-1678/2002–614A, 20 May 2002 p. 1, Exh. R-311.

Valores SICAV S.A. et al. v. The Russian Federation ("***Quasar***") arbitration proceedings, Mr. Konnov disclaimed reliance on the "proportionality" requirement.[181]

313. As is apparent from the many cases reviewed above, Russian courts did consider and rule on tax-related cases before they were seized of the dispute involving the tax assessments against Yukos, including in the "anti-abuse" area.

314. Respondent also raised a 2006 ruling of the Supreme Arbitrazh Court known as Resolution No. 53. In principle cases decided *after* the Yukos tax assessments and decisions should not be relevant for ascertaining the state of the law at the time of those assessments and decisions. However, in view of Respondent's argument that Resolution No. 53 represents the end point of the *evolution* of the anti-abuse doctrine in the Russian courts, the decision is of interest to the Tribunal in ascertaining the state of the law on the anti-abuse doctrines not only after, but also before and during the Yukos tax assessments.

315. In Resolution No. 53, the Supreme Arbitrazh Court set out to ensure greater uniformity in its evaluation of the "justifiability" of tax benefits received by the taxpayer by setting out straightforward interpretations of certain doctrines. As a starting point, it reaffirmed that the good faith of the taxpayer was presumed and that the tax authority had the burden to prove the facts upon which it relies in making its determinations. It noted that benefits may be considered unjustified when transactions are recorded without reflecting their true nature or are concluded without a business purpose or connection to economic activity. In such situations, the court would determine the rights and obligations of the taxpayer on the basis of the actual economic substance of a transaction. The Supreme Arbitrazh Court noted, however, that no adverse inference should be drawn from the fact that there was another, less beneficial way to conduct a transaction. It laid out four scenarios which may "point to" an unjustified tax benefit, and nine factors which, taken by themselves, may not constitute grounds to find a tax benefit unjustified. However, taken in concert with other factors, they may be considered as evidence of an improperly obtained benefit. Finally, it stated that a court should "establish the existence of economic or other reasons (business purpose) in the taxpayer's actions subject to evaluation of circumstances evidencing its intent to obtain an economic effect as a result of actual business or economic activity." It held that the tax benefit itself could not be considered an independent business purpose: "Therefore, if the court determines that the main purpose pursued by the

[181] Claimants' Post-Hearing Brief ¶ 32, n.67. *Quasar de Valores SICAV S.A. et al. v. The Russian Federation,* SCC Arbitration, Award, 20 July 2012, Exh. R-3383 (hereinafter "*Quasar*").

taxpayer was obtaining of income exclusively or predominantly out of the tax benefit and there was no intention to carry out actual economic activity, the tax benefit may be disallowed."[182]

316. Many articles on Resolution No. 53 have been written by Russian tax scholars and practitioners. Two in particular are cited by Mr. Konnov.[183] Both articles underline the importance of Resolution No. 53, although they reach different conclusions regarding the novelty of its content. One article by Mr. Y.M. Lermontov concludes that Resolution No. 53 was an innovation in Russian tax law: "[t]he concept of the 'bad-faith' of the taxpayer has been eliminated by Resolution No. 53," and instead other doctrines have been "incorporated into the regulatory framework."[184] Mr. Lermontov notes that in the past, "the judicial practice concerning the treatment of taxpayers as those of good faith and of bad faith in these matters used to be inconsistent," and that as a result of Resolution No. 53, more specific doctrines such as "business purpose", "substance over form" and "economic justifiability" were substituted in its place.[185]

317. The other commentary was written by Messrs. A.V. Bryzgalin and V.V. Goryunov. [186] For these authors, the doctrine affirmed in Resolution No. 53 represents less of a break with the bad-faith taxpayer doctrine that existed at the time of the Yukos assessments. Instead, they see Resolution No. 53 as *linking* the "business purpose" doctrine to the "bad-faith taxpayer" doctrine. The authors note that bad faith of the taxpayer was "considered for the first time . . . [in] N 138-0 regarding dubious schemes for payment of taxes through 'problem banks.'" The authors further note that since the doctrine had not been "directly provided for in the law," it created "uncertainty" leading to "considerable complications for . . . taxpayers, but also for the judges." Prior to Resolution No. 53, the authors write, "no criteria in this area existed at all, and the question of bad faith was completely dominated by judicial discretion." For the authors, Resolution No. 53 represents a "positive step" in which the Supreme Arbitrazh Court "attempted to establish specific indications of bad faith of taxpayers, characteristic features and approximate examples of permissible and impermissible conduct." The authors suggest that the

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182 Resolution of the Plenum of the Supreme Arbitrazh Court of the Russian Federation No. 53, 12 October 2006, p. 3, Exh. R-1475 (hereinafter "Resolution No. 53").

183 Second Konnov Report ¶ 80, n.133.

184 Y.M. Lermontov, *Commentary to the Resolution of the Plenum of the Supreme Arbitrazh Court No. 53*, Exh. R-3266.

185 *Ibid*.

186 A.V. Bryzgalin and V.V. Goryunov, *Commentary on Resolution No. 53 of the Plenum of the Supreme Arbitrazh Court of the Russian Federation*, Exh. R-3267.

change from "bad faith" to "unjustified tax benefit" is more a matter of terminology than doctrine. The authors write that "despite the substitution of terms . . . the concept of an unjustified tax benefit is illustrated in Resolution N[o]. 53 by what used to be called bad-faith behavior of taxpayers."

318. The link between these doctrines was made, as early as 2002, in a commentary on Constitutional Court Ruling 138-O that was published in 2002 by Mr. Sergey Pepeliaev, who would later be retained by Yukos in the Russian tax litigation.[187] In his commentary, Mr. Pepeliaev wrote as follows:

> In this Ruling the court considers the issue of limitations on tax planning, which implies the recognition of the right of each taxpayer to use the means, ways and methods permitted by law to reduce such taxpayer's tax liabilities to the maximum extent possible. However, sometimes tax planning goes beyond the permitted limits and results in tax evasion. The boundaries between the tax planning and tax evasion [are] determined by reference [to] the taxpayer's purposes. If tax savings are only ancillary to the relevant economic result, then the relevant tax consequences shall be determined by reference to the form of the relevant transaction. However, where the taxpayer's actions were aimed solely to reduce the amount of its tax payments rather than to achieve an economic result, this would demonstrate that the relevant transaction was inconsistent with law because the motive underlying such transaction was to avoid tax.
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> . . .
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> The expression "good faith of the parties to a transaction" is closely related to the expression "good faith taxpayer" which was used by the Constitutional Court of the Russian Federation twice in the opinion section of Resolution No. 24-P dated 12 October 1998. In other words, in the context of the Resolution, the expression "good faith of the parties to a transaction" was used in its public legal meaning. A person's actions aimed solely at tax evasion may not be regarded as actions made in good faith.
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> . . .
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> If the parties to a transaction act reasonably, i.e., if they aim to achieve the actual business result and also choose such line of action which leads to minimal tax loss, then the parties' tax liabilities should be determined formally.
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> . . .
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> lf it appears that parties act both unreasonably and not in good faith then this constitutes a ground for reassessment of the parties' tax liabilities for which various mechanisms can be used. Upon a claim brought by the tax authorities the actual relations between the parties may be assessed by court[s]. The substance of such court proceedings would be an examination of whether the actions of the relevant parties were aimed at achievement of business (economic) results or whether the idea of tax saving was the prevailing idea. . . .[188]

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187 Second Konnov Report ¶ 12(c).

188 S.G. Pepeliaev, *Commentary to the Ruling of the Constitutional Court Ruling of the Russian Federation No. 138-O of July 25, 2001*, Exh. R-352.

319. The Tribunal concludes that, in respect of the period relevant for the Yukos tax assessments and decisions, while the "bad faith taxpayer" doctrine had not yet gelled in the way that it did in 2006, in Resolution No. 53, it had already been recognized and applied in some Russian court decisions. This conclusion, while based primarily on the Tribunal's review of the cases,[189] is also supported by the cross-examination of Mr. Konnov at the Hearing, as explained in the following paragraphs.

320. In his cross-examination of Mr. Konnov, Professor Gaillard focused on the sanction that the Russian Federation imposed on Yukos in the present case, rather than on the existence of any anti-abuse doctrine *per se*.

321. Mr. Friedman emphasized the limited scope of Claimants' cross-examination of Mr. Konnov during his re-direct examination of the witness:

> MR FRIEDMAN: Just to make sure I am clear, Mr Konnov, you understood the questions yesterday to be about the remedy that's applied based on the anti-abuse doctrine, as opposed to the substance of the anti-abuse doctrine?
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> A. I thought that Professor Gaillard limited his question—and the Tribunal did the same thing—very specifically to the attribution; which I explained—and I think the record said that—that I don't view that as a separate instrument. But I was nevertheless asked the question about court cases with respect to attribution.[190]

322. As Claimants had stipulated to the existence of the bad-faith taxpayer doctrine (while contesting the scope and manner of its application), they instead implied in their argument that any such doctrine was irrelevant, since formal compliance with the legislation governing the low-tax benefits in the respective regions, including fulfilment of the terms of any applicable investment agreements, was sufficient to claim the tax benefits.[191]

323. Accordingly, in his cross-examination of Mr. Konnov, Professor Gaillard stressed the compliance of Yukos' tax scheme with the existing legislative framework. In his answer, Mr. Konnov, while acknowledging that the formal requirements of the law may have been met, reiterated the relevance of the anti-abuse doctrine:

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189 The Tribunal also observes that the ECtHR, in its separate judgments relating to the claims against the Russian Federation brought by Yukos and Messrs. Khodorkovsky and Lebedev, respectively, considered the relevant domestic (*i.e.*, Russian) law and practice, including the Russian courts' case-law on substance over form and related doctrines. *See* ECtHR Yukos Judgment ¶¶ 428–68; *Khodorkovsky v. Russia (2)* ¶¶ 422–28.

190 Transcript, Day 15 at 193–94.

191 Reply ¶¶ 148–64.

Q. So what you are saying is that the Law is not a good law, right? The Law which gives the regions the power to negotiate their taxes downwards in exchange for contributions to their fund is not a good law? The system is not good, as far as—

A. No, I am not saying that at all. I am not saying that at all. I am saying that what was done in this case, it was an abuse of law. So the Law was applied by Yukos in such an abusive manner so that, in violation of the constitutional principles which I've summarized in my report, Yukos did not pay taxes duty in Moscow. It used this whole fraudulent sham arrangement, with the use of the Mordovian companies, to evade taxes in Moscow.[192]

324. Mr. Konnov's insistence on the relevance of the anti-abuse doctrine, notwithstanding Yukos' compliance with the strict letter of the law, can also be seen in the following extract of his cross-examination by Professor Gaillard:

Q. What do you call the proportionality principle? Is it the proportionality between the investment and the benefits?

A. Correct.

Q. Right. Is this—I will use the words "proportionality principle" within your meaning, what you just said, right? Is this proportionality principle found in the black letter of the Law of Mordovia; yes or no?

A. No. As I said—

Q. Okay.

A. —neither in Mordovia, nor in Kalmykia, nor in any other jurisdictions.

Q. Fine. And we have seen that in the agreements regarding the ZATOs, the trading companies had agreed to contribute to a fund 5% of their tax benefits. We have seen that earlier, yesterday or this morning, right?

A. Right.

Q. Okay. Now, going back to the Sibirskaya case, in the Sibirskaya case we have a decision of first instance where the taxpayer won; correct?

A. As I recall, correct.

Q. Right. And in the Court of Appeal the taxpayer lost, and it had to do with the Law of Kalmykia; correct?

A. No. No. There was no—again—

Q. But it was a Kalmykian company

. . .

A. No, it was not based on the Kalmykian Law. Obviously Sibirskaya was governed by Kalmykian Law; obviously Kalmykian Law did apply to it, to the same extent Mordovian Law applied to companies registered in Mordovia. But the assessment was based on the proportionality principle, which, as we discussed, is not found—I think you used the words—in the black letters of the Law.[193]

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192 Transcript, Day 13 at 151–52.

193 Transcript, Day 14 at 218–220.

325. Having completed its review of what it considers to be the central evidence in the record in respect of the legal framework applicable to the Yukos tax optimization scheme under Russian law, the Tribunal now turns to the complex factual matrix involving Yukos' trading entities in the low-tax regions.

4. The History of the Yukos Trading Entities before 2003

326. In the present proceedings, the Parties vigorously debated the significance of the history of the Yukos trading companies, including various tax audits that took place before 2003. The pertinent activities of Yukos' trading companies took place in the regions of Mordovia and Kalmykia, as well as in the ZATOs of Lesnoy and Trekhgorny. The Tribunal will now summarize these activities and the results of the many tax audits which were issued.

(a) Mordovia

327. Mordovia is a region within the Russian Federation. Sometimes referred to as a "domestic offshore territory", in the late 1990s it was granted some autonomy as regards taxation, which made it a more attractive destination for investment and business operations.[194] This was part of a broader plan by the Russian Government in the 1990s to foster economic development in areas designated as "economically underdeveloped".[195] As noted earlier, the special exemption plan for domestic offshore territories was largely repealed as of 1 January 2004.[196]

328. On 9 March 1999, the *Law of the Republic of Mordovia No. 9-Z* ("***Law 9-Z***") was enacted.[197] *Law 9-Z* was the framework which allowed Mordovia to offer tax benefits to corporate entities operating in the region. Article 4.4 of the law states that "[t]he Government of the Republic of Mordovia shall determine the order and terms and conditions of granting the tax benefit under this Law, as well as the order of keeping reports and records to be able to obtain the tax benefits listed in this Law."[198]

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194 Transcript, Day 1 at 45–48.

195 Respondent Opening Statement, Day 2 at 109.

196 *See* paragraphs 77 and 283 above; First Konnov Report ¶ 33.

197 *Law 9-Z*, Exh. C-414.

198 *Ibid*.

329. Mr. Vladimir Dubov, a member of the Yukos management board[199] and later a member of the State Duma for the Upper Volga region (which includes Mordovia), was the primary point of contact between Yukos and the regional and federal taxation authorities in Mordovia. He appeared as a witness on behalf of Claimants.

330. In his witness statement, Mr. Dubov stated the following:

- On 20 December 1999, he attended meetings in Mordovia to explain Yukos' plan to operate through trading companies in Mordovia. He met with Mr. Nicolai Merkushkin, the head of the Republic of Mordovia; Mordovian Prime Minister Vladimir Volkov,; and Mordovian Deputy Prime Minister Vladimir Ruzhenkov, who was also Head of the Administration of the Government of Mordovia. Mr. Dubov swears that "[a]ll terms and conditions associated with the use of trading companies in the Republic of Mordovia were discussed and agreed at the meeting, including that Yukos' trading companies would pay [80 million rubles] per month to the Republic." He stated that the Mordovian authorities "fully approved" of the plan.[200]

- In late December 1999, he met with the Tax Minister of the Russian Federation, Mr. Alexander Pochinok, and Mr. Alexander Smirnov, one of Mr. Pochinok's deputy ministers, to discuss Yukos' plan to use trading companies in the Republic of Mordovia. Mr. Smirnov was very interested and called the head of the Special Inspectorate for Major Taxpayers, Mr. Aslambek Pasckachev, and the head of the Oil Department within the special inspectorate, Ms. Lydia Smirnova, into the in the meeting, to ask them to analyze the beneficial taxation plan.[201]

- After that meeting, he spoke with Mr. Gusev, First Deputy Minister in charge of the VAT Department, to discuss Yukos' plan. He thought this important as "it was obvious to me that any trading companies established in Mordovia would be claiming significant VAT refunds on the export of oil and oil products."[202] He also spoke with Ms. Olga Serdiuk,

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199 Transcript, Day 5 at 14.

200 Dubov WS ¶¶ 20–21.

201 *Ibid*. ¶¶ 22–23.

202 *Ibid*. ¶ 24.

then Deputy Head of the Indirect Taxes Department and one of the three deputy First Ministers, Mr. Kirill Ugolnikov.[203]

- Around late December 1999 or January 2000, he met with each of the deputy First Ministers at the Tax Ministry and at the Menatep office on Kolpachniy Lane to outline the plan for the Mordovian companies. Following these meetings, Mr. Smirnov called the Head of the Regional Department of the Tax Ministry in Mordovia, Mr. Aleksey Averiasov, in Mr. Dubov's presence, to inform him that such discussions had taken place and that Yukos had been "given the green light at the Ministry level for the use of trading companies in the region."[204]

- He met with the then First Deputy Minister of Finance (later Minister of Finance and Deputy Prime Minister), Mr. Alexei Kudrin at the Ministry of Finance in January 2000. They discussed establishing Yukos trading companies in Mordovia so that Yukos could take advantage of tax benefits available in the region and that Yukos' trading companies would be able to contribute to the regional economy through fixed monthly payments. Mr. Dubov recalls that "Alexei Kudrin consented to Yukos' proposal, with the proviso that Yukos' overall tax burden should essentially remain the same."[205]

331. When he was cross-examined, Mr. Dubov repeated his statement that he told Mr. Kudrin that Yukos was planning to work in Mordovia through trading companies, as well as "which taxes it will pay in each level of national budget, which preferences would the budgets provide for Yukos, what benefits Yukos would reap from these preferences and what amounts would be paid in[to] the federal budget, and if there were any issues, how they were going to be resolved."[206]

332. Mr. Dubov concludes in his witness statement that, after these meetings, "[i]t follows that all the relevant authorities, both federal and regional, including the Minister of Taxation, his first Deputies, and the First Deputy Minister of Finance were aware of, cooperated with and approved of Yukos' plan to operate through the trading companies in the Republic of Mordovia

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203 *Ibid*.

204 *Ibid*. ¶ 25.

205 *Ibid*. ¶ 26. It is common ground between Claimants and Respondent (hereinafter "the Parties") that the point of Yukos' tax arrangements was to lower its tax burden, not to keep it at the level it would have been at without resort to them.

206 Transcript, Day 5 at 84.

to take advantage of the favorable tax climate."[207] In Mr. Dubov's view, this was favorable both for Mordovia and the Russian Federation, as any improvement in the financial situation of Mordovia would decrease the burden it placed on the federal budget. According to Mr. Dubov, "[t]he Russian Federation was clearly interested in decreasing the significant disparities in well-being between the regions [of the Federation]."[208]

333. The record reveals that, as the trading companies began operations, VAT refunds to the companies were very significant. In fact, VAT refunds to the trading companies often exceeded the total amount of VAT collected in Mordovia from all the other companies operating on its territory. The regional section of the Federal Treasury therefore had to transfer the necessary funds to the Tax Ministry's regional VAT Department. This decision to transfer funds, according to Mr. Dubov, had to be taken at the federal level, including obtaining the approval of the Ministry of Finance.

334. During his cross-examination, Mr. Dubov explained that "[w]hen, as a result of the operations of the trading companies, the VAT refunds increased many times over, many fold, by many hundreds of per cent, the Tax Ministry department asked the question why[;] the Tax Ministry, the Tax and Charges Ministry for Mordovia replied that we have Yukos trading entities incorporated here, these have to do with the Yukos exports; that is why the VAT refunds are so high."[209] He also stated that "[t]his is exactly why, before the scheme became operational, I had cleared [it] with the head of the department and the First Deputy Minister who was in charge of this department."[210]

335. In addition, in his witness statement, Mr. Dubov affirms that the funds paid into the Mordovian budget were used to fund various projects, such as Internet House, an internet-training center, and the rebuilding of the Saransk Airport. In 2001, according to Mr. Dubov, several dignitaries, including President Vladimir Putin, repeatedly visited the area (using the airport) and discussed the trading companies' work in the region. Mr. Dubov states: "During such visits, President Putin was told by Nicolai Merkushkin, the Head of the Republic of Mordovia, and other representatives of the Republic of Mordovia, about the social, cultural and industrial projects that had been developed in the region in the previous year through the support and

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207 Dubov WS ¶ 27.

208 *Ibid.* ¶ 29.

209 Transcript, Day 5 at 149–50.

210 Transcript, Day 5 at 150.

cooperation of Yukos."[211] Mr. Dubov also recalls that President Putin had been told about several other improvement projects funded by Yukos' support, such as the building of plants for machinery construction, construction materials and the production of optic fiber; the realization of a number of environmental projects such as the recycling of rotten wood and raw materials; the rehabilitation of the meat industry; reconstruction of the Saransk Theatre and Saransk Art Museum; the construction of two asphalt plants just outside of Saransk; and the reconstruction of the Saransk-Moscow highway.[212]

336. Mr. Dubov concludes that "[i]t follows that the federal authorities, who had to authorize the VAT refund, as well as any subsequent transfer of funds, were fully aware of Yukos' trading structure, including the activities of the production and trading companies and the transactions between them."[213]

337. The Tribunal notes that during his cross-examination, Mr. Dubov could not confirm that the VAT forms submitted by the trading companies to the Tax Ministry contained the full particulars as to how the tax optimization scheme was being implemented by Yukos. This was because, as he said, he was not familiar with the specifics of the VAT submissions although he knew that they would be submitted to the Leninsky district of Saransk (Mordovia) and they were likely to be very large.[214] It seems unlikely to the Tribunal that such information would have been disclosed in the VAT forms, as the tax benefits of the low-tax regions did not extend to VAT.

338. During his cross-examination, Mr. Dubov affirmed that he only discussed with Mr. Kudrin "the general scheme", not the formalities or the details of the activities of the trading companies.[215] The Tribunal further notes that in his witness statement, Mr. Dubov asserts that "[p]rior to the attacks on Yukos, which began in the Summer of 2003, the Russian authorities never challenged the legality of this structure or the materiality of the facts underlying this structure."[216] During his cross-examination before the Tribunal, he stated that he had no

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211 Dubov WS ¶ 33.

212 *Ibid.* ¶ 33; Memorial ¶ 711.

213 Dubov WS ¶ 44.

214 Transcript, Day 5 at 152–54.

215 Transcript, Day 5 at 81–83.

216 Dubov WS ¶ 12.

knowledge of the use of the ZATO Lesnoy companies,[217] and in light of such testimony, Mr. Dubov's evidence must be understood as being limited to Yukos' activities in Mordovia.

339. In the following subsections, the Tribunal will review the detailed information that was presented to it regarding the trading companies incorporated in Mordovia.

i. Alta-Trade (Mercury XXIII)

340. Alta-Trade was incorporated on 17 December 1999 as Mercury XXIII pursuant to the resolution of a meeting of the company's founders, Polikant ZAO and A-Trust OOO, each with a 50 percent [RUR 5,000] stake in the share capital. In March 2001, Nefteinvest OOO became a shareholder, taking a 2 percent (RUR 200) share in the company's share capital.[218] In August 2001, Yukos-Import OOO acquired the shares of Polikant ZAO and A-Trust OOO, and became the owner of 98 percent of the share capital (RUR 9,800).[219]

341. On 27 June 2001, Alta-Trade concluded an investment agreement with Mordovia, which was supplemented in March 2002.[220]

342. The record reveals two decisions by the Saransk Tax Inspectorate in 2001 where Alta-Trade was denied the right to offset the VAT in respect of some of its activities. The decision of 15 June 2001 notes that Alta-Trade is "an enterprise producing oil products and selling its output domestically and [abroad]," that it purchases crude oil from Yu-Mordovia, and that sales are made through OAO NK Yukos and ZAO Trading House Angarsk-Nefto as commission agents.[221] The decision of 29 October 2001 refers to transactions with, for example, Siberian Transportation Company and noted that the commission agent was Yukos Export Trade.[222] Thus, this information pertinent to the activities of Alta-Trade in Mordovia and linking Alta-Trade to the Yukos "family" was known to the authorities as early as 2001.

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217 Transcript, Day 5 at 101–102.

218 Field Tax Audit Report No. 08-1/1 of OAO Yukos Oil Company, 29 December 2003 p. 34, Exh. C-103 (hereinafter "2000 Audit Report").

219 *Ibid*. pp. 34–35.

220 Investment Agreement No. 5, 27 June 2001, as supplemented, Exh. C-1114.

221 Decision of the Inspectorate of the Ministry of Taxes and Levies of the Russian Federation for the Leninsky District of Saransk No. 23, 15 June 2001, Exh. C-1110.

222 Decision of the Inspectorate of the Ministry of Taxes and Levies of the Russian Federation for the Leninsky District of Saransk No. 48, 29 October 2001, Exh. C-1116.

343. In April 2002, Alta-Trade's first ever field tax audit was conducted. It covered the year 2000.[223] The report from that audit noted the tax-benefit structure under Law 9-Z and the investment agreement between Mordovia and Alta-Trade. It noted that Alta-Trade was engaged in "crude oil refining [through intermediaries], sale of crude oil and oil products in the domestic market, as well as for export."[224] It noted the tax benefit structure under Law 9-Z,[225] and that the company had no capital assets on its balance sheet.[226] It also noted that Alta-Trade's accounting and tax services were completed by Yukos Invest.[227] The Audit Report found no violation of any tax laws.[228]

344. As will be seen in the next chapter, tax reassessments would eventually be made against Yukos for Alta-Trade for the years 2000,[229] 2001,[230] 2002[231] and 2003,[232] totaling RUR 7,143,036,557 (approximately. USD 238,101,219).[233]

ii. Fargoil

345. Fargoil was registered with state authorities on 23 May 2001. The sole founder of Fargoil was Mikhail Nikolayevich Silayev, who owned 100 percent of the share capital (RUR 10,000). On 25 May 2001, he transferred full ownership of the shares to Nassaubridge Management Limited, a company incorporated in Cyprus, for RUR 11,000.[234]

346. According to the Ministry of Taxation, "[i]n order to get the opportunity to have dividends taxed at a 5% rate, Nassaubridge Management Limited, pursuant to Article 10 of the

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223 Field Tax Audit Report No. 02-52 of OOO Alta Trade, 19 April 2002 ¶ 2.3, Exh. C-1120.

224 *Ibid.* ¶ 1.7.

225 *Ibid.* ¶ 2.8.

226 *Ibid.* ¶ 2.5.

227 *Ibid.* ¶ 2.2.

228 *Ibid.* ¶ 2.5. However, there was a 500 ruble (Approx. USD 17) fine for Alta Trade's Director because of incomplete presentation of all required documents.

229 Decision No. 14-3-05/1609-1, 14 April 2004 pp. 26–27, Exh. C-104 (hereinafter "2000 Decision").

230 Decision No. 30-3-15/3, 2 September 2004 p. 55, Exh. C-155 (hereinafter "2001 Decision").

231 Decision No. 52/896, 16 November 2004 p. 101, Exh. C-175 (hereainfter "2002 Decision").

232 Decision No. 52/95, 6 December 2004 p. 56, Exh. C-190 (hereinafter "2003 Decision").

233 Fiscal Years 2000–2004, Breakdown of the tax reassessments against Yukos by region or ZATO and company, excluding interest and fines p. 6, Exh. C-1752 (hereinafter "Yukos Tax Reassessment Breakdown"). The RUR to USD exchange rate is approximate, based on a rate of 30:1.

234 2002 Decision, p. 106, Exh. C-175.

Agreement between the Government of the Russian Federation and the Government of the Republic of Cyprus on Avoidance of Double Taxation of Income and Capital of 5 December 1998, made a direct investment in Fargoil OOO capital, equivalent to USD 120,000 (Bank Payment Order No. 1 of 7 February 2002, issued by Nassaubridge Management Limited, worth 3,590,000 paid as a share capital contribution based on an application of 31 January 2002)."[235] Fargoil's accounts were prepared by Yukos Financial Accounting Centre OOO.[236]

347. An investment agreement was concluded between Fargoil and Mordovia on 27 June 2001, and supplemented on 26 March 2002.[237] In April 2002, a report of the Directorate on Implementation of the special-development program was issued pursuant to that agreement, which indicated that Fargoil had contributed over RUR 102 Million to the region.[238]

348. In September 2003, a Field Tax Audit Report for 2001 to 2002 was issued. It found no violation of Article 40 of the Russian Tax Code; but did find some underpayments, resulting in an order to Fargoil to pay additional road tax and income tax in the amount of RUR 590,847,939 (USD 19.7 Million). Notably, the report concluded that "Fargoil lawfully used exemptions applicable to all taxes under review."[239]

349. Tax reassessments would eventually be made against Yukos for Fargoil for the years 2001,[240] 2002[241] and 2003,[242] totaling RUR 130,243,731,762 (approximately USD 4,341,457,725).[243] The Tribunal notes this was by far the largest of the tax reassessments levied against any one of the trading companies.

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235 *Ibid.*

236 *Ibid*. p. 107.

237 Investment Agreement No. 9, 27 June 2001, as supplemented, Exh. C-1142.

238 Report of the Directorate on Implementation of the Republic's Special-Purpose Development Program of the Republic of Mordovia for 2001–2005 on the Use of Investments Received from OOO Fargoil under Investment Agreement No. 9 of June 27, 2001 for the Year 2001, 15 April 2002, Exh. C-1118.

239 Field Tax Audit Report No. 02-105 of OOO Fargoil, 3 September 2003 ¶ 2.16, Exh. C-1124.

240 2001 Decision, pp. 110–11, Exh. C-155.

241 2002 Decision, pp. 123–24, Exh. C-175.

242 2003 Decision, pp. 76–77, Exh. C-190.

243 Yukos Tax Reassessment Breakdown p. 6, Exh. C-1752. The RUR to USD exchange rate used here is based on a rate of 30:1.

iii. Macro-Trade

350. Macro-Trade was incorporated on 14 May 2001. The sole founder and chief accountant of Macro-Trade was Ms. Gulnura Karimovna Zhukova, who was also the founder and director of Mega-Alliance OOO. Pursuant to a resolution of 24 May 2002 and amendments to the charter of Macro-Trade on 22 October 2002, her shareholding was transferred, in equal 50 percent shares, to Conbrook Limited (LLC) and Silverdale Trading Limited (LLC), both registered in Cyprus. On 16 December 2002, Macro-Trade's share capital was increased to RUR 7,700,000 and "was formed by a deposit of cash assets into the entity's current account from an account at Trust and Investment Bank JSCB on 20 December 2001 [*sic*]."[244]

351. Ms. Zhukova submitted a statement in court proceedings in Moscow in May of 2005 in which she alleged that she knew nothing about becoming a director of Macro-Trade and that her name was on the books of the company as a result of a fraud. She stated that in December 1998 or early 1999, her purse with her passport had been stolen. She stated that she did not report the theft because the passport was returned at the end of January 1999.[245] Mr. Konnov, in his first expert report, referred to Ms. Zukhova's statement.[246] When Professor Gaillard cross-examined Mr. Konnov on this "story", Professor Gaillard pointed out that Macro-Trade was incorporated in May 2001, more than two years *after* Ms. Zukhova's passport was returned to her.[247]

352. An investment agreement was concluded between Macro-Trade and Mordovia, exempting the company from paying property tax and corporation profit tax payable to the republican and local budgets of the Republic of Mordovia.[248]

353. Tax reassessments would eventually be made against Yukos for Macro-Trade for the years 2003[249] and 2004,[250] totaling RUR 841,582,281 (approximately USD 28,052,743).[251]

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244 2003 Decision, p. 93, Exh. C-190.

245 Application by the Russian Federal Tax Service's Inter-District Inspectorate No. 1 for Major Taxpayers to the Federal Arbitrazh Court for the Moscow District, 4 May 2005 pp. 15–16, Exh. R-257; Transcript, Day 13 at 38.

246 First Konnov Report ¶ 20, n.20.

247 Transcript, Day 13 at 39.

248 2003 Decision, p. 100, Exh. C-190.

249 *Ibid*. pp. 100–01.

250 Decision No. 52/292, 17 March 2006, p. 86, Exh. R-1539 (hereinafter "2004 Decision").

251 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

iv. Mars XXII (Energotrade)

354. Mars XXII was incorporated on 17 December 1999. The founders were OOO Akra, registered in the Kaluga Region, and Renmet ZAO, registered in Moscow, both with equal shares of 50 percent (RUR 5,000).[252] Renmet ZAO is also a founder of Elbrus OOO, which had a 20 percent holding in the share capital of Yu-Mordovia and Yukos-M. Ms. Tatiana Subbotina was one of the directors of Mars XXII. In a witness statement of 18 May 2004, Ms. Subbotina affirmed that, while she was formally in charge of the company, she only signed documents and did not know whether any investment agreements were concluded by Mars-XXII.[253] According to its charter, the main activities of Mars XXII were the production and wholesale sale of oil products in the internal market and for export.[254]

355. The Tribunal notes that an investment agreement was concluded between Mars XXII and Mordovia on 27 June 2001, and supplemented on 26 March 2002.[255]

356. On 27 December 2001, a decision was issued by the Saransk Tax Inspectorate on "a Partial Refusal to Refund (Offset) VAT Amounts." The decision notes that the commission agent for the export transactions is OAO NK Yukos. The decision refers to oil prices as well as a chain of VAT transactions, and notes that the suppliers of the crude oil at issue were Ratmir and Norteks.[256] Again, this information linking Mars XXII to the Yukos "family" was known to the authorities as early as 2001.

357. In October 2003, a Field Tax Audit Report was issued for 2000 to 2002. It specifically stated that the "terms and conditions for applying the special taxation procedure have been complied with."[257] Some minor violations were found, however, with respect to personal income and profit taxes. The decision specifically noted that Mars XXII used Yukos FBTs for all of their accounting services.[258]

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252 2000 Audit Report, p. 20, Exh. C-103.

253 First Konnov Report ¶ 20, n.20 (citing Witness Statement of Subbotina T.G. (Protocol No. 431la, 18 May 2004), Exh. R-258)

254 2000 Audit Report, p. 21, Exh. C-103.

255 Investment Agreement between Mars XII and Mordovia, 27 June 2011, Exh. C-1111.

256 Decision of the Inspectorate of the Ministry of Taxes and Levies of the Russian Federation for the Leninsky District of Saransk No. 53, 27 December 2001, Exh. C-1117.

257 Field Tax Audit Report No. 02-126 of Mars XXII, 22 October 2003, p. 4, Exh. C-1125.

258 *Ibid*. p. 2.

358. Tax reassessments would eventually be made against Yukos for Mars XXII (Energotrade) for the years 2000,[259] 2001,[260] 2003[261] and 2004,[262] totaling RUR 55,959,738,409 (approximately USD 1,865,324,614).[263]

v. Ratmir (Pluton XXVI)

359. Ratmir was incorporated on 17 December 1999. Ratmir was originally incorporated under the name of Pluton XXVI OOO. The founders of Ratmir were Gem OOO, with an 18 percent share (RUR 1,800); Sonata OOO, with an 80 percent share (RUR 8,000); and Nefteinvest OOO with a 2 percent (RUR 200).[264] All of the founders were registered outside of Mordovia..[265] Sonata also founded Yu-Mordovia, and maintained a 20 percent stake in that company.

360. Ratmir's accounts were managed by Yukos-Invest.[266] According to the Tax Ministry, "Ratmir OOO bought and sold crude oil, gas condensate, oil products, petrochemical products, and subsequently sold oil products and petrochemical products for export."[267]

361. An investment agreement was concluded between Ratmir and Mordovia on 27 June 2001 and was supplemented on 26 March 2002.[268]

362. In April 2002, a Field Tax Audit Report was issued for the year 2000.[269] It noted that there were no capital assets on the balance sheet (no physical facilities to store oil); and that Ratmir was exempt from property and profit tax pursuant to *Law 9-Z*.[270] It found only a few minor

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259 2000 Decision, , p. 14, Exh. C-104.

260 2001 Decision, pp. 122–23, Exh. C-155.

261 2003 Decision, pp. 91–92, Exh. C-190.

262 2004 Decision, pp. 80–81, Exh. R-1539.

263 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

264 2000 Audit Report, p. 55, Exh. C-103.

265 *Ibid*.

266 *Ibid*. p. 56.

267 *Ibid*.

268 Investment Agreement No. 26 between Mordovia and OOO Ratmir, 27 June 2001, as supplemented, Exh. C-1115.

269 Field Tax Audit Report No. 02-51, 19 April 2002, Exh. C-1119.

270 *Ibid*. pp. 2, 4, 5.

violations and ordered the company to pay RUR 43,299 (approximately USD 1,440) in relation to the profit tax[271]

363. In October 2002, a Field Tax Audit Report was issued for the year 2001. It noted that Ratmir was enjoying benefits under the Mordovian tax law, including the exact amounts involved. It found no violations of any tax laws. The report also noted that Ratmir's accounting reports were managed by Yukos FBTs.[272] This information linking Ratmir to the Yukos "family" was known to the authorities in 2002.

364. Tax reassessments would eventually be made against Yukos for Ratmir for the years 2000,[273] 2001,[274] 2002,[275] and 2003,[276] totaling RUR 12,373,090,752 (approximately USD 412,436,359).[277]

vi. Yukos-M

365. Yukos-M was incorporated on 20 January 2000 and registered on 24 January 2000. When it was founded, its share capital was divided into 24 ordinary, registered shares, each with a nominal value of RUR 400 (96 percent of the company's share capital) and 1 registered preference share with a nominal value of RUR 400 (4 percent of the company's share capital). Elbrus owned 23 ordinary registered shares, totaling RUR 9,200 or 92 percent of the share capital. OAO Yukos Oil Company owned one registered preference share with a nominal value of RUR 400 or 4 percent of the share capital and one ordinary registered share with a nominal value of RUR 400 or 4 percent of the share capital (for a total of 8 percent of the share capital). The Tribunal notes that Elbrus and Yukos Oil Company were also co-founders of Yu-Mordovia OOO, each with 20 percent of the share capital.[278] On 22 December 2000, "OAO Yukos Oil Company became the company's sole shareholder (owner of 100% of the company's ordinary and preference shares)".[279] Yukos-M's accounts were managed by Yukos-Invest.[280] According

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271 *Ibid*. p. 8. The RUR to USD exchange rate used here is approximate based on a rate of 30:1.

272 Field Tax Audit Report No. 02–144 of OOO Ratmir ¶ 2.1, 16 October 2002, Exh. C-1121.

273 2000 Decision, p. 49, Exh. C-104.

274 2001 Decision, pp. 42–43, Exh. C-155.

275 2002 Decision, p. 105, Exh. C-175.

276 2003 Decision, pp. 60–61, Exh. C-190.

277 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

278 2000 Audit Report, p. 41, Exh. C-103.

279 *Ibid*.

to the charter documents, in the year 2000, the company was engaged in the sale of crude oil on the domestic and export markets.[281]

366. Yukos-M and Mordovia entered into an investment agreement on 27 June 2001, which was later supplemented on 26 March 2002.[282]

367. In April 2002, a Field Tax Audit Report was issued for the year 2000, but this document is not in the record. In October 2002, a Field Tax Audit Report was issued for 2001. It noted the tax benefits accruing to Yukos-M under *Law 9-Z* and the investment agreement between Mordovia and Yukos-M. It specifically mentioned that for the period under review, Yukos-M engaged in domestic and export sales of crude oil as well as other activities, and found no violation of any tax law.[283]

368. Tax reassessments would eventually be made against Yukos for Yukos-M for the years 2000,[284] 2001,[285] 2002[286] and 2003,[287] totaling RUR 29,519,084,452 (approximately USD 983,969,482).[288]

vii. Yu-Mordovia

369. Yu-Mordovia was incorporated on 2 December 1999 and registered on 17 December 1999. The sole founder of Yu-Mordovia OOO was OAO Yukos Oil Company.[289] On 17 January 2000, amendments were made to Yu-Mordovia's charter regarding the identity of the founders, the value of the share capital and the number of shares. The following each had a 20 percent (2.0) share in the share capital: OAO Yukos Oil Company, Sonata OOO, Elbrus OOO, Stekloprommash ZAO and A-Trust OOO.[290] The shareholders were registered outside

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280 *Ibid.*

281 *Ibid.* p. 42.

282 Investment Agreement Between Mordovia and Yukos-M, 27 June 2001, as supplemented, Exh. C-1112.

283 Field Tax Audit Report No. 02-145 of ZAO Yukos-M, 16 October 2002, pp. 2–4 Exh. C-1122.

284 2000 Decision, , p. 35, Exh. C-104.

285 2001 Decision, pp. 64–65, Exh. C-155.

286 2002 Decision, pp. 96–98, Exh. C-175.

287 2003 Decision, pp. 48–49, Exh. C-190.

288 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

289 2000 Audit Report, p. 51, Exh. C-103. According to Exhibit C-103, the incorporation of Yu-Mordovia OOO was authorized at the meeting of the Board of Directors of OAO Yukos Oil Company by Resolution No. 120/1-19 of 2 December 1999.

290 *Ibid.* pp. 51–52.

Mordovia, either in the Tyumen Region (OAO Yukos Oil Company) or Moscow (the remaining four shareholders).[291] Yu-Mordovia and Mordovia entered into an investment agreement on 27 June 2001, which was later supplemented on 26 March 2002.[292]

370. The company's tax assessment, sent to the tax authorities in Saransk, Mordovia on 30 July 2001, described the details of the tax arrangement between Yu-Mordovia and Mordovia, including the tax on actual profit for the first half of 2001, with precise amounts of the benefits enjoyed and amounts paid under the Mordovian law.[293]

371. Tax reassessments would eventually be made against Yukos for Yu-Mordovia for the years 2000,[294] 2001,[295] 2002[296] and 2003,[297] totaling RUR 21,018,327,538 (approximately USD 700,610,918).[298]

(b) Kalmykia

372. Kalmykia is a low-tax region in Russia. Only one trading company was based there, Siberian Transportation Company (Sibirskaya), registered in 1998. Kalmykia was authorized to offer tax benefits under the *Law of the Republic of Kalmykia No. 12-II-Z on Tax Benefits Granted to Enterprises Making Investments in the Economy of the Republic of Kalmykia* of 12 March 1999.[299] Aimed at "further enhancement of the investment climate" in the region, the law was designed to offer exemptions from certain local taxes and corporate taxes to companies making investments in the region.[300]

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291 *Ibid*. p. 52.

292 Investment Agreement No. 24 Between Mordovia and OOO Yu Mordovia, 27 June 2001, Exh. C-1113.

293 Attachment No. 9 to Instruction of the Ministry of Taxes and Levies of the Russian Federation No. 62 of 15 June 2000, 30 July 20001, Exh. C-1747.

294 2000 Decision, pp. 44–45, Exh. C-104.

295 2001 Decision, pp. 80–81, Exh. C-155.

296 2002 Decision, p. 90, Exh. C-175.

297 2003 Decision, p. 43, Exh. C-190.

298 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

299 *Law of the Republic of Kalmykia No. 12-II-Z On Tax Benefits Granted to Enterprises Making Investments in the Economy of the Republic of Kalmykia*, 12 March 1999, Exh. C-413.

300 *Ibid*.

i. Siberian Transportation Company (Sibirskaya)

373. Sibirskaya was founded by Step ZAO, registered in Kaluzhskaya Region, and Polinep ZAO, registered in Moscow, both holding 50 percent shares.[301] The Tribunal notes that Polinep ZAO was also a founder of Sonata OOO and Elbrus OOO, which were founders of Yu-Mordovia OOO and Yukos-M ZAO.[302]

374. Sibirskaya received tax benefits under the *Law of the Republic of Kalmykia No. 12-II-Z* of 12 March 1999 referred to above and the *Resolution of the Elista Municipal Assembly No. 7* of 25 January 2001.[303]

375. In September 2001, a resolution was issued by the Inspectorate of the Ministry of Taxes and Levies of Russia (Elista). It found that the Siberian Transportation Company was ineligible for the tax benefits applied to it in the autonomous region.[304] On the same day, a tax payment demand was issued to recoup the costs of the inappropriately applied benefits, in the amount of RUR 6,918,617 (approximately USD 230,000).[305]

376. In December 2001, the Arbitrazh Court of the Republic of Kalmykia ruled that the tax incentives were, in fact, *lawfully* applied to the Siberian Transportation Company and the resolution and payment demand were declared invalid. In addition, the court specifically stated that it had not found any evidence that the company had acted in bad faith or that it abused its rights.[306] The Inspectorate of the Ministry of Taxes and Levies of Russia (Elista) appealed the December 2001 judgment. The court of appeal upheld the decision of the lower court,

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301 2000 Decision, p. 8, Exh. C-104.

302 *Ibid*.

303 *Law of the Republic of Kalmykia No. 12-II-Z*, 12 March 1999, Exh. C-413. The resolution is referred to in Exh. R-311. As is the case with many of the documents referred to below, although the existence of this particular document (the resolution) is evidenced by a reference in an exhibit that is in the record, the resolution itself is not in the record. Claimants have criticized Respondent for failing to provide a complete record of the pre-2003 audits and related documents.

304 Resolution of the Federal Arbitrazh Court of the North-Caucasian District, Case No. F08-1678/2002-614A, 20 May 2002, Exh. R-311 (referring to Resolution No. 01-24/2261 of the Inspectorate of the Ministry of Taxes and Levies of Russia, 25 September 2001).

305 *Ibid*. (referring to *Tax payment demand No. 01-23/2261*, 25 September 2001). The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

306 *Ibid*. (referring to Decision of the Arbitrazh Court of the Republic of Kalmykia, Case No. A22-1306/2001-6/129, 5 December 2001).

affirming that the resolution and the payment demand were invalid. The court of appeal found no bad faith on the part of the Siberian Transportation Company.[307]

377. The Inspectorate of the Ministry of Taxes and Levies of Russia (Elista) appealed this decision to the Federal Arbitrazh Court of the North-Caucasian District. The Federal Arbitrazh Court reversed the decisions of the lower courts and ruled that the Siberian Transportation Company was not eligible for the benefits and that the company had acted in bad faith. The resolution and the payment demand therefore became valid once again and were reinstated.[308] The Federal Arbitrazh Court held that the tax benefits granted to the company were disproportionate to the investment it had made in Kalmykia. It found that the amount invested was 0.4 percent of the amount of tax benefits. There is no further information in the record as to any further steps in those proceedings, and, in particular, no evidence that the company appealed the decision of the Federal Arbitrazh Court to the Supreme Arbitrazh Court.

378. Tax reassessments would eventually be made against Yukos for the Siberian Transportation Company for the year 2000,[309] totaling RUR 240,437,174 (approximately USD 8,014,572).[310]

(c) Lesnoy and Trekhgorny

379. Lesnoy and Trekhgorny are ZATOs. As noted earlier, ZATOs or "Closed Adminstrative Territorial Units" are restricted-access territories "established in the former Soviet Union from the late 1940s as defense and nuclear power plant cities, which included communities with sensitive military, industrial or scientific facilities, such as arms plants or nuclear research sites."[311] Due to the fact that their local economies were particularly dependent on increasingly obsolete military or nuclear functions, the ZATOs faced economic collapse at the end of the Cold War. To address the problem, in 1992, the Russian State Duma "enacted a federal law to define the special tax regime of the ZATOs and the financing of these territories by the federal government, and guaranteed the ZATOs' residents certain social and health benefits."[312] The number of restricted access jurisdictions in Russia is unknown, and it was not until the late

307 *Ibid*. (referring to the Resolution of the appellate court, Case No. A22-1306/2001-6/129, 12 March 2002).

308 *Ibid*.

309 2000 Decision, p. 11, Exh. C-104.

310 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

311 Counter-Memorial ¶ 226, n.274.

312 *Ibid*.

1990s that the territories were even named or mapped.[313] In 1996, about half of the ZATOs were declassified of ZATO status.

i. Lesnoy

380. At the end of 1997, four trading companies were established by Yukos in Lesnoy: Business-Oil, Forest-Oil, Mitra, and Vald-Oil. In early 1998, the trading companies entered into agreements with the Lesnoy Town Administration to make investments in the region that would entitle them to certain tax benefits.[314] These were renewed in 2000.[315]

381. In January 1999, the trading companies based in Lesnoy and the Lesnoy Administration agreed to allow the companies to use interest-bearing promissory notes of OAO Yukos Oil Company in order to pay their taxes.[316] This agreement was later formalized in a decision by the head of ZATO Lesnoy.[317]

382. In 1999, the Lesnoy Administration also entered into several other agreements with the trading companies. Resolution 189 of the Duma of Lesnoy referred to joint investment activity within the framework of a partnership "between the Lesnoy administration and YUKOS OC OJSC."[318] The investments included construction and reconstruction of gas stations based on joint-activity agreements entered into "for a total of [RUR] 2,730 Million."[319] In late 1999, three of the four

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313 Vladimir Samoylenko, *Government Policies in Regard to Internal Tax Havens in Russia*, Publication of International Tax & Investment Center, December 2003, p. 10, Exh. C-577.

314 2000 Decision, Exh. C-104 (referring to Agreement No. 10, 9 February 1998 and Agreement No. 4, 28 January 2000 (Business-Oil); Agreement No. 3, 28 January 2000 (Mitra); Agreement No. 2, 28 January 2000 and Agreement No. [unknown] (Vald-Oil)); Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999 p. 5, Exh. R-294 (referring to Agreement No. 11, 9 February 1998 (Forest Oil)).

315 2000 Decision, Exh. C-104 (referring to Agreement No. 4 between the Lesnoy Administration and Business-Oil, 28 January 2000; Agreement No. 3 between the Lesnoy Administration and Mitra, 28 January 2000; Agreement No. 2 between the Lesnoy Administration and Vald-Oil, 28 January 2000. There is no information on a renewal in favour of Forest-Oil, though it seems likely there was one.

316 Report No. 04-14/11-1, 22 February 2002 pp. 7, 9, 11, 12, Exh. R-304 (referring to agreements of 6 January 1999 allowing the use of OAO NK Yukos promissory notes for tax payments by the four trading companies). *See also* Claimants' Rebuttal, Transcript, Day 20 at 50 for further context.

317 Report No. 04-14/11-1, 22 February 2002 pp. 7, 9, 11, 12, Exh. R-304 (referring to Decision No. 1734a of Head of Lesnoy Administration to allow the trading companies to pay taxes for 1999 with OAO NK Yukos promissory notes of OAO NK Yukos, 21 December 1999).

318 Decree of the Investigation Committee of the Russian Federation, 16 January 2002, p. 2, Exh. R-377 (referring to *Resolution 189 of the Duma of Lesnoy*, 15 December 1999).

319 *Ibid*.

trading companies were subjected to "desk audits", which "confirmed the validity in application of additional tax incentives granted."[320]

383. On 3 December 1999, the Minister of Taxes of the Russian Federation instructed the Interregional State Tax Inspectorate for Operational Control over Problem Taxpayers to audit the legality of tax incentives granted in the Lesnoy ZATO to Mitra, Business Oil and Forest Oil.[321]

384. There is in the record an undated Internal Tax Ministry "Memorandum on the results of the audit" initiated on 3 December 1999.[322] The Tribunal recalls that this memorandum has been the subject of extensive representations by the Parties.

385. The Tribunal notes that, in essence, the memorandum concludes that while each entity has the *formal* right to receive the "additional tax incentives under Law of the Russian Federation No. 67-FZ of 2 April 1999"[323] based on an examination of the entity's operations, it was established during the interrogation of a witness, in respect of each entity, that "the employees residing on the ZATO territory are not involved in the work related to the main activity of the company."[324]

386. Respondent submitted that this memorandum and the investigation which preceded it "put Yukos on notice" of the tax authorities' investigations into the legality of the use of the ZATOs. On the other hand, Claimants replied that the memorandum was a document internal to the tax ministry.[325] Claimants also aver that contemporaneous field tax audits conducted in March and

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320 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999 pp. 1, 3, 5, Exh. R-294 (referring to Desk Audit Report No. 4 for Mitra, 29 October 1999; Desk Audit Report No. 3 for Business Oil, 1 November 1999; Desk Audit Report No. 5 for Forest Oil, 1 November 1999).

321 *Ibid*., p. 1.

322 *Ibid.* The memorandum is undated but considered to be from early-to-mid 2000 on the basis of the documents referenced in it. It appears that the audit report, whose findings were summarized in this undated memorandum, was issued on 7 March 2000. *See* Statement No. 6 on the legality of the use by OOO Business-Oil in 1999 and 2000 of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6, 29 June 2001, p. 4, Exh. R-295.

323 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999 pp. 2, 4, 6, Exh. R-294

324 *Ibid*., pp. 3, 4, 6.

325 Respondent's Opening Slides, p. 48; Claimants' Post-Hearing Brief ¶¶ 57–58; *see also* Transcript, Day 14 at 86.

May 2000 found no violations of any tax law by Business Oil, Forest Oil or Mitra in relation to the application of these taxation arrangements.[326]

387. At approximately the same time, Yukos undertook a series of corporate restructurings which resulted in the merger of the audited Lesnoy companies (*i.e.*, Business-Oil, Forest-Oil, Mitra, and Vald-Oil) into another, new company, OOO Perspektiva Optimum, that was registered in the Aginsky Buryatsky Autonomous Okrug (**"ABAO"**) in the Chita Region, which is located thousands of miles from the ZATO of Lesnoy.

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

389. As a result of these restructurings, on 21 May 2001, the Lesnoy and the Trekhgorny trading entities, as well as the subsequently merged successor entities (OOO Perspektiva Optimum and OOO Trading Company Alkhanay), were liquidated. The new entity that emerged was named OOO Investproekt and was registered in the Kirov region. In August 2001, Investproekt moved across Russia to the Chita Region.

390. These restructurings and movements by Yukos—referred to collectively by Respondent as the "**Lesnoy Shuffle**"—are seen differently by the Parties. According to Claimants, they were merely a simplification of the corporate group of "hundreds of companies." [327] Claimants also noted that the restructurings occurred before any Tax Ministry decisions were rendered against it.[328] Respondent, on the other hand, submitted that they were indicative of a pattern of behavior on the part of Yukos that shows an intent to frustrate the taxation authorities.[329] While the Tribunal need not determine why these restructurings took place at this time, it has formed

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326 These documents are not in the record but see Statement No. 6 on the legality of the use by OOO Business-Oil in 1999 and 2000 of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6, 29 June 2001, Exh. R-295 (referring to Field Tax Audit Report No. 31 on Business-Oil, 7 March 2000); Decision No. 36, 8 June 2000, Exh. R-2260 (referring to Field Tax Audit Report Act No. 36 on Forest-Oil, 5 May 2000); Statement No. 8 on the audit of OOO Mitra, 11 June 2001, Exh. R-297 (referring to Field Tax Audit Report Act No. 249 on Mitra, 5 May 2000).

327 Transcript, Day 20 at 43.

328 Claimants' Post-Hearing Brief ¶ 64.

329 Transcript, Day 21 at 57–60.

the view that the simplification claim is a simplification. No persuasive argument has been advanced by Claimants to explain why the series of mergers occurred at this precise time.[330] At the same time, the Tribunal notes that the tax authorities were then slowly moving away from the taxation autonomy previously given to the ZATOs and that, on 1 January 2002, the right of the ZATOs to grant any tax incentives was removed from the law completely.[331]

391. In late June and early July 2001, the Tax Ministry circulated internally several memoranda (or "statements") relating to the tax benefits granted to the Lesnoy companies.[332] The memoranda examined the lawfulness of the benefits granted between 1 January 1999 and March 2001. Internal Tax Ministry Statement No. 6, which examined the benefits granted to Business-Oil, found that the tax incentives were actually not in accordance with the law on ZATOs and not approved by the Ministry of Finance. It also found a violation due to payment of taxes with promissory notes. It assessed taxes of approximately RUR 2.8 Billion (USD 98 Million) for the whole period. The memorandum also notes specifically that the Lesnoy entities were enterprises of OAO NK Yukos.[333]

392. Internal Tax Ministry Statement No. 7, which examined the benefits granted to Forest-Oil, found that the company's employees residing in Lesnoy were not engaged in trading, and also found violations due to payment of taxes with Yukos promissory notes and assessed approximately RUR 671 Million (USD 22 Million) in taxes that were not paid in cash.[334]

393. Benefits granted to Mitra were examined in Internal Tax Ministry Statement No. 8, which found that Lesnoy unlawfully granted tax incentives, found a violation due to payment of taxes

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330 Respondent's Closing Slides, pp. 8–12 (chronicling the series of moves that were taken "for no stated business reason".)

331 First Konnov Report ¶ 33. This change did not affect other types of low-tax regions at this time, although some of their powers to grant incentives were also curbed.

332 Statement No. 6 on the legality of the use by OOO Business-Oil in 1999 and 2000 of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6, 29 June 2001, Exh. R-295; Statement No. 7 on the audit of OOO Forest-Oil), 11 July 2001, Exh. R-296; Statement No. 8 on the audit of OOO Mitra, 11 July 2001, Exh. R-297; Statement No. 9 on the audit of Vald-Oil, 11 July 2001, Exh. R-298.

333 Statement No. 6 on the legality of the use by OOO Business-Oil in 1999 and 2000 of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6, 29 June 2001 pp. 14–18, Exh. R-295. Contrast the Respondent's submission that the Russian Federation didn't know about the Lesnoy companies' association with Yukos until 2003. *See* Transcript, Day 18 at 29–31 (Respondent's closing). The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

334 Statement No. 7 on the audit of OOO Forest-Oil, 11 July 2001, Exh. R-296. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

by Yukos promissory notes and assessed approximately RUR 783 Million (USD 26 Million) in taxes paid with promissory notes.[335]

394. Internal Tax Ministry Statement No. 9 examined benefits granted to Vald-Oil. It found that Lesnoy could not grant incentives for 2000 and assessed that RUR 986 Million (USD 33 Million) was owed. It also found fault on the basis of a substance over form analysis, and a violation due to payment of taxes by Yukos promissory notes in the amount of RUR 1.8 Billion (USD 60 Million).[336]

395. In September 2001, a criminal investigation was initiated to look into whether the managers of the Lesnoy trading companies were involved in tax evasion.[337]

396. In October 2001, a decision was taken to conduct a repeat field tax audit of Investproekt,[338] and a request was made that the company release the accounting documents of Forest-Oil, Mitra, and Vald-Oil.[339] The repeat Field Tax Audit Report was issued in November 2001 with respect to the legality of the use of the additional tax incentives by the trading companies in the year 1999.[340]

397. Later in November 2001, Ms. Irina Golub, Yukos' Chief Accountant, received an e-mail from Mr. V.N. Kartashov, a general director of Yukos. The e-mail contained a document itemizing in tabular format, all of the information that Mr. Kartashov had regarding investigations into trading companies across the ZATOs and other low-tax regions.[341] It identified, in a column entitled "Risks", a criminal case "in connection with tax evasion" for the four Lesnoy entities and nine Trekhgorny entities. The document also noted that office personnel in all 13 of those firms had been interrogated, including the general directors of some of the Lesnoy companies. The entries for the Lesnoy entities also noted that some documents had been seized.

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335 Statement No. 8 on the audit of OOO Mitra, 11 July 2001, Exh. R-297. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

336 *Internal Tax Ministry Statement No. 8* (Vald-Oil), 11 July 2001, Exh. R-298. The RUR to USD exchange rate used here is based on a rate of 30:1.

337 Decree on institution and initiation of criminal proceedings (against Managers of Business Oil, Forest Oil, Mitra, and Vald-Oil in relation to payment of taxes by Yukos promissory notes), 3 September 2001, Exh. R-376.

338 Report No. 04-14/11-1, 22 February 2002, Exh. R-304 (referring to Decision No. 04-14/11 on the conduct of a repeat field tax audit of Investproekt, 13 October 2001).

339 Report No. 04-14/11-1, 22 February 2002 ¶ 2.3.1, Exh. R-304 (referring to request of 16 October 2001from tax authorities to Investproekt for accounting documents of Forest-Oil, Mitra, and Vald-Oil).

340 Repeat Field Tax Audit Report No. 04-14/11 of OOO Investproekt, 9 November 2001, Exh. R-2250.

341 E-mail from Ms. Golub to Mr. Kartashov, 23 November 2001, Exh. R-3338.

398. In December 2001, Ms. Golub drafted a letter to be used as a template by one or more of the directors of the Lesnoy trading companies regarding the investigation into the use of promissory notes and sent it to Mr. D.V. Gololobov, Deputy Head of Yukos' Legal Department.[342] Later, Mr. V.G. Aleksanyan, the Head of the Legal Department, wrote to Ms. Golub regarding her draft letter, asking that in correspondence with the authorities, no reference be made to the tax incentives granted by Lesnoy.[343] Respondent argued during the Hearing that this demonstrates knowledge of and intent to conceal wrongdoing by Yukos.[344] Claimants answered that the document merely notes that the tax incentives were not at issue in the investigation (only the use of promissory notes to pay taxes was), and that Mr. Aleksanyan was simply asking Ms. Golub not to bring up an issue that was not being investigated.[345]

399. In December 2001, the tax authorities decided "to conduct additional control activities in respect of Investproekt."[346]

400. In January 2002, the criminal investigation of the directors of the Lesnoy trading companies was terminated because the investigation had not determined that a crime was committed. The report stated that "there is no constitution of a crime," and "tax payments in non-monetary form cannot indicate the intention of tax evasion."[347] The document also concludes that the head of the Lesnoy Administration, Mr. A.I. Ivannikov, believed at the time that tax payments by promissory notes were legal and that his actions and the actions of Lesnoy officials relating to granting of tax benefits should be considered as exceeding their authority and as negligent.[348]

401. However, a few days later, that decision was reversed.[349] The reason then given was that no "legal assessment was conducted during the preliminary investigation as to whether the selection by the [trading companies] of such a knowingly illegal method of tax payment involving intentional overpayment of charged taxes and subsequent refund of surplus sums to

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342 Draft letter regarding investigation into use of promissory notes, undated, Exh. R-415.

343 E-mail from Mr. Aleksanyan to Ms. Golub, 14 December 2001, Exh. R-3244.

344 Transcript, Day 18 at 34–35.

345 Transcript, Day 20 at 61.

346 Report No. 14/11-1, 22 February 2002, Exh. R-304 (referring to Decision No. 04-15/10 to conduct additional control activities on Investproekt, 17 December 2001).

347 Decree on termination of criminal case no. 135070 (in part), 16 January 2002, Exh. R-377.

348 *Ibid*.

349 Decree on the Reversal of the Decree to Discontinue Criminal Case No. 135070, 1 February 2002, Exh. R-381.

the accounts of these same companies in real monetary form could be considered as 'another method' of tax avoidance . . . ."[350]

402. Ultimately though, the Tribunal notes that the investigation was suspended because, in the words of the resolution, "all possible investigative actions have been taken in the absence of an accused."[351] The resolution noted that "this type of tax crime should be assessed as a tax evasion scheme by making advance payments for taxes of future periods," and that "[h]ere a mandatory condition is the fact that the advance payment is made in non-monetary form."[352] The resolution concluded that it was not possible to determine who among the directors of the trading companies or who in the Municipal Department of the City of Lesnoy actually committed a crime.[353] Claimants stressed, in their Closing Statement, that no further action was taken.[354] In this connection, the Tribunal recalls that Mr. Khodorkovsky and Mr. Lebedev were ultimately convicted, *inter alia*, for tax evasion, including in relation to the trading companies' use of promissory notes to pay taxes in Lesnoy.[355]

403. In the period between the reversal and the suspension of the criminal case regarding the promissory notes, the report on additional control measures against Investproekt for 1999 was released.[356] It considered that Business-Oil was not entitled to tax benefits in 1999, as it "was carrying out its business within ZATO Lesnoy as a matter of form only."[357] The report also considered that the other Lesnoy companies were not entitled to tax benefits in 1999. The report estimated their tax liabilities on the basis of Business-Oil as a "similar taxpayer".[358]

404. The report assessed the value of the tax benefits that it concluded had been improperly granted at approximately RUR 5.3 Billion (USD 177 Million). However, no assessment or decision

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350 *Ibid*., p. 3.

351 Resolution on Suspension of a Preliminary Investigation Due to Failure to Establish an Individual to be Accused, 4 March 2002, Exh. R-378.

352 *Ibid*.

353 *Ibid*.

354 Transcript, Day 16 at 224 ("There was no court decision issued on any of these, to our knowledge; and nothing has been filed by the Respondent to the contrary. . . In particular, none of the directors or the officials of the City of Lesnoy were convicted, in absentia or otherwise. So these are just the decrees rendered by the prosecution in relation to these facts in relation to the investigation.")

355 Judgment in the Name of the Russian Federation, Meshchansky District Court of the City of Moscow, 16 May 2005, p. 57, Exh. R-379.

356 Report No. 04-14/11-1, 22 February 2002, Exh. R-304.

357 *Ibid*., p. 2.

358 *Ibid*., p. 4.

was issued on the basis of this report to recoup the funds, which could have occurred any time up until 31 December 2002, before becoming time barred.[359] No assessment was issued during the subsequent ten-month period against Investproekt.

405. The Tribunal notes that, in March 2002, Mr. Dmitry Maruev, Yukos' Deputy Financial Manager, e-mailed M. U. Barbarovich and V. M. Zhuravlev and asked that they clean their e-mail folders and servers of references to a number of companies, some of which ("Alebra, Greis, Business Oil, Vald Oil, Kverkys [sic], Kolrein, Mitra, Muskorn, Nortex") had been merged into Investproekt.[360]

406. Around this time, a demand requesting enforcement of a tax debt against Investproekt in the amount of RUR 25 Million (USD 833,000) was sent by the Ministry of Taxes and Levies for Chernyshevsk District to Bailiffs in the Chita region. It was returned by the bailiffs who considered this matter to be outside of their jurisdiction since, when the debt was incurred, the company was located in Kirov. The bailiffs also noted that Investproekt's executive S. A. Verketin still resided in Kirov, and supplied his address.[361]

407. In April 2002, a decision was issued not to hold Investproekt liable for tax offenses in 2000. Rather, it proposed to collect taxes but not fines as offenses were "discovered after the completion of their reorganization."[362] It assessed the taxes owed at RUR 11.985 Billion (approximately USD 400 Million).[363] Two months later, a decision was issued by the Federal Arbitrazh Court for the North West District in the *Pribrezhnoye* case, which found (on nearly identical facts to those relied upon in the decision against Investproekt) that the tax authorities had acted in breach of the Russian Tax Code.[364] Claimants argued that this decision explains, at least in part, the reason why the tax assessment against Investproekt was never collected. In

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359 *Ibid.*; *see also* Claimants' Post-Hearing Brief ¶ 63, n.136.

360 D. L. Maruev e-mail to M. U. Barbarovich and V.M. Zhuravlev, 15 March 2002, Exh. R-4040. The e-mail listed the following companies: Alebra, Belz, Business-Oil, Vald-Oil, Greis, Kverkys, Kolrein, Mitra, Muksar, Muskron, Nortex and Flander.

361 Letter from Acting Senior Court Bailiff L.M. Lobanova to the Head of the Interdistrict Inspectorate No. 4 of the Ministry of Taxes and Levies for Chernyshersk District, Exh. R-306.

362 Decision No. 02-11/1/1, 2 April 2002 p. 8, Exh. R-303.

363 *Ibid.* p. 7.

364 *Pribrezhnoye*,, Exh. C-1278. *See also* Claimants' Post-Hearing Brief ¶¶ 68–70.

their Post-Hearing Brief, Claimants submit that "in the non-political circumstances that prevailed in 2002, the assessment would not have survived court review."[365]

408. However, in August 2003, a decision was issued relating to the activities of the Investproekt companies in the year 2000. The taxes owing were assessed at RUR 11.985 Billion (USD 400 Million); and this time, the authorities decided that they would also fine Investproekt, adding an additional approximate amount of RUR 2.4 Billion (USD 84 Million).[366] It is not clear to the Tribunal as to whether this assessment was ever paid.[367] The Tribunal notes that the basis for reversing the April 2002 decision (*i.e.*, the decision not to hold the company liable) was not explained in the August 2003 decision.

Business-Oil

409. Business-Oil was registered by order of the head of the Administration of the Town of Lesnoy, on 30 December 1997, with RUR 10,000 capital. It was founded by Special Project OOO (holding 5 percent of the shares) and Rasin OOO (holding 95 percent of the shares).

410. In February 1998, Business-Oil and the Lesnoy Town Administration concluded an investment agreement, which granted incentives in relation to 17 different types of taxes and required payment of 5 percent of tax benefits granted by the administration to an off-budgetary fund.[368] This agreement was later supplemented in 2000, and provided additional incentives in relation to eight additional taxes.[369]

411. In November 1999, a desk audit was conducted. The audit report confirmed the validity of the application of the additional tax incentives granted.[370] The following month, a resolution of the tax authorities was issued which lead to an audit regarding compliance with the tax laws of the

365 Claimants' Post-Hearing Brief ¶ 69.

366 Decision No. 2.6-23 of the Department of the Ministry of Taxes and Levies of the Russian Federation for the Chita Region and Agynsky Butyatsky Autonomous District, 8 August 2003, Exh. R-305. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

367 Transcript, Day 20 at 85.

368 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999, Exh. R-294 and 2000 Decision, Exh. C-104 (referring to Agreement No. 10 Between the Lesnoy Town Administration and OOO Business-Oil, 9 February 1998).

369 2000 Decision, Exh. C-104 (referring to Agreement No. 4 Between the Lesnoy Town Administration and OOO Business-Oil, 28 January 2000).

370 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999 p. 5, Exh. R-294 (referring to a desk audit report No. 3, 1 November 1999).

Russian Federation and a verification of the terms and conditions under which additional tax incentives were granted between 1 January 1998 and 1 October 1999.[371] In March 2000, a Field Tax Audit Report was issued regarding the lawfulness of the additional incentives for 1998 and nine months of 1999. The report concluded that "no infringement of the tax legislation was established."[372]

412. As set out above, however, an internal memorandum of the Tax Ministry questioned the entitlement of Business-Oil to the tax benefits, on the basis that it might not have been fulfilling the requirements of the legislation in substance (as opposed to form). This, and other concerns about the entity's conduct, led to a criminal investigation inquiring into whether the managers of the Lesnoy entities were involved in tax evasion. The investigation was ultimately suspended, but charges relating to the Lesnoy entities figured in the case by the Russian prosecutor against Messrs. Lebedev and Khodorkovsky in 2003.

413. On 5 March 2001, Business-Oil was merged into Perspektiva Optimum, which later merged with Alkhanai Trading to become Investproekt.

414. Tax reassessments would ultimately be made against Yukos for Business-Oil for the year 2000,[373] totaling RUR 1,620,951,772 (approximately USD 56,698,046).[374]

Forest-Oil

415. Forest-Oil was registered by Resolution 1409 of the Lesnoy Town Administration on 31 December 1997. In February 1998, Forest-Oil and the Lesnoy Town Administration concluded an investment agreement which granted incentives in relation to 16 different types of taxes and required payment of 5 percent of tax benefits to an off-budgetary fund.[375]

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371 *Ibid*. (referring to Resolution No. 175, 16 December 1999).

372 *See* Statement No. 6 on the legality of the use by OOO Business-Oil in 1999 and 2000 of additional tax incentives granted by the head of the municipal formation of Town of Lesnoy No. 6, 29 June 2001, p. 4, Exh. R-295 (referring to Field Tax Audit Report No. 31, 7 March 2000).

373 2000 Decision, p. 65, Exh. C-104.

374 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004

375 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999, p. 5, Exh. R-294 (referring to Agreement No. 11 Between the Lesnoy Town Administration and OOO Forest-Oil, 9 February 1998).

416. In November 1999, a desk audit was performed which confirmed the validity of the additional tax incentives granted.[376]

417. In December 1999, a resolution of the tax authorities was issued leading to a field tax audit for 1 January 1998 to 1 October 1999, in order "to inspect its compliance with the tax laws of the Russian Federation and check the terms and conditions under which additional tax incentives were granted."[377] In May 2000, a Field Tax Audit Report was issued, which found no violation in relation to tax incentives, but found a VAT shortfall of RUR 107,142 [USD 3,500].[378] In June 2000, a decision in relation to that report held Forest-Oil liable for a 20% fine of RUR 21,428 (USD 700).[379]

418. As set out above, however, an internal memorandum of the Tax Ministry questioned the entitlement of Forest Oil to the tax benefits because it might not have been fulfilling the requirements of the legislation in substance (as opposed to form). This, and other concerns about the entity's conduct, led to a criminal investigation inquiring into whether the managers of the Lesnoy entities were involved in tax evasion. The investigation was ultimately suspended, but, as noted earlier, charges relating to the Lesnoy entities figured in the case by the Russian prosecutor against Messrs. Lebedev and Khodorkovsky in 2003.

419. On 5 March 2001, Forest-Oil was merged into Perspektiva Optimum, which later merged into Investproekt.

420. No tax reassessments would be made against Yukos for Forest-Oil.

Mitra

421. Mitra was registered by Resolution 1355 of the Lesnoy Town Administration on 22 December 1997. It was founded by OOO Alan, with registered address in Kaluga and a 95 percent shareholding, and OOO Special Project, with registered address in Lesnoy and a 5 percent shareholding. As of 15 June 2000, OOO Neftemarket-2000, with registered address in Moscow

376 *Ibid*. p. 3 (referring to Desk Audit Report No. 5, 1 November 1999).

377 *Ibid*. (referring to Resolution No. 174, 6 December 1999).

378 Decision No. 36, 8 June 2000, Exh. R-2260 (referring to Field Tax Audit Report No. 36, 5 May 2000). The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

379 *Ibid*. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

(and itself 100% owned by OAO Yukos Oil Company) held 100 percent of the shares in Mitra.[380]

422. In February 1998, Mitra and the Lesnoy Town Administration concluded an investment agreement,[381] which was supplemented in a further agreement in January of 2000, in which the administration provided additional incentives in respect of 8 types of taxes.[382]

423. In October 1999, a Field Tax Audit Report was issued,[383] followed by a desk audit report[384] which confirmed the validity of the additional tax incentives granted. In December 1999, a resolution of the tax authorities was issued which led to the conduct of a field tax audit for 1 January 1998 to 1 October 1999 "to inspect its compliance with the tax laws of the Russian Federation and check the terms and conditions under which additional tax incentives were granted."[385] In May 2000, the Field Tax Audit Report was released. It found no violation in relation to tax incentives and only a profit tax error in the amount of RUR 3,122,000 (USD 105,000).[386]

424. As set out above, however, an internal memorandum of the Tax Ministry questioned the entitlement of Mitra to the tax benefits, on the basis that it might not have been fulfilling the requirements of the legislation in substance (as opposed to form). This, and other concerns about the entity's conduct, led to a criminal investigation inquiring into whether the managers of the Lesnoy entities were involved in tax evasion. The investigation was ultimately suspended, but, as noted earlier, charges relating to the Lesnoy entities figured in the case by the Russian prosecutor against Messrs. Lebedev and Khodorkovsky in 2003.

425. On 5 March 2001, Mitra was merged into Perspektiva Optimum, which later merged into Investproekt.

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380 2000 Decision, pp. 72–73, Exh. C-104.

381 Memorandum on the results of the audit of the legality of additional tax incentives granted to Mitra, Business-Oil and Forest-Oil in Lesnoy for 1998 and 9 months of 1999, p. 1, Exh. R-294 (referring to Agreement No. 7, 3 February 1998).

382 2000 Decision, pp. 73–74, Exh. C-104 (referring to Agreement No. 3, 28 January 2000)

383 *Ibid*. p. 1 (referring to Field Tax Audit Report No. 76, 8 October 1999).

384 *Ibid*. (referring to Desk Audit Report No. 4, 29 October 1999).

385 *Ibid*. (referring to Resolution No. 249, 16 December 1999).

386 Statement No. 8 on the audit of OOO Mitra (referring to Field Tax Audit Report No. 249, 5 May 2000).

426. Tax reassessments would later be made against Yukos for Mitra for the year 2000,[387] totaling RUR 27,124,001 (USD 948,750).[388]

Vald-Oil

427. Vald-Oil was registered by Resolution 1441 of the Lesnoy Town Administration on 30 December 1997. It was founded by OOO Neftemarket, holding 5 percent of the shares, and OOO Al-Gem holding 95 percent of the shares.

428. In February 1998, Vald-Oil and the Lesnoy Town Administration apparently concluded an investment agreement[389] which granted incentives in relation to 16 different types of taxes and required payment of 5% of the value of the tax benefits to an off-budgetary fund. It was supplemented by a further agreement in January of 2000.[390]

429. As set out above, however, concerns that Vald Oil might not have been fulfilling the requirements of the legislation in substance (as opposed to form), and other concerns about the entity's conduct, led to a criminal investigation inquiring into whether the managers of the Lesnoy entities were involved in tax evasion. The investigation was ultimately suspended, but, as noted earlier, charges relating to the Lesnoy entities figured in the case by the Russian prosecutor against Messrs. Lebedev and Khodorkovsky in 2003.

430. On 5 March 2001, Vald-Oil was merged into Perspektiva Optimum, which later merged into Investproekt.

431. Tax reassessments would eventually be made against Yukos for Vald-Oil for the year 2000,[391] totaling RUR 1,362,216,581 (USD 47,647,943).[392]

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387 2000 Decision, p. 76, Exh. C-104.

388 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004, Exh. R-334.

389 2000 Decision, p. 6, Exh. C-104 (referring to investment agreements with, among others,Vald Oil).

390 2000 Decision, p. 80, Exh. C-104 (referring to Agreement No. 2, 28 January 2000).

391 *Ibid*., p. 83.

392 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004, Exh. R-334.

ii. Trekhgorny

432. Far less information is available to the Tribunal regarding the activities of the trading companies in the Trekhgorny ZATO than is available for those in Lesnoy. What the Tribunal has gleaned from the record is that in March 2001, some of the companies based in Trekhgorny ("Greys", "Nortex", "Alebra", "Muskron", "Flander", "Kolrein" and "Kverkus") merged into Torgovaya Kompaniya Alkhanay or Alkhanai Trading on 16 March 2001, a company registered in Aginskoye, in the Aginsko-Buryatsky region.[393] Two months later, in May 2001, Alkhanai Trading merged with Perspektiva Optimum (the company created from the Lesnoy trading companies) into Investproekt, a company initially based in Kirov, but which then moved to the Chita Autonomous Region as of August 2001.[394]

Grace

433. Grace was registered by Order 1316 of the Trekhgorny Municipal Administration on 25 July 1997. On 15 March 2001, it merged into Alkhanai Trading, which later merged into Investproekt. Grace was founded by ZAO Trigor (holding 5 percent of the shares) and OOO Bark (holding 95 percent).[395]

434. On 11 March 1998, Grace and the Trekhgorny Municipal Administration concluded an investment agreement, supplemented by another agreement on 21 January 2000, under which incentives in relation to 17 different types of taxes were granted.[396]

435. Tax reassessments would eventually be made against Yukos for Grace for the year 2000,[397] totaling RUR 20,247,201 (USD 708,212).[398]

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393 Judgment in the Name of the Russian Federation, Meshchansky District Court of the City of Moscow, 16 May 2005, p. 48, Exh. R-379.

394 *See* various documents on Alkhanay and Perspektiva Optimum, 20 May 2001, Exh. R-302; *see also* Information letter from the Inspectorate of the Ministry of Taxes and Levies of the Russian Federation for Shabalinskiy District, 20 August 2001, Exh. R-301 (noting Investproekt's change of address to the Chita Region). For further information as to Investproekt, see paragraphs 389–408 above.

395 2000 Decision, p. 27, Exh. C-104.

396 *Ibid*., pp. 29–30 (referring to Tax Agreement No. 95, 11 March 1998 and a supplementary tax agreement dated 21 November 2000).

397 *Ibid*. pp. 30–31.

398 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

Muskron

436. Muskron was registered by Order 1433 of the Municipality of Trekhgorny on 12 August 1997. It was founded by Trigor ZAO, with an address in Trekhgorny and a 5 percent shareholding, as well as Vokit OOO, with an address in Moscow and a 95 percent shareholding. Vokit bought out Trigor in April of 2000, before selling a 2 percent stake to Neftetrade (itself wholly owned by OAO Yukos Oil Company at the time of Neftetrade's incorporation). As of September 2000, Neftetrade had acquired 100 percent of Muskron's shareholding.[399]

437. On 12 July 1998, Muskron and the Trekhgorny Municipal Administration concluded an investment agreement, with a supplementary agreement on 12 January 2000, which granted incentives in relation to eight different types of taxes.[400]

438. On 15 March 2001, Muskron was merged into Alkhanai Trading, which then merged into Investproekt.[401]

439. Tax reassessments would eventually be made against Yukos for Muskron for the year 2000,[402] totaling RUR 7,398,094 (USD 258,772).[403]

Norteks (aka Nortex)

440. Norteks was registered by Order 1435 of the Municipality of Trekhgorny 12 August 1997.[404] It was founded by Trigor ZAO, with an address in Trekhgorny and a 5 percent shareholding, as well as OOO Corvet, with an address in Kaluga and a 95 percent shareholding. OOO Neftetrade bought Trigor's shares in Norteks in June of 2000.[405]

441. On 6 February 1998, Norteks and the Trekhgorny Municipal Administration concluded an investment agreement, supplemented by another agreement on 21 January 2000, granting

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399 2000 Decision, p. 36–37, Exh. C-104.

400 *Ibid*. pp. 39–40 (referring to Tax Agreement No. 67, 12 July 1998 and a supplementary tax agreement dated 12 January 2000).

401 *Ibid*., p. 35.

402 *Ibid*., p. 41.

403 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

404 2000 Decision, p. 14, Exh. C-104.

405 *Ibid*., p. 15.

incentives in relation to eight different types of taxes and requiring payment of five percent of tax benefits into administration's account.[406]

442. On 15 March 2001, Norteks was merged into Alkhanai Trading, which then merged into Investproekt.[407]

443. Tax reassessments would eventually be made against Yukos for Norteks for the year 2000,[408] totaling RUR 3,152,537,572 (USD 110 Million).[409]

Kverkus (aka Quercus)

444. Kverkus was registered by Order 1315 of the Administration of the Municipality of Trekhgorny on 25 July 1997.[410] It was founded by Trigor ZAO, with an address in Trekhgorny and a 5 percent shareholding, as well as OOO Cadet, with an in Kaluga and a 95 percent shareholding. OOO Neftetrade bought out Trigor's shares in Kverkus in June of 2000.[411]

445. On 26 August 1997, Kverkus and the Trekhgorny Municipal Administration concluded an agreement granting tax benefits to the trading companies.[412] On 11 March 1998, a second investment agreement was concluded,[413] which was supplemented on 21 January 2000,[414] granting incentives in relation to eight types of taxes.

446. On 15 March 2001, Kverkus was merged into Alkhanai Trading, which then merged into Investproekt.

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406 *Ibid*., pp. 17–18 (referring to Tax Agreement No. 9, 6 February 1998 and a supplementary tax agreement dated 21 January 2000).

407 *Ibid*., p. 14.

408 *Ibid*., p. 19.

409 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004, Exh. R-334.

410 2000 Decision, p. 49, Exh. C-104.

411 *Ibid.*, p. 50.

412 *Ibid*., p. 52 (referring to Tax Agreement No. 51, 26 August 1997).

413 *Ibid*. (referring to Tax Agreement No. 103, 11 March 1998).

414 *Ibid*. (referring to supplementary tax agreement, 21 January 2000).

447. Tax reassessments would eventually be made against Yukos for Kverkus for the year 2000,[415] totaling RUR 3,031,422,237 (USD 106,033,825).[416]

Colrain (aka Kolrein)

448. Colrain was registered by Order 1431 of the Municipality of Trekhgorny on 12 August 1997.[417] It was founded by Trigor ZAO, with an address in Trekhgorny and a 5 percent shareholding, as well as OOO Bark, with an address in Kaluga and a 95 percent shareholding.[418] In November 1999, Trigor sold its five percent share in Colrain to Polinep ZAO.[419] Neftetrade then bought that five percent share in June 2000.[420]

449. In August 1997, Colrain and the Trekhgorny Municipal Administration concluded an agreement granting tax benefits to the company.[421] In February 1998, a second investment agreement was concluded,[422] which was amended once in 1999[423] and supplemented in January 2000,[424] granting incentives in relation to eight types of taxes.

450. On 15 March 2001, Colrain merged into Alkhanai Trading, which then merged into Investproekt.[425]

451. No tax reassessments would be made against Yukos for Colrain.

Virtus

452. Virtus was registered by Order 1116 of the Head of the Municipality of Trekhgorny on 27 June 1997.[426] It was founded by OOO Akra OOO, with an address in Kaluga and a 90 percent

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415 *Ibid*., p. 55.

416 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

417 2000 Decision, p. 57, Exh. C-104.

418 *Ibid.*, p. 58.

419 *Ibid*.

420 *Ibid*.

421 *Ibid*., p. 59 (referring to Tax Agreement No. 44, 20 August 1997).

422 *Ibid*. (referring to Tax Agreement No. 8, 6 February 1998).

423 *Ibid*. (referring to amendments on 12 July 1999).

424 *Ibid*. (referring to a supplementary tax agreement, 21 January 2000).

425 *Ibid*., p. 58.

shareholding, OOO Depor with an address in Moscowand a 5 percent shareholding, and Trigor ZAO, with an address in Trekhgorny and a 5% shareholding. Akra bought Trigor's shares in Virtus in March of 2000.[427]

453. On 6 February 1998, Virtus and Trekhgorny Municipal Administration concluded an investment agreement,[428] which was supplemented on 21 January 2000.[429] It granted incentives to the company in relation to eight different types of taxes, and required payment of five percent of tax benefits into the administration's account.

454. Tax reassessments would eventually be made against Yukos for Virtus for the year 2000,[430] totaling RUR 2,359,700 (USD 82,538).[431]

(d) Sarov

455. Sarov is a ZATO in the Russian Federation.

i. Yuksar

456. Yuksar was registered by the Sarov Municipal Administration on 13 October 1997.[432] Yuksar was founded by Yukos with a 49 percent shareholding and YNG with a 51 percent shareholding.[433] Yuksar was ultimately liquidated.[434]

457. On 23 October 1997, Yuksar and the Sarov Municipal Council concluded an agreement granting tax incentives to the company.[435] It was supplemented on 12 March 1998.[436]

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426 2000 Decision, p. 68, Exh. C-104.

427 *Ibid.* pp. 67–68.

428 *Ibid*., pp. 68–69 (referring to Tax Agreement No. 7, 6 February 1998).

429 *Ibid.*, p. 69 (referring to supplementary tax agreement, 21 January 2000).

430 *Ibid*., p. 69.

431 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

432 2000 Decision, p. 20, Exh. C-104

433 *Ibid*.

434 *Ibid* (referring to extract from Unified State Register of Legal Entities on 3 November 2003).

435 *Ibid*., p. 22 (referring to Tax Agreement No. 74/01-17, 23 October 1997).

436 *Ibid*. (referring to supplementary tax agreement, 12 March 1998).

458. Tax reassessments would ultimately be made against Yukos for Yuksar for the year 2000,[437] totaling RUR 95,875,131 (USD 3,353,544).[438]

(e) Baikonur

459. As noted earlier, Baikonur is a low-tax region, leased by the Russian Federation from Kazakhstan during the Soviet era for use as a spaceport and aerospace facility.[439]

i. Mega-Alliance (aka Mega-Alyans)

460. Mega-Alliance was registered by Order 00411 of the Administration of Baikonur on 21 December 2000.[440] The sole founder of the company was Ms. Gulnara Karimovna Zhukova, who was also a founder of Macro-Trade. The share capital of the company was RUR 8,350. On 28 April 2001, amendments were made to the Charter of Mega-Alliance OOO under which the sole shareholder of Mega-Alliance became Dorchestergate Trading Limited, a company registered in Cyprus.[441]

461. As noted in paragraph 351 above, Ms. Zhukova later denied any connection to Mega-Alliance or Macro-Trade, both of which she was alleged to have founded. A letter dated 24 October 2003 from the Russian Federation Federal Security Service's Directorate for Moscow Space Forces indicated that Ms. Zhukova had denied any connection with Mega-Alliance and reiterated her story about the theft of her passport.[442]

462. In 2001, Mega-Alliance and the Administration of Baikonur entered into a tax agreement.[443] It granted benefits to the company in relation to four types of taxes and required payments to the value of three percent of their tax benefits into the "target funds" for the development of the region of Baikonur.

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437 *Ibid*., p. 23.

438 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

439 Transcript, Day 14 at 54.

440 2001 Decision, p. 112, Exh. C-155.

441 *Ibid*.

442 2001 Decision, p. 112, Exh. C-155 (referring to Letter No. 31/4664 from the Russian Federation Federal Security Service's Directorate for Moscow Space Forces, 24 October 2003).

443 *Ibid*., p. 114 (referring to contract between the Administration of Baikonur and Mega-Alliance, 24 October 2003).

463. Later that year, the decision of the Government of the Russian Federation No. 747 on the Approval of the Rules for the Granting of Tax Privileges to Organisations and Individual Businessmen Registered on the Territory of the City of Baikonur was issued.[444] It granted permission to the head of the Administration of Baikonur to grant tax privileges, provided that the individual businessman or organization had "the presence of premises, of property, industrial or other complexes necessary for the manufacture of goods, works or services and situated on the territory of the city of Baikonur (including the Baikonur Spaceport); [and] the realisation of the products, works or services on the territory of the city of Baikonur (including the Baikonur Spaceport)."[445] It also cautioned that previously offered tax benefits that conflicted with the decision would be considered terminated from the date the decision entered into force.[446]

464. In 2002, Mega-Alliance merged into Regionalniy Finansoviy Tsentr or Regional Finance Center.[447] Regional Finance Center was liquidated in July of that year.[448]

465. Tax reassessments would later be made against Yukos for Mega Alliance for the year 2001,[449] totaling RUR 1,276,878,700 (USD 43,646,213).[450]

(f) Evenkia

466. The Evenkia autonomous district is located in Eastern Siberia.[451] At the time that the trading companies were established in Evenkia, the district had a federally financed budget, fuel supplies were difficult to secure, and unemployment was very high.[452] Of all the regions of the

444 Decision of the Government of the Russian Federation No. 747, 25 October 2001, Exh. C-411.

445 *Ibid*.

446 *Ibid*.

447 Notice on record with the unified state register of legal entities of entry on dissolution of legal entity, 19 April 2002, Exh. R-3158.

448 Information Extract No. 29170, 27 March 2012, Exh. R-3159.

449 2001 Decision, p. 115, Exh. C-155.

450 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 29.2552:1, the official exchange rate on 2 September 2004.

451 *Yukos Review*, Issue # 3, May–June 2001, p. 8, Exh. C-9.

452 *Ibid.*, p. 5.

Russian Federation, Evenkia ranked last in average per capita volume of industrial production, and 69th (out of 89) in terms of per capita income.[453]

467. In September 1998, Law No. 108 of the Evenkia Autonomous Region "On the Particularities of the Tax System in the Evenkiysky Autonomous District" was enacted,[454] which offered incentives to investors in the region. Pursuant to Article 6(1)(d) of the law, preferential tax rates were offered to participants in investment projects on the territory of the Evenkiysky Autonomous District. Pursuant to Article 5(1) of the Law, commercial and noncommercial entities were deemed participants of investment projects which are created in the territory of the region, regardless of the origin of their capital, and can include those with foreign legal entities as shareholders, so long as they were participants in programs for the social and economic development of the region and investment projects.

468. In May 2001, Mr. Boris Zolotarev, the former head of Yukos R&M, became governor of Evenkia. After his election, he spoke about the positive effects he hoped Yukos investment could have on the region.[455]

i. Evoil

469. Evoil was registered by Order 158 of Administration of Ilimpiisk District of Evenkia on 23 May 2002.[456] It was founded by Fiana Ltd., a limited liability company registered in Cyprus.[457]

470. In June 2001, pursuant to an order of the Administration of the Evenkiysky Autonomous District, "On Application of Special Tax Regime," Evoil was granted targeted tax benefits.[458] It also enjoyed benefits under Law 108 of 24 September 1998, including corporate profit tax payable at a reduced rate of 10.5 percent and a property tax rate of 0 percent.[459]

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453 *Ibid.*, p. 8.

454 Law of the Evenkiysky Autonomous District No. 108, 24 September 1998, Exh. C-412.

455 *Yukos Review*, Issue # 3, May–June 2001, p. 5, Exh. C-9.

456 2002 Decision, p. 146, Exh. C-175.

457 *Ibid*.

458 Resolution of the Federal Arbitrazh Court for the Moscow District No. KA-A40/3222-05, p. 30, Exh. C-184 (referring to Order No. 53 of the Administration of the Evenkiysky Autonomous District, 29 June 2001).

459 2002 Decision, p. 154, Exh. C-175.

471. Tax reassessments would later be made against Yukos for Evoil for the years 2002[460] and 2003,[461] totaling RUR 203,629,769 (approximately USD 6,787,659).[462]

ii. Interneft

472. Interneft was registered by Order 333 of Administration of Ilimpiisk District of Evenkia on 23 October 1998.[463] The sole founder of Interneft is OOO Netax Advertising Agency, registered in Kalmykia.[464] It was founded with an initial capital of RUR 8,400, split into 100 ordinary registered shares with nominal value of RUR 84.[465]

473. On 26 July 1999, Interneft was awarded a "Certificate of assignment of the status of Participant in the investment programs of the Evenki Autonomous Region."[466]

474. Tax reassessments would later be made against Yukos for Interneft for the year 2000,[467] totaling RUR 224,642 (USD 7,858).[468]

iii. Petroleum-Trading (Trion)

475. Petroleum-Trading was registered under the name Trion by Order 146-p of the Administration of Ilimpiisk District of Evenkia on 25 April 2000. Its new name was registered by Order 193 of Administration of Ilimpiisk District of Evenkia on 31 May 2000.[469] Petroleum-Trading was founded by Neftepromstroiservice ZAO and Neftepromburservice ZAO, each holding

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460 *Ibid*. pp. 154–55.

461 2003 Decision, p. 142, Exh. C-190.

462 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

463 2000 Decision, p. 76, Exh. C-104

464 *Ibid*.

465 *Ibid*.

466 *Ibid*., p. 77.

467 *Ibid.*, p. 78.

468 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 28.5892:1, the official exchange rate on 14 April 2004.

469 2000 Decision, p. 55, Exh. C-104.

50 percent of the share capital. Both parent companies were registered in Kalmykia.[470] The founding capital was RUR 8,400.

476. Pursuant to Order No. 53 of the Administration of the Evenkiysky Autonomous District of 29 June 2001, "On Application of Special Tax Regime," Petroleum-Trading was granted targeted tax benefits.[471]

477. Tax reassessments would be later made against Yukos for Petroleum-Trading for the years 2000[472] and 2002[473] totaling RUR 90,943,100 (approximately USD 3,031,437).[474]

iv. Ratibor

478. Ratibor was registered by Order 168-p of the Administration of the Evenkiysky Autonomous District on 21 July 2000. It was registered with tax authorities and state authorities on 14 February 2001.[475] It was founded by Ms. Svetlana Ivanovna Vorobyeva, with a share capital of RUR 10,000.[476] On 25 May 2001, 100 percent of the share capital of Ratibor OOO was transferred to Dunsley Limited, a company registered in Cyprus. Dunsley was, in turn, owned by Doluen Limited, with 99.9 percent of the shares, registered in Cyprus, and Abakus (Nominis) Limited, with 0.1 percent of the shares, also registered in Cyprus.[477]

479. Pursuant to Order No. 53 of the Administration of the Evenkiysky Autonomous District of June 2001, "On the application of the Special Taxation Procedure," Ratibor was granted targeted tax benefits.[478]

480. Tax reassessments would later be made against Yukos for Ratibor for the years 2001[479] and 2002,[480] totaling RUR 13,870,285,714 (approximately USD 462,342,857).[481]

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470 *Ibid.*, p. 55–56.

471 Resolution of the Federal Arbitrazh Court for the Moscow District No. KA-A40/3222-05 p. 30, Exh. C-184 (referring to Order No. 53 of the Administration of the Evenkiysky Autonomous District, 29 June 2001).

472 2000 Decision, p. 57, Exh. C-104.

473 2002 Decision, p. 163–64, Exh. C-175.

474 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

475 2001 Decision, p. 82, Exh. C-155.

476 *Ibid*.

477 *Ibid.*

478 *Ibid*., p. 99.

v. Yukos Vostok Trade

481. Yukos Vostok Trade was registered by Decision 36 of the Interdistrict Inspectorate of the Russian Ministry of Taxes and Levies No. 3 for the Evenki Autonomous District, 9 February 2004.[482] It was founded by OAO Yukos Oil Company with 70 percent of the shareholding and Yukos-Import with 30 percent of the shareholding.[483]

482. While there is no reference to any tax agreements on the record, the Tribunal notes that Field Tax Audit Report No. 52/996 refers to Yukos Vostok Trade making use of the beneficial tax system in Law 108 of 24 September 1998, with a preferential income tax rate reduced to 13 percent and a preferential property tax rate of 0 percent.[484]

483. Tax reassessments would later be made against Yukos for Yukos Vostok Trade for 2004,[485] totaling RUR 8,660,507,192 (USD 311,337,530).[486]

5. Tribunal's Observations

484. Having set out the evidence regarding Yukos' tax optimization scheme, the Tribunal now returns to the question posed at the beginning of this chapter: does the record which it has reviewed at length demonstrate that Yukos was merely taking advantage of the legislation in place in the low-tax regions of the Russian Federation to minimize its taxes, or was there an element of abuse in its activities that made them illegal under Russian law?

485. The Tribunal first reiterates that the evidence reveals—indeed, the Parties are agreed—that the Russian Federation had enacted (in the late 1990s and early 2000s) a legislative structure to encourage investment in some of its low-tax regions, and that Yukos (as did many other Russian companies, including other oil companies) sought to take advantage of that legislative

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479 *Ibid.*, pp. 99–100.

480 2002 Decision, p. 146, Exh. C-175.

481 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. The RUR to USD exchange rate used here is approximate, based on a rate of 30:1.

482 2004 Decision, p. 86, Exh. R-1539.

483 *Ibid*.

484 Field Tax Audit Report No. 52/996, p. 84, 27 December 2005.

485 2004 Decision, pp. 90–91, Exh. R-1539.

486 Yukos Tax Reassessment Breakdown, p. 6, Exh. C-1752. RUR to USD calculated at 27.8171:1, the official exchange rate on 17 March 2006.

structure. As a result, Yukos set up trading companies in various low-tax regions and, where required, entered into investment agreements with the local authorities.

486. There is evidence in the record that Mr. Dubov informed the authorities, at least in respect of the Yukos trading companies in Mordovia, that Yukos was using the legislative arrangements in place to minimize its taxes, and that none of his interlocutors, including the then First Deputy of Finance, Alexei Kudrin, formulated any objection. Finally, the Tribunal recalls that few of the audits of the trading companies conducted in the regions prior to 2003 ever resulted in any tax assessments, and, when they did, the transgressions were generally minor and the assessments insignificant.

487. In this connection, the Tribunal notes that Respondent chose not to call any fact witnesses to challenge Claimants' fact witnesses. That is unfortunate. The Tribunal would have been assisted, for example, by the evidence of Mr. Kudrin who, after his meeting with Mr. Dubov, became Minister of Finance and Deputy Prime Minister of the Russian Federation. Instead, Respondent has relied solely on the documentary record to build its case that Yukos' activities in the low-tax regions were abusive and illegal. As Claimants pointed out during the Hearing, and as the Tribunal found out for itself, the documentary record compiled and presented by Respondent to the Tribunal, while significant, is selective and unfortunately incomplete.

488. The record does reveal, however, that Yukos had some concerns about the legality of its trading operations in certain low-tax regions, notably in Lesnoy and Trekhgorny. As recorded in the previous section of the present chapter, there were audit reports and memoranda that attest to an investigation of whether the practices of some of the Yukos trading companies in those regions were abusing the system, since those companies were acting in conformity with the relevant legislation in form only and not in substance.

489. The Tribunal recalls that, in November 2001, after an extensive corporate restructuring had taken place (as a result of which the trading entities in Lesnoy and Trekhgorny ceased to exist, and were merged into entities created in other regions), Ms. Irina Golub, the Chief Accountant of Yukos, received a document by e-mail from Mr. Kartashov, a general director of Yukos. That document referred specifically to the ongoing investigations in Lesnoy and Trekhgorny by the Federal Tax Police Service of Sverdlovsk as part of a criminal case "in connection with tax evasion" by the Yukos entities and to the fact that office personnel in Lesnoy and Trekhgorny (including, in the case of the Lesnoy entities, the General Directors) had been interrogated by tax authorities.

490. The Tribunal notes here that the Investigation Group of the Russian Federation's Federal Tax Police Agency for the Sverdlovsk Region was the organization that had issued the "Decree on the institution and initiation of criminal proceedings"[487]—looking into the payment of taxes with promissory notes—three weeks earlier.

491. During the Hearing and in its Post-Hearing Brief, Respondent referred many times to the Kartashov e-mail, as well as the following evidence, which, it argued, demonstrated that Yukos knew that its scheme was unlawful and "took pains to conceal its scheme from the authorities":[488]

- Firstly, the 22 April 2002 memorandum from Mr. Maly, in which he expressed his concern that if Yukos' affiliation with the trading entities were included in the SEC filing, that information "may be used by the Russian tax authorities to challenge [Yukos'] approach to certain transactions and, consequently, will result in substantial tax claims against the [c]ompany";[489]

- Secondly, the e-mail from Mr. Maruev (from the Treasury Department) to employees in 2002 to "clean your folders" of references to the Lesnoy trading companies;[490]

- Thirdly, the internal memorandum from Yukos' General Counsel Mr. Aleksanyan advising Ms. Golub not to draw the attention of the authorities to the use of tax incentives in the ZATO Lesnoy, since "an investigation into the legality of the use of the incentives . . . entails substantial risks, including under criminal law";[491]

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487 Decree on the institution and initiation of criminal proceedings of the Investigation Group of the Russian Federation's Federal Tax Police Agency for the Sverdlovsk Region, 3 September 2001, Exh. R-376.

488 Respondent's Post-Hearing Brief ¶¶ 29, 38.

489 E-mail from P.N. Maly to O.V. Sheyko, 14 May 2002, Exh. R-184.

490 E-mail from D.L. Maruev to M.U. Barbarovich and V.M. Zuravlev, 15 March 2002, cc'ing V.A. Podzarov, Exh. R-4040.

491 Letter from V.G. Aleksanyan to I.Y. Golub dated 14 December 2001. Exh. R-3244. Professor Gaillard argued during the hearing that Mr. Aleksanyan was simply saying "don't …rub an issue which has not been opened." Transcript, Day 20 at 61. The full discussion can be found at Transcript, Day 20 at 57–62. Professor Gaillard suggested that Ms. Golub:

> "…receives a letter from Aleksanyan, who is the boss two steps above her. . . which says, 'You'—I summarise it, and then we will go to the details. Basically it says, 'You stupid, you don't understand that it's not about the tax incentives, it's about the promissory notes. So why do you prepare a letter talking about tax incentives? That's not at issue here.'" Transcript, Day 20 at 58–59.

- Fourthly, Mr. Khodorkovsky's refusal in early 2003 to sign Yukos' registration statement (for a confidential SEC filing) over concerns for his "personal risks";[492] and

- Fifthly, a "blackline" version of Yukos' draft filing for the SEC sent on 23 July 2002 by Natalia Kuznetsova of PwC to Stephen Wilson (at that time Yukos' international tax director), proposing that the following be deleted from an earlier draft: "We use tax optimization mechanisms that may be challenged by the tax authorities" and "If a number of regional tax incentives we have used to reduce our tax burden are successfully challenged by the Russian tax authorities, we will face significant losses associated with the additionally assessed amount of tax and related interest and penalties."[493]

492. In their reply to the evidence regarding concern over potential tax liabilities, Claimants submit that the Russian tax authorities "were notorious for displaying arbitrary and unpredictable interpretations of law generating significant and unquantifiable risks for taxpayers[,] risks that Yukos and other Russian oil companies . . . disclosed in their financial statements."[494] They conclude that references by Yukos' management to such risks "[could not] reasonably be construed as evidencing 'knowledge' or 'belief' that Yukos' tax structure was unlawful."[495] Claimants also argue that Respondent's reliance on Mr. Maly's e-mail was "much ado about nothing," and that "it is clear that any risks were neither a problem, nor an obstacle, to Yukos pursuing the NYSE listing because Yukos continued to draft its Form F-1 into mid-March 2003, nearly a year after this memo."[496] Claimants also note that, in respect of the blackline filing that it "in fact states—in a sentence the Respondent omits to quote—that Yukos' management '<u>believe the tax mechanisms used by us comply</u>.'"[497]

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492 E-mail from M.B. Khodorkovsky to O.V. Sheiko, 20 February 2003, Exh. R-3611.

493 Facsimile transmission from Natalia Kusnetsova to Stephen Wilson dated 23 July 2002, pp. 133–34, Exh. R-1477.

494 Claimants' Post-Hearing Brief ¶ 15.

495 *Ibid*.

496 Reply ¶ 111.

497 Reply ¶ 199 (emphasis in original). As Claimants note, the full paragraph reads:

"Our results of operation have historically benefited significantly from the use of tax [illegible] mechanisms. We believe that the tax mechanisms used by us comply with relevant [illegible]. If, however, we phase out all of our current tax optimization mechanisms due to changes to the tax regime or other reasons, we may have to pay significantly higher taxes in the future, and our result of operation may be adversely affected. In addition, if the various initiatives we have used to reduce our tax burden are successfully challenged by the Russian tax authorities we may face significant losses associated with the assessed amount of tax underpaid and related interest and penalties, which would have a material impact on our financial condition and results of operation."

Ibid. n.337.

493. In fact, the record before the Tribunal reveals that Lukoil, Rosneft, Sibneft and TNK, in their financial statements in those years, all referred to the significant risks associated with the varying interpretation by the Russian tax authorities of the Russian tax legislation.[498]

494. Although the Yukos entities in Lesnoy and Trekhgorny were only a small part of Yukos' tax optimization scheme,[499] it is clear to the Tribunal that these entities were being investigated as of late 1999 by the tax authorities in these regions, and were suspected of being "shams". It is the view of the Tribunal that the legal basis for this scrutiny was the jurisprudential "good faith taxpayer" doctrine ("substance over form" or "anti-abuse" doctrine) and that, within the senior management of Yukos, there were a number of persons who were aware that Yukos was vulnerable in respect of certain facets of its tax optimization scheme.

495. As for the existence of the "good faith taxpayer" doctrine in Russia at that time, the Tribunal has reviewed the evidence of Mr. Konnov, the only expert on Russian tax law to give evidence in these proceedings, who appeared on behalf of Respondent. Although Claimants elected not

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498 *See* Consolidated Financial Statements of OAO Lukoil, 30 May 2003, Exh. C-371; Consolidated Financial Statements of OJSC Rosneft Oil Company (hereinafter "Rosneft"), 24 June 2005, C-373; Consolidated Financial Statements of AO Siberian Oil Company, 21 June 2002, C-384;and Consolidated Financial Statements of TNK International Limited, 15 May 2003, C-390. To illustrate, the following is the warning contained in Lukoil's financial statements for the period ending 31 December 2002

"The taxation systems in the Russian Federation and other emerging markets where Group companies operate are relatively new and are characterized by numerous taxes and changing legislation, which may be applied retroactively and is sometimes unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among different tax authorities within the same jurisdictions and among taxing authorities in different jurisdictions. Taxes are subject to review and investigation by a number of authorities, which are enabled by law to impose severe fines, penalties and interest charges. Such factors may create taxation risks in the Russian Federation and other countries where Group companies operate substantially more significant than those in other countries where taxation regimes have been subject to development and clarification over long periods.

. . .

The regional organizational structure of the Russian Federation tax authorities and the regional judicial system can mean that taxation issues successfully defended in one region may be unsuccessful in another region. The tax authorities in each region may have a different interpretation of similar taxation issues. There is however some degree of direction provided from the central authority based in Moscow on particular taxation issues.

The Group has implemented tax planning and management strategies based on existing legislation at the time of implementation. The Group is subject to tax authority audits on an ongoing basis, as is normal in the Russian environment, and, at times, the authorities have attempted to impose additional significant taxes on the Group. Management believes that it has adequately met and provided for tax liabilities based on its interpretation of existing tax legislation. However, the relevant tax authorities may have differing interpretations and the effects could be significant."

Exh. C-371, pp. 30–31 (emphasis added).

499 The tax assessments levied against Yukos in connection with the trading entities in Lesnoy and Trekhgorny, which related only to the 2000 tax year (since the entities ceased to exist in early 2001), represented approximately 19 percent of the total tax assessment against Yukos for 2000, and represented under 3 percent of the total of all tax assessments against Yukos (for the years 2000–2003). *See* Yukos Tax Reassessment Breakdown, Exh. C-1752.

to present their own expert on Russian tax law,[500] in their written submissions, they referred to and criticized various Russian court decisions, which they contended did not support Respondent's interpretation. As noted earlier in the present chapter, the Tribunal has considered Claimant's submissions.

496. The Tribunal has also considered the lengthy cross-examination of Mr. Konnov by Professor Gaillard. The Tribunal recalls again that Professor Gaillard did not challenge Mr. Konnov on the existence of the anti-abuse doctrine but rather sought Respondent's expert's acknowledgement that the Yukos tax optimization scheme complied with the existing legislative framework in Russia as well as in the regions. The Tribunal notes in this context that Claimants stipulate to the existence of the "bad-faith taxpayer" doctrine in their Reply, but argue that "neither it nor any other alleged judicial doctrine had previously been applied as in the Yukos case."[501]

497. As a matter of background fact, the record before the Tribunal is clear that, at the time of the issuance on 29 December 2003 of the Field Tax Audit Report, the "bad faith taxpayer" doctrine, although it had not yet gelled in the way that it did in 2006 in the ruling of the Supreme Arbitrazh Court in Resolution No. 53, had been recognized and applied in some Russian court decisions.

498. The Tribunal recalls that the eminent Russian tax lawyer, Mr. Sergey Pepeliaev, who later represented Yukos in the Russian tax litigation, wrote in 2002 that the doctrine existed and that "[i]f it appears that parties act both unreasonably and not in good faith then this constitutes a ground for reassessment of the parties' tax liabilities . . . ."[502]

499. Beyond this conclusion, which the Tribunal considers a matter of fact, the Tribunal does not need to determine, as a matter of Russian law, whether any of the activities of the Yukos

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500 The Tribunal notes that in the *RosInvestCo* arbitration, the claimant presented a Russian tax law expert, Professor Maggs. The Russian Federation relied on Mr. Konnov. The *RosInvestCo* tribunal stated that it found Professor Maggs' evidence more persuasive, but it also acknowledged that Professor Maggs did not dispute the existence of the "bad faith taxpayer" doctrine. *See RosInvestCo* ¶¶ 432, 495, Exh. C-1049. Similarly, in the *Quasar* arbitration, claimants presented a Russian tax law expert, Professor Stephan, as well as an expert on the *Russian Civil Code*, Professor Mozolin, who opined, *inter alia*, on the distinction between good and bad faith taxpayers. *See Quasar*, ¶ 66, 77–78, Exh. R-3383. As in this arbitration, and the *RosInvestCo* arbitration, the Russian Federation's expert on Russian law was Mr. Konnov. As in the *RosInvestCo* case, the debate turned primarily on the application to Yukos of the anti-abuse doctrine, as opposed to the existence of the anti-abuse doctrine.

501 Reply ¶ 217, n.368.

502 S.G. Pepeliaev, *Commentary to the Ruling of the Constitutional Court Ruling of the Russian Federation No. 138-O of July 25, 2001*, Exh. R-352.

trading companies in the low tax regions in 2000, 2001, 2002, and 2003 in the implementation of its tax optimization scheme were in violation of this doctrine. As noted in the introduction to the present chapter, it is not the role of the Tribunal in the present arbitrations to sit as a court applying Russian law.

500. However, the Tribunal does note that that, in using the available tax benefit legislation in the Russian Federation, the Yukos group principally availed itself of facilities under the laws of Mordovia, the region which represents approximately 78 percent of the 2000 to 2004 tax reassessments against Yukos. Another significant portion of the reassessments relates to Evenkia, while the tax reassessments in ZATO Lesnoy and Trekhgorny represent less than three percent of the total. It is important for the Tribunal to stress that the bad faith doctrine was never used against Yukos prior to December 2003.

501. The Tribunal will now turn in the next chapter of its Award to the central question which it posed at the beginning of the present chapter: were the December 2003 and the subsequent tax assessments a legitimate exercise by the Russian Federation of its prerogative to enforce its tax laws or were they, as Claimants argued, a mere fabrication of massive tax claims against Yukos serving as instruments which allowed the premeditated expropriation of all Yukos assets by the State after the arrest of Mr. Lebedev and Mr. Khodorkovsky.

502. As will be seen, a crucial consideration for the Tribunal concerns the remedy or sanction of "re-attribution", and the application of the "re-attribution" remedy to revenues (for purposes of profit tax) without a corresponding "re-attribution" of tax filings for purposes of VAT. Also considered in the next chapter is the legitimacy of associated fines levied against Yukos, notably the "willful offender" and "repeat offender" fines.

B. THE TAX ASSESSMENTS STARTING IN DECEMBER 2003

1. Introduction

503. This chapter addresses the next crucial facet in the factual narrative of the present arbitration, namely the tax assessments that were issued against Yukos starting in December 2003, the manner in which those assessments were made and how they were reasoned and, eventually, enforced.

504. This important review will lead the Tribunal to consider a central question in this case: were the December 2003 and subsequent tax assessments covering the tax years 2000 to 2004 a

legitimate exercise by the Russian Federation of its prerogative to enforce its tax laws (Respondent's position), or were they a fabrication of massive tax claims against Yukos that allowed the premeditated expropriation of all Yukos assets by the State (Claimants' position)? Or does the record rather suggest that the truth lies somewhere between these two positions: could certain taxes in the assessments have legitimately been imposed while others plainly not, and were the consequential sanctions inexorably exacted by Russian authorities so excessively disproportionate as to require an answer to the question described as key by counsel for the claimant in *Quasar*, Mr. O.T. Johnson: "Why would Russia have treated Yukos as it did if its purpose was to collect taxes?"[503]

505. A closely related question concerns the arrests in 2003 of Messrs. Lebedev and Khodorkovsky: were the arrests and the subsequent convictions of Messrs. Lebedev and Khodorkovsky (not once but twice), again, a legitimate exercise by the Russian Federation of its prerogative to enforce its criminal and tax laws (Respondent's position), or were they a politically motivated attack on these individuals as part of a broader campaign to confiscate the rich assets of Yukos (Claimants' position)?

506. The issues raised by the arrests and convictions of Messrs. Lebedev and Khodorkovsky, and of other individuals connected with Yukos, and the alleged harassment of Yukos management, are addressed in detail in Chapter VIII.C of the present Award. The Tribunal considers it opportune however at this time to comment upon some of the circumstances surrounding those arrests.

507. Claimants have argued that the arrests, and the broader campaign of harassment and intimidation of the leading officers and employees of Yukos, were prompted by President Putin's desire to retaliate against Mr. Khodorkovsky and Yukos for Mr. Khodorkovsky's political and social activism, which Claimants allege became intolerable for President Putin subsequent to a public encounter between the two men in February 2003.

508. Specifically, on 19 February 2003, in the context of a meeting between President Putin and a group of the country's most powerful businessmen, a televised confrontation between President Putin and Mr. Khodorkovsky took place.[504] According to the testimony of Dr. Illarionov,

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503 *Quasar* ¶ 41, Exh. R-3383.

504 Video recording and transcript of the meeting of the members of the Union of Industrialists and Entrepreneurs with President V. Putin held in the Ekaterininsky Hall, Kremlin, 19 February 2003, Exh. C-1396.

President Putin had scheduled regular meetings between himself and the business leaders, facilitated by the Russian Union of Industrialists and Entrepreneurs headed by Mr. Arkady Volsky.[505]

509. At the meeting, which would, according to Dr. Illarionov, turn out to be the last of its kind, Mr. Khodorkovsky made a presentation on the topic of corruption. In his presentation, he asserted that corruption in Russia was rife, and that it was "rotting the Russian Government and the Presidential Administration."[506] While no names were mentioned, relates Dr. Illarionov, President Putin did discuss the acquisition of Severnaya Neft by Rosneft, for which Rosneft had paid approximately USD 622 million. Dr. Illarionov states that "[i]t was widely considered that the price was exaggerated and that a portion of the price represented kickbacks to State officials."[507]

510. Dr. Illarionov concludes as follows in relation to his understanding of the significance of that encounter:

> During his closing remarks, the President turned to Mr. Khodorkovsky and stated that everyone knew how various assets, including Yukos, were acquired. The President indicated to Khodorkovsky that "I return the ball in your corner" . . . . Later, it became clear that this was a signal to the governing elites that Mr. Khodorkovsky could be attacked and he was no longer tolerated.[508]

511. At the same time, the Tribunal's findings in the previous chapter of the present Award suggest that well before the clash between President Putin and Mr. Khodorkovsky at the February 2003 meeting, the tax authorities of the Russian Federation were challenging the tax benefits claimed by some Yukos entities (in ZATO Lesnoy) and, in a few cases, had made findings adverse to those trading companies. Moreover, the Tribunal recalls, as it did in the previous chapter, that Messrs. Khodorkovsky and Lebedev were ultimately convicted, *inter alia*, for tax evasion in relation to Yukos' activities in Lesnoy, in which (the record revealed) the authorities had suspended an investigation into the commission of tax crimes because, according to the conclusions in the relevant Resolution, it was not then possible to determine who actually committed the crimes.

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505 Illarionov WS ¶ 23.

506 *Ibid.* ¶ 29.

507 *Ibid.* (citation omitted).

508 *Ibid.* ¶ 31.

512. Respondent emphasized Yukos' earlier tax problems in its comments on the February 2003 meeting. Respondent noted in its Closing Statement that President Putin publicly told Mr. Khodorkovsky that the political protection or assistance he was allegedly receiving from the Kremlin until that meeting would be removed, and he added that "we've talked about taxes before."[509]

513. Based on the extensive record that was presented to it, the Tribunal is unable to accept the proposition that the February 2003 confrontation created Yukos' tax problems and that, but for such a confrontation, Yukos would have avoided any and all tax reassessments against it. While this meeting may well have marked a turning point in the relations between Yukos and the Russian Federation, as the Tribunal observed in the previous chapter, within the senior management of Yukos, and well before February 2003, there were individuals who were aware that the company's tax optimization mechanisms were vulnerable and could be challenged by the tax authorities. Some of the evidence presented to the Tribunal also revealed that there was at least some awareness within Yukos that a successful challenge to the Yukos tax structure would result in "substantial tax claims"[510] or "significant losses associated with the additional assessed amount of tax and related interest and penalties"[511] and possibly even criminal liability. At the same time, the Tribunal notes that the tax assessments and decisions against Yukos led not just to "substantial tax claims" or to "significant losses" but to its bankruptcy and destruction, and to the transfer of the principal assets of Yukos to Rosneft, a company controlled by the Russian Federation.

514. The crucial question addressed in this chapter of the Award, therefore, is whether Claimants have discharged their burden of proof and established that the tax assessments, and the enforcement processes of the Russian Federation which followed, are more consistent with the conclusion that they evidence a punitive campaign against Yukos and its principal beneficial owners with sanctions entirely disproportionate to the company's tax liability, rather than with the conclusion that they were a legitimate exercise of tax enforcement.

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509 Transcript, Day 18 at 113. Counsel for Respondent interprets this as "I am not going to protect Mr. Khodorkovsky anymore. He is on his own." *Ibid*. The full quote of the President's remark is: "We have already discussed it with you recently, that your company, for example, has had problems with the payment of taxes." Transcript of the 19 February 2003 Meeting, Exh. C-1396.

510 E-mail from P.N. Maly to O.V. Sheyko, 14 May 2002, Exh. R-184. *See* paragraph 491 above.

511 Facsimile transmission from Natalia Kuznetsova to Stephen Wilson, 23 July 2002 p.134, Exh. R-1477. *See* paragraph 491 above.

515. In the Tribunal's view, it may well be that, while Yukos was vulnerable on some aspects of its tax optimization scheme, and possibly even would have faced "substantial tax claims" that might have resulted in "significant losses," principally because of the sham-like nature of some elements of its operations in at least some of the low-tax regions, the State apparatus decided to take advantage of that vulnerability by launching a full assault on Yukos and its beneficial owners in order to bankrupt Yukos and appropriate its assets while, at the same time, removing Mr. Khodorkovsky from the political arena.

516. Dr. Illarionov asserts in his witness statement that "various possible justifications for Mr. Khodorkovsky's arrest and Yukos' dismantlement were tested in the Fall of 2003."[512] He then goes on to list fifteen "theories" that, he says, "were gradually created as a smoke screen and advanced for public consumption," including "tax evasion schemes."[513] In other words, Yukos' tax arrangements in certain low-tax regions (some of which, notably in ZATO Lesnoy, as related in Chapter VIII.A, were being scrutinized as of 1999 by the tax authorities and were suspected of being "shams") may have served as a plausible pretext for the State apparatus to crush Mr. Khodorkovsky and expropriate Yukos. In this chapter, the Tribunal considers evidence that is crucial to its determination of this central issue in the present proceedings. The Tribunal observes again that its conclusions in this chapter are only concerned with factual findings. The determination of the relevant legal issues under the provisions of the ECT will be considered later, in Part X of the Award.

2. Chronology of the Tax Assessments and Related Decisions

517. On 29 December 2003, the tax authorities of the Russian Federation issued the first of five tax assessments against Yukos based on the alleged abuse by Yukos of its tax optimization scheme. These five assessments were:

512 Illarionov WS ¶ 36.

513 *Ibid.*

Tax Year	Date of Tax Audit Report	Date of Tax Decision	Total Amount Assessed (USD billion)
2000	29 Dec. 2003 (Exh. C-103)	14 Apr. 2004 (Exh. C-104)	3.48
2001	30 June 2004 (Exh. R-345)	2 Sept. 2004 (Exh. C-155)	4.10
2002	29 Oct. 2004 (Exh. R-346)	16 Nov. 2004 (Exh. C-175)	6.76
2003	19 Nov. 2004 (Exh. R-1583)	6 Dec. 2004 (Exh. C-190)	6.10
2004	27 Dec. 2005 (Exh. C-200)	17 Mar. 2006 (Exh. R-1539)	3.74
Total for Tax Years 2000–2004			**24.18**

518. For each year that the Tax Ministry re-assessed Yukos a Repeat/Field Tax Audit Report and a Decision were issued. For ease of reference, in this chapter, each Audit Report and Decision will be referred to by the tax year to which it relates. For example, the Tax Ministry audited Yukos' activities in the year 2000. It issued Field Tax Audit Report No. 08-1/1 on 29 December 2003 ("**2000 Audit Report**"). It issued Decision No. 14-3-05/1609-1 to hold the taxpayer fiscally liable for a tax offense on 14 April 2004 ("**2000 Decision**").

519. In the subsections below, the Tribunal records, for each tax year, the extensive chronology of tax assessments and related decisions of the tax authorities, bailiffs and Russian courts. These events as such are not disputed by the Parties.

(a) The 2000 Decision

520. As noted above, on 29 December 2003, the 2000 Audit Report, was issued.[514] It was followed, on 14 April 2004, by the 2000 Decision holding the taxpayer liable for a tax offense.[515] It levied the following amounts in tax arrears:

[514] 2000 Audit Report, Exh. C-103.

[515] 2000 Decision, Exh. C-104.

COMPANY	TAX BENEFITS	VAT	TOTAL
Alta Trade	RUR 2,491,817,840	RUR 467,486,102	RUR 2,959,303,942 (USD 104 Million)
Mars XXII	RUR 18,393,165		RUR 18,393,165 (USD 643,361)
Ratmir	RUR 4,336,209,757	RUR 1,770,256,037	RUR 6,106,465,794 (USD 213,593,448)
Yukos-M	RUR 14,456,555,351	RUR 9,697,309,558	RUR 24,153,864,909 (USD 845 Million)
Yu-Mordovia	RUR 2,210,007,592	RUR 2,045,653,454	RUR 4,255,661,046 (USD 149 Million)
Sibirskaya	RUR 240,437,174		RUR 240,437,174 (USD 8.4 Million)
Business-Oil	RUR 1,584,766,950 PN:* RUR 36,184,822		RUR 1,620,951,772 (USD 56.7 Million)
Mitra	RUR 27,124,001		RUR 27,124,001 (USD 948,750)
Vald-Oil	RUR 1,304,431,717 PN:* RUR 57,784,864		RUR 1,362,216,581 (USD 47,647,943)
Grace	RUR 20,247,201		RUR 20,247,201 (USD 708,212)
Muskron	RUR 7,398,094		RUR 7,398,094 (USD 258,772)
Nortex	RUR 3,152,537,572		RUR 3,152,537,572 (USD 110 Million)
Quercus	RUR 3,031,422,237		RUR 3,031,422,237 (USD 106,033,825)
Virtus	RUR 2,359,700		RUR 2,359,700 (USD 82,538)
Yuksar	RUR 95,875,131		RUR 95,875,131 (USD 3. 353,544)

COMPANY	TAX BENEFITS	VAT	TOTAL
Interneft	RUR 224,642		RUR 224,642 (USD 7,858)**
Petroleum-Trading	RUR 23,333,365		RUR 23,333,365 (USD 816,160)

* "PN" indicates taxes considered unpaid as they were paid with promissory notes.
** Interneft is ultimately removed from this list by the Decision of 26 May 2004, for not being legally "interdependent."[516]

521. On the same day, 14 April 2004, a tax payment demand was issued to Yukos in the amount of RUR 80,179,841,454 (USD 2.8 billion).[517] Payment was due just two days later, on 16 April 2004. Also on 14 April 2004, a related fine was issued, imposing penalties in the amount of RUR 19,195,696,780 (USD 671 million).[518] Payment of this sum was also due on 16 April 2004. The total amount payable within two days by Yukos was thus approximately USD 3.48 billion.

522. On 15 April 2004, the Tax Ministry registered its claim with the Moscow Arbitrazh Court.[519] On the same day, a ruling of the Moscow Arbitrazh Court prohibiting Yukos from alienating and encumbering "in any way" its assets, including shares and other securities, was issued.[520] Writs of enforcement were also issued.[521] On 16 April 2004, a resolution of the bailiffs was issued and enforcement proceedings were commenced.[522]

523. Yukos began parallel proceedings to those initiated by the Tax Ministry, challenging the 2000 Decision as unlawful. On 19 May 2004, Judge Cheburashkina granted interim relief *suspending* the effect of the 2000 Decision, pending a judgment on the merits of Yukos'

516 Decision of the Moscow Arbitrazh Court, Case No. A40-17699-04-09-241, 26 May 2004, Exh. C-116.

517 Tax Payment Demand No. 14-3-05/1610-8, 14 April 2004, Exh. C-105.

518 Tax Penalty Payment Demand No. 14-3-05/1611-1, 14 April 2004, Exh. C-106.

519 Ruling of the Moscow Arbitrazh Court to proceed with a claim, to prepare the case for hearing, and to schedule preliminary hearing, Case No. A40-17669/04-109-241, 15 April 2004, Exh. C-107.

520 Ruling of the Moscow Arbitrazh Court on adoption of interim measures, 15 April 2004, Exh. C-108 (hereainfter "April 2004 Injunction").

521 Enforcement Writs of the Moscow Arbitrazh Court Nos. 370735, 16 April 2004; 370738, 15 April 2004; 370739, 16 April 2004; 370740, 16 April 2004, Exh. C-109.

522 Resolution of Bailiff D.A. Borisoff to initiate enforcement proceeding No. 11/5975, 16 April 2004, Exh. C-110.

petition in respect of the lawfulness of the 2000 Decision.[523] In her decision, Judge Cheburashkina wrote that the seizure of such assets would "cause significant damage to the Applicant's activities and make it impossible to execute the judicial act" and that "the Applicant has presented evidence demonstrating that the consequences indicated in Article 90(2) of the RF Arbitrazh Procedure Code might arise, and that serious damage and disruption might be caused to production activities."[524]

524. On 26 May 2004, Yukos made a motion in the collection proceedings (those initiated by the Tax Ministry) to join the Republic of Mordovia in those proceedings.[525] The motion was not successful. Presumably, Yukos sought the joinder of Mordovia, by far the major focus of its trading companies' activities and investments, in the expectation that Mordovian officials would support the legitimacy of Yukos' tax optimization procedures and attest to the value of Yukos' substantial investments in Mordovia.

525. In the collection proceedings, the court had also denied Yukos' motion to stay the proceedings.[526] In a decision dated 26 May 2004 and released on 28 May 2004, Judge Grechishkin of the Moscow Arbitrazh Court granted the Tax Ministry's petition, allowing the collection of tax arrears, interest and fines in the amount of RUR 99,375,110,548 (USD 3.48 billion) pertaining to the 2000 Decision.[527]

526. Judge Grechishkin found that Yukos had acted in bad faith,[528] that the use by the trading companies of tax benefits was illegal because it was "not aimed at strengthening the economy of the Republic of Mordovia" but rather was used to "evade payment of taxes."[529] The judge adopted the same reasoning as the Tax Ministry on the VAT issue, writing that: "In order to use its right to the benefit, the taxpayer had to declare its right and confirm its right by documents in accordance with the current legislation. . . . The taxpayer—OAO Yukos Oil Company—did not declare its desire to use its benefit either in 2000 or later."[530] However, this

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523 Ruling of the Moscow Arbitrazh Court to suspend the effect of Decision No. 14-3-05/1609-1 of 14 April 2004, Case No. A40-21839/04-75-276 p. 2, 19 May 2004, Exh. C-112.

524 *Ibid*.

525 Motion to join a third party to the proceeding, Case No. A40-17699-04-09-241, 26 May 2004, Exh. C-115.

526 Ruling of the Moscow Arbitrazh Court, Case No. A40-17699-04-09-241, 14 May, 2004, Exh. C-111.

527 Decision of the Moscow Arbitrazh Court, Case No. A40-17699-04-09-241, 26 May 2004, Exh. C-116.

528 *Ibid*., p. 14.

529 *Ibid*., p. 15.

530 *Ibid.*, p. 19.

judgment could not be executed by the Tax Ministry as the interim relief in the parallel proceedings prevented enforcement until a determination of the lawfulness of the 2000 Decision was made.

527. On 11 June 2004, Judge Cheburashkina, the presiding judge in the case brought by Yukos against the lawfulness of the 2000 Decision, was challenged by the Tax Ministry for bias towards Yukos in the granting of interim relief on 19 May 2004.[531] The Tax Ministry cited several reasons as a basis for her removal for bias towards Yukos, including: the allegation that the interim measures "did not comply with the principles of justice in a democratic constitutional State";[532] the allegation that the judge granted a "recess solely for OAO Yukos Oil Company to file a petition to stay proceedings in the [parallel] case to collect tax arrears, interest and fines," which the Tax Ministry saw as "evidence of the Judge's interest in the outcome of the proceedings in favor of the taxpayer";[533] her "behavior" in the preliminary court proceedings;[534] the allegation that the judge declined the petition of the Tax Ministry to abandon these proceedings in favour of the other set of collection proceedings initiated by the Tax Ministry;[535] and the allegation that the Tax Ministry was not granted extra time to copy documents to bring to court.[536] The challenge was upheld by the Moscow Arbitrazh Court the same day.

528. On 15 June 2004, Judge O.R. Mikhailova, a deputy chair of the Moscow Arbitrazh Court, was appointed to replace Judge Cheburashkina.[537] On 22 June 2004, Judge Mikhailova set the date of 19 July 2004 for the hearing of the merits phase of the case on the lawfulness of the 2000 Decision. She also directed the Tax Ministry to provide originals of the documents rather than photocopies and to organize the documents, including explanations "in order to confirm which circumstances they support."[538]

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531 Russian Federation Ministry of Taxes and Levies, Challenge to Judge N.P. Cheburashkina, Moscow Arbitrazh Court, Case No. 21839/04-76-276, 11 June 2004, Exh. C-117.

532 *Ibid*., p. 2 (emphasis in original omitted).

533 *Ibid*. (emphasis in original omitted).

534 *Ibid*.

535 *Ibid*., p. 3.

536 *Ibid.*, pp. 3–4.

537 Ruling of the Moscow Arbitrazh Court, Case No. 21839/04-76-276 p. 1, 22 June 2004, Exh. C-119.

538 *Ibid*.

529. In the proceedings to initiate collection of the taxes assessed in the 2000 Decision, on 29 June 2004, a resolution of the Moscow Arbitrazh Court reduced the amount to be collected to approximately USD 3.42 billion.[539]

530. In a decision dated 23 June 2004 but published on 30 June 2004, the interim measures granted by Judge Cheburashkina were annulled by an appeal panel of the Moscow Arbitrazh Court.[540] The court reasoned that as the Tax Ministry had not, at the time of the filing of the request, placed any direct collection orders in accordance with Article 46(4) of the Russian Tax Code on Yukos' bank accounts, the interim measures had been granted without the proper basis in law.[541] It also concluded that there were other specific procedures that could be followed under Article 91(1)(5) (in lieu of the interim relief granted under Article 90(2)) that did not require interim measures.[542]

531. Also on 30 June 2004, a resolution of Bailiff Solovyova was issued initiating enforcement proceedings.[543] The bailiff then issued several more resolutions freezing cash in 16 Yukos bank accounts up to the total amount of taxes then due.[544]

532. On 30 June 2004, the Tax Ministry obtained the reversal of the interim measures and initiated enforcement proceedings. On the same day, the Field Tax Audit Report for 2001 was released.[545] It assessed taxes, interest, and fines totaling approximately USD 4.1 billion.[546]

533. On 1 July 2004, another resolution was issued by Bailiff Solovyova limiting Yukos' rights pertaining to securities of 37 production, refining, and research subsidiaries.[547]

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539 Appeal Resolution of the Moscow Arbitrazh Court, Case No. A40-17699/04-109-241, 29 June 2004, Exh. C-121.

540 Appeal Resolution of the Moscow Arbitrazh Court, Case No. A40-21839/04-76-276, 23 June 2004, Exh. C-120.

541 *Ibid*., p. 4.

542 *Ibid*.

543 Resolution of Bailiff I.D. Soloyvova to initiate enforcement proceeding No. 10249/21/04, 30 June 2004, Exh. C-123.

544 Resolution of Bailiff I.D. Solovyova to seize monies No. 10249/21/04, 30 June 2004, Exh. C-124.

545 Repeat Field Tax Audit Report No. 30-3-14/1 (2001), 30 June 2004, Exh. R-345.

546 *Ibid.* at 132–33. The results of the audit will be discussed below at paragraphs 545–56, in connection with the Tax Ministry decision to which it relates.

547 Resolution of Bailiff I.D. Solovyova to restrict the rights of the securities owner, 1 July 2004, Exh. C-125; *see also* Memorial ¶ 341.

534. On 9 July 2004, Bailiff Solovyova issued a resolution for a seven percent enforcement fee for the proceedings relating to the 2000 Decision.[548] The fee amounted to approximately more than RUR 6.8 billion (approximately USD 240 million).

535. On 13 July 2004, further resolutions were issued by the bailiffs to seize Yukos' 14.5 percent stake in Sibneft which had been ordered by the Chukotka Arbitrazh Court as an interim measure in those proceedings.[549] The Chukotka proceedings had been initiated by Mr. Roman Abramovich and they related to disputes following the Yukos–Sibneft aborted merger. The Tribunal notes that while this seizure was not directly related to Yukos' trading companies, as will be seen later, it limited the options available to Yukos to satisfy the payment demands it was facing.

536. On 14 July 2004, pursuant to another resolution of the bailiffs, 43 ordinary shares and 13 preferred shares of Yukos in YNG were seized.[550] At the same time, a resolution to restrict the rights of the securities owner with respect to those shares was issued.[551]

537. On 16 July 2004, Mr. Steven Theede sent a letter signed by Mr. Bruce Misamore to Mr. Alexei Kudrin, then Minister of Finance. In the letter, Yukos petitioned the Ministry, "[i]n consideration of the unprecedented nature of the sum that is subject to collection from OAO Yukos Oil Company" for deferral of, or the opportunity to pay in installments, the amount imposed by the collection decision of the Moscow Arbitrazh Court issued on 28 May 2004.[552] When he gave evidence, Mr. Theede acknowledged that the letter was not perfect (the proposals did not have a great deal of detail) but he described the letter as an attempt "to create a dialogue [between Yukos and the Russian Federation]."[553]

538. In the days leading to the Hearing on the Merits in the case brought by Yukos against the lawfulness of the 2000 Decision, certain statements were made "in the mass media relat[ing] to

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548 Resolution of Bailiff I.D. Solovyoya No. 10249/21/04 to collect an enforcement fee, 9 July 2004, Exh. C-132;

549 Resolutions of Bailiff A.Yu. Seregin to initiate enforcement proceedings Nos. 10599/10/04, 10603/10/04, 10606/10/04, 10607/10/04 and 10608/10/04, 13 July 2004, Exh. C-133; *see also* Memorial ¶¶ 225–28

550 Decision of the Moscow Arbitrazh Court, Case No. A40-36718/04-79-445, 6 August 2004, p. 2, Exh. C-141 (referring to 14 July 2004 seizure of Yukos' shares in Yuganskneftegaz (hereinafter "YNG").

551 *Ibid*., p. 1.

552 Letter from Steven Theede to Alexei Kudrin, signed by Bruce Misamore, 16 July 2004, Exh. C-138.

553 Transcript, Day 10 at 53–55.

the [Yukos] case."[554] The statements apparently included charges of bias against Judge Mikhailova because she had previously written articles for a magazine edited by one of Yukos' lawyers, Mr. Sergey Pepeliaev.[555] While Judge Mikhailova denied the accusations of bias, she nonetheless asked to be recused.[556] On 19 July 2004, the day Judge Mikhailova had originally scheduled a hearing on the lawfulness of the 2000 Decision, the Moscow Arbitrazh Court granted her request to resign.[557]

539. On 6 August 2004, Yukos in-house counsel, Mr. Gololobov, sent a letter to the Chief Bailiff of the Russian Federation renewing Yukos' request to give priority to its 20 percent stake in Sibneft above other assets. The same day, the Moscow Arbitrazh Court found that a 14 July 2004 bailiff's resolution to seize shares of YNG was issued in error and that, instead, Yukos' 20 percent stake in Sibneft should have been seized.[558] The court ruled that federal law on enforcement proceedings outlines a priority order for enforcement against a debtor's assets and enforcement against lower assets is only possible when the higher assets are insufficient to settle the debts.[559] Since the shares in YNG were of a lower priority than the more liquid Sibneft shares, they should not have been seized before the Sibneft shares.[560] Claimants consider this to be a "rare victory" by Yukos before the Russian courts.[561]

540. On 12 August 2004, a ruling of the Moscow Arbitrazh Court denied Yukos' petition to pay by installments the amount levied by the Moscow Arbitrazh Court on 28 May 2004.[562] Five days later, the same court denied Yukos' application that the bailiffs undertake enforcement against its 34.5 percent stake in Sibneft before enforcement against other assets.[563]

541. In a decision of 18 August 2004 released on 23 August 2004, Yukos' "rare victory" was overturned by the Ninth Arbitrazh Court of Appeal. The court quashed the 6 August 2004

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554 Ruling of the Moscow Arbitrazh Court, Case No. A40-21839/04 76-276, p. 1, 19 July 2004, Exh. C-139 (emphasis in original omitted).

555 *Ibid*., p. 3.

556 *Ibid*., p. 4.

557 *Ibid*.

558 Decision of the Moscow Arbitrazh Court, Case No. A40-36718/04-79-445, p. 26, 6 August 2004, Exh. C-141

559 *Ibid*.

560 *Ibid*.

561 Memorial ¶ 349.

562 Ruling of the Moscow Arbitrazh Court, Case No. A40-1397/04ip-109, 12 August 2004, Exh. C-142.

563 Decision of the Moscow Arbitrazh Court, Case No. A40-34962/04-94-425, 17 August 2004, Exh. C-143.

decision to give priority to enforcement against the 20 percent stake in Sibneft. The court found that, as the shares in YNG had been issued by YNG after its privatization, they were not related to primary production and thus could be considered as a higher priority.[564] As Yukos had not discharged its debt "voluntarily," the court found that the YNG shares were part of an inventory legally open to seizure by the bailiffs.[565]

542. On 30 August 2004, the Tax Ministry sent a letter to Yukos, denying its request for deferred payment or payment by installments.[566] This letter was in response to the letter intended to "create a dialogue" between Yukos and the Russian Federation sent more than a month earlier to the Finance Ministry by Messrs. Theede and Misamore.

543. On 9 September 2004, five days after a decision reassessing taxes against Yukos for 2001, a letter from the Deputy Head of the Bailiffs Department notified the company that the arbitrazh courts had approved seizures against YNG and other production subsidiaries.[567]

544. On 23 November 2004, the resolution of the Ninth Arbitrazh Court of Appeal of 16 November 2004 was issued. It affirmed the lawfulness of the 2000 Decision.[568]

(b) The 2001 Decision

545. On 2 September 2004, Decision No. 30-3-15/3 holding the taxpayer fiscally liable for a tax offense ("**2001 Decision**") was issued.[569] It imposed the following taxes:

COMPANY	TAX BENEFITS	VAT	TOTAL
Alta-Trade	RUR 1,271,988,200	RUR 1,841,854,300	RUR 3,113,842,500 (USD 106,437,232)
Fargoil	RUR 1,907,396,200	RUR 3,170,995,300	RUR 5,078,391,500 (USD 173,589,362)

564 Resolution of the Ninth Arbitrazh Court of Appeal, Case No. 09AP-1554/04-AK, p. 4, 23 August 2004, Exh. C-144.

565 *Ibid*., pp.4–5.

566 Letter from the Russian Tax Ministry to Yukos, 30 August 2004, Exh. C-145.

567 Letter from the Russian Ministry of Justice to Yukos, 9 September 2004, Exh. C-146.

568 Resolution of the Ninth Arbitrazh Court of Appeal, Case No. 09 AP-4078/04-AK, 23 November 2004, Exh. C-147.

569 2001 Decision, Exh. C-155.

COMPANY	TAX BENEFITS	VAT	TOTAL
Mars XXII (Energotrade)	RUR 3,056,000	RUR 18,009,000	RUR 21,065,000 (USD 720,043)
Ratmir	RUR 1,787,339,500	RUR 4,303,815,200	RUR 6,091,154,700 (USD 208,207,590)
Yukos-M	RUR 1,723,009,600	RUR 3,220,911,200	RUR 4,943,920,800 (USD 168,992,890)
Yu-Mordovia	RUR 8,153,611,600	RUR 8,470,436,200	RUR 16,624,047,800 (USD 568,242,494)
Mega-Alliance	RUR 1,276,878,700		RUR 1,276,878,700 (USD 43,646,213)
Ratibor	RUR 5,729,645,900	RUR 7,880,489,700	RUR 13,610,135,600 (USD 465,221,075)

546. It also assessed penalties and fines.

547. On the same day, a tax payment demand with respect to the 2001 Decision was issued in the amount of RUR 79,279,641,154 (approximately USD 2.7 billion). Again, payment was due two days later, on 4 September 2004.[570] A tax penalty was issued in the amount of RUR 40,607,549,520 (approximately USD 1.3 billion), which was also due on 4 September 2004.[571] The total due by 4 September was thus approximately USD 4.1 billion.

548. On 3 September 2004, the petition of the Tax Ministry to collect tax penalties of RUR 40,607,549,600 (approximately USD 1.3 billion) was served on Yukos.[572]

549. On 6 September 2004, a decision was issued by the Interregional Inspectorate of the Tax Ministry.[573] It ordered the automatic collection of the tax payment demand (approximately USD 2.7 billion) from Yukos bank accounts. Three days later, on 9 September 2004, a resolution of Bailiff Borisov to initiate enforcement proceedings was issued.[574] On the same

570 Tax Payment Demand No. 133, 2 September 2004, Exh. C-156.

571 Tax Penalty Payment Demand No. 133, 2 September 2004, Exh. C-157.

572 Russian Tax Ministry Petition to collect tax Penalties, 3 September 2004, Exh. C-158.

573 Decision No. 52/595, 6 September 2004, Exh. C-159.

574 Resolution of Bailiff D.A. Borisov to initiate enforcement proceeding No. 13022/11/04, 9 September 2004, Exh. C-161.

day, there was another resolution of Bailiff Borisov to join the enforcement proceedings for the 2000 Decision and the 2001 Decision.[575]

550. On 16 September 2004, Yukos reiterated its petition for voluntary enforcement by the bailiffs against its holdings in Sibneft and non-core subsidiaries.[576] No response was received from the bailiffs.[577] The next communication received from the bailiffs was on 20 September 2004, when they issued a resolution to collect a seven percent enforcement fee—RUR 5,549,574,880.78 (approximately USD 190 million) for the 2001 Decision.[578]

551. As it had done in respect of the 2000 Decision, Yukos challenged the lawfulness of the 2001 Decision. Parallel proceedings were filed by the Tax Ministry for collection of the 2001 Decision. Judge Dzuba ruled in favour of the Tax Ministry.[579]

552. On 29 October 2004, a Field Tax Audit Report for 2002 was released.[580] It assessed tax arrears, interest, and fines of approximately USD 6.8 billion.[581]

553. On 12 November 2004, Yukos sent a letter to the Judicial Collegium of the Russian Federation complaining that its challenge to Judge Korotenko in the proceedings concerning the lawfulness of the 2001 Decision had not been heard.[582] Yukos had challenged Judge Korotenko for bias, on the ground that he had presided over the appeal panel of the Moscow Arbitrazh Court which had made a decision in favour of the Tax Ministry in respect of the 2000 Decision.

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575 Resolution of Bailiff D.A. Borisov to join into consolidated enforcement proceedings, 9 September 2004, Exh. C-162. The consolidated enforcement proceeding is No. 10249/21/04.

576 Yukos' petition for voluntary enforcement of Resolution of 09.09.2004 to initiate an enforcement proceeding and Demand of 30.06.2004, Exh. C-163.

577 Memorial ¶ 354.

578 Resolution of the Bailiffs, 20 September 2004, Exh. C-164. RUR to USD is approximate, based on an exchange rate of 29.2552:1, the exchange rate on 2 September 2004, the date that the payment demand was issued.

579 Memorial ¶ 261.

580 Field Tax Audit Report No. 52/852, 29 October 2004, Exh. R-346.

581 The results of the audit will be discussed below at paragraphs 557–65, in connection with the Tax Ministry decision to which it relates. RUR to USD is approximate, based on a ratio of 28.6696:1, the exchange rate on 16 November 2004, the date the Payment Demand was issued for the 2002 Decision.

582 Letter from Yukos to Highest Judicial Qualification Collegium of the Russian Federation, 12 November 2004, Exh. C-165.

554. In a hearing on 16-17 November 2004, Judge Korotenko denied Yukos' request to join the trading companies as third parties in the case against the 2001 Decision.[583] Judge Korotenko also denied Yukos' motion to obtain an expert opinion on market prices of oil.[584]

555. On 18 November 2004, the Moscow Arbitrazh Court, Judge Korotenko presiding, affirmed the legality of the two-day time limits set forth in the previous payment demands.[585] The court also rejected the arguments relating to the "massive" amounts assessed and the short time granted for voluntary payment. The court stated that "[t]he tax legislation does not stipulate any deadline for voluntary fulfillment by the taxpayer of the demand to pay taxes. Upon issue of the Claim, the Inspectorate is entitled to stipulate a time period for its voluntary execution."[586] This decision of the Moscow Arbitrazh Court was announced on the same day as a *one*-day payment demand, relating to Decision No. 52/896 holding the taxpayer liable for a tax offense ("**2002 Decision**"), became due. It also affirmed the lawfulness of the 2001 Decision.

556. Later, on 16 February 2005, a resolution of the Ninth Arbitrazh Court of Appeal of 9 February 2005, was issued. It reduced the overall amount payable for 2001 by approximately USD 150 million.[587] On 15 November 2005, the Federal Arbitrazh Court for the Moscow District also reduced, slightly, the amount of fines payable for 2001.[588]

(c) The 2002 Decision

557. On 16 November 2004, the 2002 Decision was issued.[589] It levied the following taxes:

COMPANY	TAX BENEFITS	VAT	TOTAL
Alta-Trade	RUR 64,129,180		RUR 64,129,180 (USD 2,236,836)

583 Moscow Arbitrazh Court, Transcript of the Hearing of 16–17 November 2004 in Moscow, Exh. C-166.

584 *Ibid*.

585 Decision of the Moscow Arbitrazh Court, Case Nos. A40-51085/04-143-92 and A40-54628/04-143-134, 17 November 2004, Exh. R-252.

586 *Ibid.* at 15.

587 Resolution of the Ninth Arbitrazh Court of Appeal, 16 February 2005, Exh. C-167.

588 Resolution of the Federal Arbitrazh Court for the Moscow District, Case No. A40-45410/04-141-34, 15 November 2005, Exh. C-168; *see* Memorial ¶ 257.

589 2002 Decision, Exh. C-175.

COMPANY	TAX BENEFITS	VAT	TOTAL
Fargoil	RUR 20,705,417,918	RUR 34,812,409,914	RUR 55,517,827,832 (USD 1,936,470,262)
Ratmir	RUR 167,135,313		RUR 167,135,313 (USD 5,829,705)
Yukos-M	RUR 25,947,077	RUR 260,150,323	RUR 286,097,400 (USD 9,979,121)
Yu-Mordovia	RUR 104,408,575		RUR 104,408,575 (USD 3,641,787)
Evoil	RUR 29,678,098		RUR 29,678,098 (USD 1,035,177)
Petroleum-Trading	RUR 8,145,551	RUR 59,464,184	RUR 67,609,735 (USD 2,358,238)
Ratibor	RUR 260,150,114		RUR 260,150,114 (USD 9,074,076)
OAO Yukos Oil Company			RUR 33,789,516,238

558. It also assessed penalties and fines.

559. On 16 November 2004, a tax payment demand was issued in the amount of RUR 121,771,662,841 (USD 4.2 billion). Payment was due on 17 November 2004—*one* day later.[590] Similarly, on 16 November a tax penalty payment demand was issued in the amount of RUR 72,040,907,796 (USD 2.5 billion). Payment was also due on 17 November 2004.[591] The total amount due in one day was approximately USD 6.7 billion.

560. On 18 November 2004, a decision was issued by the Tax Ministry to enforce and collect taxes and interest against the assets of Yukos.[592] On the same day, Bailiff I.V. Kochergin initiated

590 Tax Payment Demand No. 175, 16 November 2004, Exh. C-176.

591 Tax Penalty Payment Demand No. 175/1, 16 November 2004, Exh. C-177.

592 Decision No. 52/900, 18 November 2004, Exh. C-178.

enforcement proceedings and joined these proceedings to the two earlier proceedings for 2000 and 2001.[593]

561. On 19 November 2004, Field Audit Report No. 52/907 for 2003 was issued.[594] It assessed tax arrears, interest and fines of approximately USD 5.9 billion.[595]

562. On 24 November 2004, Yukos filed a petition for voluntary enforcement of the resolution of 18 November 2004.[596] No response was received from the bailiffs.

563. In relation to the 2002 Decision, there were no parallel proceedings: only a single proceeding which addressed both the lawfulness and the collection of the 2002 Decision. In a hearing on 8-9 December 2004, Yukos challenged Judge D.I. Dzuba, because, it submitted, the judge had "already formed a subjective negative opinion about OAO Yukos Oil Company as the guilty party" since he had presided over the collections case relating to the 2001 Decision. The challenge was never heard by the court.[597] On 16 December 2004, Judge Dzuba denied Yukos' request to obtain an expert opinion on oil market prices.[598]

564. Between these events, on 9 December 2004, a resolution of the bailiffs to collect a 7 percent enforcement fee, RUR 2,737,919,857.85, was issued.[599] On 23 December 2004, the court upheld the lawfulness of the 2002 Decision.

565. On 30 June 2005, a resolution of the Federal Arbitrazh Court was issued, upholding earlier court decisions and reducing the overall amount payable for 2002 by USD 45.70 million.[600]

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593 Resolution of Bailiff I.V. Kochergin to initiate enforcement proceeding No. 15315/4/04 and join it to consolidated enforcement proceeding No. 10249/21/04, 18 November 2004, Exh. C-179.

594 Field Audit Report No. 52/907, 19 November 2004, Exh. R-1583. The results of the audit will be discussed below at paragraphs 566–74, in connection with the Tax Ministry decision to which it relates.

595 RUR to USD is approximate, based on a ratio of 27.8171:1, the exchange rate on 6 December 2004, the date the Payment Demand was issued for the 2003 Decision.

596 Yukos' petition for voluntary enforcement of Resolution 19.11.2004 to initiate an enforcement proceeding, Exh. C-180.

597 Transcripts of the Preliminary Hearing of the Moscow Arbitrazh Court, Case Nos. A40-61058/04-141-151 and A40-63472/04-141-162, Exh. C-181 and Exh. C-183.

598 Transcript of the Preliminary Hearing of the Moscow Arbitrazh Court, Case Nos. A40-61058/04-141-151 and A40-63472/04-141-162 p. 22, Exh. C-183.

599 Resolution of Bailiff I.V. Kochergin to collect a seven percent enforcement fee, 9 December 2004, Exh. C-182.

600 Resolution of the Federal Arbitrazh Court No. KA-A40/3222-5, Case Nos. A40-61058/04-141-151 and A40-63472/04-141-162, 30 June 2005, Exh. C-184. *See also* Memorial ¶ 260 n.384.

(d) The 2003 Decision

566. On 6 December 2004, Decision No. 52/985 holding the taxpayer fiscally liable for a tax offense was issued ("**2003 Decision**").[601] It levied the following taxes:

COMPANY	TAX BENEFITS	VAT	TOTAL
Alta-Trade	RUR 26,192,854		RUR 26,192,854 (USD 937,901)
Fargoil	RUR 22,549,425,143	RUR 47,098,087,287	RUR 69,647,512,430 (USD 2,458,096,703)
Macro-Trade	RUR 408,084,717	RUR 46,810,044	RUR 454,894,761 (USD 16,288,650)
Energotrade (formerly Mars XXII)	RUR 7,147,772,476	RUR 6,826,447,412	RUR 13,974,219,888 (USD 500,382,062)
Ratmir	RUR 8,345,945		RUR 8,345,945 (USD 298,848)
Yukos-M	RUR 135,201,343		RUR 135,201,343 (USD 4,841,224)
Yu-Mordovia	RUR 34,210,117		RUR 34,210,117 (USD 1,224,979)
Evoil	RUR 173,951,671		RUR 173,951,671 (USD 6,228,777)
OAO Yukos Oil Company			RUR 1,773,658,844

567. It also assessed penalties and fines.

568. On 6 December 2004, a tax payment demand was issued in the amount of RUR 101,464,118,510 (USD 3.6 billion).[602] Payment was due one day later, on 7 December 2004. A tax penalty payment demand was also issued on 6 December 2004, in the amount of RUR 68,939,326,976 (USD 2.4 billion).[603] Payment of this amount was also due one day later,

601 2003 Decision, Exh. C-190.

602 Tax Payment Demand No. 186, 6 December 2004, Exh. C-191.

603 Tax Penalty Payment Demand No. 186/1, 6 December 2004, Exh. C-192.

on 7 December 2004. The total due one day after the payment demands were issued was approximately USD 6 billion.

569. On 8 December 2004, a resolution of the Tax Ministry was issued to enforce and collect taxes and interest against Yukos' assets.[604] The following day, Bailiff Kochergin issued a resolution which initiated enforcement proceedings, and joined them to the previous enforcement proceedings.[605]

570. On 16 December 2004, Yukos again petitioned for voluntary enforcement only against assets of first priority, and requested that the bailiffs not collect an enforcement fee.[606]

571. The Tribunal notes that, on 31 January 2005, an Interpol "Red Notice" was issued against Mr. Vladimir Dubov, who at this time was living in Israel. It noted that he was "accused of budgetary funds misappropriation."[607]

572. On 28 April 2005, the decision was issued by the Moscow Arbitrazh Court[608] reducing the overall amount payable for 2003 by approximately USD 2.6 million.

573. The Tribunal also notes that, on 16 May 2005, in another Russian court Messrs. Khodorkovsky and Lebedev were convicted of tax evasion and embezzlement.[609]

574. On 5 December 2005, the Federal Arbitrazh Court for Moscow issued a resolution affirming a small reduction of fines for 2003 by a lower court.[610]

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604 Resolution No. 52/999 of the Tax Ministry's Interregional Inspectorate for Major Taxpayers No. 1, 8 December 2004, Exh. C-193.

605 Resolution of Bailiff I.V. Kochergin to initiate enforcement proceeding No. 16305/4/04 and join it to consolidated enforcement proceeding No. 10249/21/04, 9 December 2004, Exh. C-194.

606 Yukos' petition for voluntary enforcement of the Resolution of 9 December 2004 to initiate an enforcement proceeding, 16 December 2004, Exh. C-195.

607 *Interpol Wants YUKOS V. Dubov and M. Brudno*, Kommersant, 31 January 2005, Exh. C-749.

608 Decision of the Moscow Arbitrazh Court, Case Nos. A40-4338/05-107-9 and A40-7780/05-98-90, 28 April 2005, Exh. C-196.

609 Judgment of the Meshchansky District Court for the City of Moscow, 16 May 2005, Exh. R-379.

610 Resolution of the Federal Arbitrazh Court for Moscow District, Case Nos. A40-4338/05-107-9 and A40-7780/05-98-90, 5 December 2005, Exh. C-197. *See also* Memorial ¶ 264, n.393.

(e) The 2004 Decision

575. On 27 December 2005, a Field Tax Audit Report for 2004 was issued.[611] It assessed tax arrears, interest, and fines against Yukos at approximately USD 3.9 billion.[612]

576. On 17 March 2006, Decision No. 52/292 was issued holding Yukos fiscally liable for the commission of a tax offence, ("**2004 Decision**").[613] It levied the following taxes:

COMPANY	TAX BENEFITS	VAT	TOTAL
Macro-Trade		RUR 386,687,520	RUR 386,687,520 (USD 13,901,072)
Energotrade (formerly Mars XXII)		RUR 41,946,060,356	RUR 41,946,060,356 (USD 1,507,923,556)
Yukos Vostok Trade	RUR 1,224,013,181	RUR 7,436,494,011	RUR 8,660,507,192 (USD 311,337,530)
OAO Yukos Oil Company			RUR 3,105,399,900

577. The Tribunal notes that there are no documents in the record evidencing a tax payment demand or a tax penalty payment demand issued in respect of the 2004 Decision.

578. However, on 21 June 2006, the Moscow Arbitrazh Court issued a decision[614] confirming the lawfulness of the Tax Ministry's claims relating to the arrears claimed in the 2004 Decision in the amount of RUR 66,391,719,284 (USD 2.4 billion). On 18 August 2004, the Ninth Arbitrazh Court of Appeal issued a resolution, ordering a determination of the lawfulness of the 2004 fines in the amount of RUR 42,036,873,518 (USD 1.7 billion) in separate proceedings.[615]

611 Field Tax Audit Report No. 52/996, 27 December 2005, Exh. C-200.

612 RUR to USD is approximate, based on a ratio of 27.8171:1, the exchange rate on 17 March 2006—the date of the 2004 Decision.

613 2004 Decision, Exh. R-1539.

614 Decision of the Moscow Arbitrazh Court, Case No. A40-11836/06-88-35 "B", 21 June 2006, Exh. R-538.

615 Resolution of the Ninth Arbitrazh Court of Appeal No. 09AP-8628/2006 GK, 18 August 2006, Exh. C-336.

The lawfulness of the fines was eventually affirmed by the Moscow Arbitrazh Court on 6 October 2006.[616]

(f) Observation

579. This chronology of the five tax assessments against Yukos for the years 2000–2004 and related decisions of the Tax Ministry, the Russian courts and the bailiffs is lengthy and tedious. But it is very much part of the factual matrix which will inform the Tribunal when it answers the question posed at the outset of the chapter: "Why would Russia have treated Yukos as it did if its purpose was to collect taxes?"

3. The Taxes Assessed Against Yukos

580. The principal taxes assessed against Yukos were profit tax and VAT. Together they account for over 95 percent of the total amount of more than USD 24 billion including related fines and interest. Details in relation to profit tax and certain other revenue-based taxes are provided in Subsection (a) below. Details in relation to VAT are set out in Subsection (b) below.

(a) Profit Tax and Other Revenue-based Taxes

581. As shown in the table below, for the tax years 2000 to 2004, the tax authorities imposed a demand for the payment of profit tax (including interest and fines) ranging from USD 261 million to USD 4 billion per year, for a total of **USD 9.5 billion**. This represents some 39 percent of the total tax claims levied against Yukos in the reassessments for those years. Other revenue-based taxes (also including interest and fines) assessed against Yukos added approximately USD 1 billion to the total. The breakdown by individual tax year is as follows:[617]

(IN USD BILLION)	**2000**	**2001**	**2002**	**2003**	**2004**	**Total**	**%**
Profit tax	1.356	1.695	4.005	2.184	0.261	9.502	39.3
Property tax	0.006	0.010	0.009	0.013	0.003	0.039	0.2
Road users tax	0.258	0.002	0.001	–	–	0.261	1.1

616 Decision of the Moscow Arbitrazh Court, Case Nos. A40-37697/06-141-233 and A40-49860/06-127-206, 6 October 2006, Exh. C-201.

617 Figures derived from Details of Yukos' Alleged Tax Reassessments, Exh. C-593; *see also* Claimants' Opening Slides, pp. 62–63.

(IN USD BILLION)	2000	2001	2002	2003	2004	Total	%
Tax for the maintenance of housing, social and culture facilities	0.209	–	–	–	–	0.209	0.9
Tax on sales of combustibles and lubricants	0.570	–	–	–	–	0.570	2.4
Advertisement tax	–	–	–	0.006	0.002	0.008	0.03
Total	**2.399**	**1.707**	**4.015**	**2.203**	**0.266**	**10.589**	**43.93**

582. The reasoning by the tax authorities for the imposition of profit tax and the other sundry revenue-based taxes did not vary substantively from year to year. For purposes of the present chapter, the Tribunal will therefore consider the documents relating to the 2000 tax year.

583. The 2000 Audit Report concludes that, during the year 2000, Yukos knowingly and deliberately operated a tax evasion scheme through the use of "sham dependent entities". The Audit Report describes the "discovery"[618] of the scheme as follows:

> During the field tax audit, non-payment by OAO Yukos Oil Company of corporate profit tax, road users tax, property tax and housing support tax, arising from the use of an unlawful scheme involving evasion of tax through artificial creation of sham companies in the oil and oil product movement chain, which were registered in territories with a beneficial tax regime, was discovered.
>
> The aim of using this scheme was non-payment of taxes on the sum of revenue (income) received from the sale of oil and oil products. For this purpose OAO Yukos Oil Company created sham dependent entities, which functioned as oil and oil product owners (hereinafter – the "owners"). These entities were registered in territories in which a beneficial tax regime applied (Closed administrative-territorial formations) [CATF], regions of the Russian Federation, providing tax benefits on investments). OAO Yukos Oil Company had control over the operations, conducted by the oil and oil product "owners", by participating in the transactions as an intermediary (confirmed by documents shown in Attachment No. *14* to the field tax audit document) or by bringing in other entities dependent on OAO Yukos Oil Company to participate in transactions as an intermediary.[619]

584. The 2000 Audit Report continues:

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618 According to Mr. Konnov the use of the term "discovered" at the end of the first paragraph of the cited passage of the Audit Report ("[…] non-payment […] of corporate profit tax […] arising from the use of an unlawful scheme involving evasion of taxes […] was discovered.") is a mistranslation. Mr. Konnov suggested that the original wording in Russian is better translated as "the audit concluded or established that […]." Transcript, Day 13 at 167; *see also* Respondent's Closing Slides, p. 97.

619 2000 Audit Report, pp. 7–8, Exh. C-103.

> The audit established that the actual owner of the oil and oil products was OAO Yukos Oil Company. The oil was in fact acquired and transferred for refining, and the oil and oil products sold, by OAO Yukos Oil Company, as evidenced by the actual movement of oil and oil products from production entities to oil refineries or to oil bases controlled by OAO Yukos Oil Company, as confirmed in the trade and transport documents, and also the direct participation by OAO Yukos Oil Company in all the operations. The following also provides proof that the oil and oil products actually belonged to OAO Yukos Oil Company [*sic*] and that the tax evasion scheme applied by them was illegal:
>
> - interdependence of persons participating in the transactions and their control by OAO Yukos Oil Company;
> - registration of the "owners" in territories with beneficial tax regimes;
> - non-activity by the "owners" in their places of registration;
> - the fictitious commission payments to OAO Yukos Oil Company, which are much smaller than the actual payments made on the intermediary market;
> - the understated prices of acquisition of oil from production entities and from other sham companies;
> - the conduct of accounting in all the entities by OOO Yukos-Invest, or by Yukos-FBTs OOO, which are dependent on OAO Yukos Oil Company;
> - the opening of accounts for all the entities in the same banks, which are dependent on OAO Yukos Oil Company;
> - the utilisation of promissory note settlements between the entities, or settlements by means of mutual set-off.[620]

585. The 2000 Audit Report goes into great detail in explaining the tax benefits that were claimed by each of the trading entities. The Audit Reports for subsequent tax years generally follow the same form. They audit OAO Yukos Oil Company and the trading companies. They are divided into separate sections for each trading company; some of the later reassessments also include sums assessed directly against OAO Yukos Oil Company. The sections on the trading companies generally begin with an overview of the incorporation, ownership, and capital of the company. They then affirm that the directors of the company and its operations are not based in the region in which it had been incorporated, which according to the authors of the Audit Reports, shows that the company could not benefit from preferential taxation agreements offered to companies operating in the low-tax regions. The reassessments then assert that the trading companies are "interrelated" and thus "dependent" on OAO Yukos Oil Company, thereby allowing OAO Yukos Oil Company to fraudulently claim taxation benefits.

586. The 2000 Audit Report concludes in relation to the tax evasion by Yukos as follows:

> The tax evasion by OAO Yukos Oil Company, through registration of sham companies in territories with preferential tax rates, with the exclusive aim of evading tax, and

620 *Ibid.*, pp. 8–9.

> which . . . did not actually trade or engage in any activity in those territories or indeed anywhere else, or invest any money in the economies of the relevant constituent entities of the Russian Federation, and which, therefore, illegally applied the additional tax benefits, indicates that OAO Yukos Oil Company acted in bad faith.
>
> According to the Russian Federation Constitutional Court's 25 July 2001 Ruling No. 138-O interpreting the provision contained in Article 3(7) of the RF Tax Code, in the area of taxation there is a presumption of good faith on the part of taxpayers.
>
> As is evident from the above-mentioned Ruling, the presumption of taxpayer good faith, enshrined in the RF Tax Code, presupposes an obligation on the tax authorities to prove any bad faith on the part of taxpayers in the manner set out by the Russian Federation Tax Code, and to conduct the necessary audits in order to establish such bad faith with the aim of ensuring a balance between state and private interests.
>
> Similar provisions are contained in RF Constitutional Court Rulings Nos. 4-O dated 10.01.2002 and 108-O dated 14.05.2002.
>
> The Judgements of the Presidium of the RF Supreme Court of Arbitration Nos. 9408/00 dated 18.09.2001, 7374/01 dated 18.06.2002, 6294/01 dated 05.11.2002 and 11259/02 dated 17.12.2002, and a letter from the Deputy President of the RF Supreme Court of Arbitration No. S5-5/up-342 dated 17.04.2002, also point out the need to examine the question of bad faith on the part of taxpayers, that is, their commission of deliberate acts aimed at not fulfilling the constitutional obligation to pay taxes.
>
> The above-mentioned circumstances, namely OAO Yukos Oil Company carrying out operations involving the purchase and sale of oil and oil products, indicate Yukos Oil Company's OAO bad faith, which evidences its deliberate actions in evading payment of taxes through the application of illegal schemes.
>
> . . . According to the Regulations of 01.01.2000 on the accounting policy for the year 2000, in OAO Yukos Oil Company for purposes of taxation (in order to calculate corporate profit tax, value added tax, Road users tax and housing support tax) revenue from the sale of products and goods (work, services) was determined on the basis of actual payments.
>
> For purposes of taxation revenue was indicated by the entity in the accounts in the line 010 of the account using form No. 2 "Profit and Loss Account" taking into account the Information on the procedure for determination of data indicated in line 1 of "Calculation of tax on actual profit" in a sum of RUR 36,396,312,000 (RUR 36,264,009,000 in Form No. 2, "Profit and Loss Account" + RUR 132,303,000 according to the Information on the procedure for determination of data indicated in p. 1 of "Calculation of tax on actual profit").
>
> According to the data of the audit, revenue from the sale of goods (work, services) amounted to RUR 245,907,712,162.
>
> Thus, the revenue from the sale of goods (work, services) in the sum of RUR 209,511,400,162 was understated as a result of non-indication in the accounting registers of the revenue which had been received as a result of utilising a scheme with the participation of sham entities which were dependent on OAO Yukos Oil Company and which had been created for the purpose of tax evasion on the part of OAO Yukos Oil Company . . . .[621]

587. The 16 November 2004 decision of the Ninth Arbitrazh Court of Appeal upheld the 2000 Decision to hold Yukos liable for all these taxes. The English translation of the judgment is 25 pages long. The key passages, which the Tribunal believes should be set out so as to give

[621] *Ibid.*, pp. 14–15.

visibility to the court's reasoning (which the Tribunal will consider later as part of the totality of the evidence), follow:

> OAO Yukos Oil Company did not agree with the decision of the Court and filed an appeal requesting that the decision of the Court of First Instance be quashed and that the presented claim be granted in full: to declare unlawful the Russian Federation Ministry of Taxes and Levies Decision No. 14-3-05/1609-1 of 14.04.2004 to Hold the Taxpayer Fiscally Liable for a Tax Offense.
>
> . . . The interested party, the Russian Federation Ministry of Taxes and Levies, argues that the Court of First Instance legally and justifiably found that the decision and resolution issued in Case No. A40-17669/04-109-241 [*i.e.*, the 26 May 2004 decision], which involves the same parties as Case No. A40-21839/04-76-276 [*i.e.*, the case before the Court of Appeal], established the legality and validity of the disputed RF Tax Ministry Decision, the circumstances surrounding OAO Yukos Oil Company's performance of actions aimed at evading taxes through the artificial formation of entities registered in territories with preferential tax rates and their "participation" in the chain of movement of oil and oil products, and the illegality and invalidity of OAO Yukos Oil Company's arguments regarding the illegality of the RF Tax Ministry's disputed Decision.
>
> . . .
>
> Pursuant to Article 69(2) of the RF Arbitrazh Procedure Code, facts established by the legally effective judicial act of an arbitrazh court in connection with a previously heard case do not need to be proven again when the arbitrazh court hears another case involving the same parties.
>
> The Court Decision of 26.05.2004 in Case No. A40-17669/ 04-109-241 established that the tax authority did not breach the requirements of Article 87 of the RF Tax Code when issuing Decision No. 14-3-05/1609-1 of 14.04.2004. The Court found that RF Tax Ministry Decision No. 14-3-05/1609-1 of 14.04.2004 is consistent with the Russian Federation Tax Code, federal laws adopted pursuant to the RF Tax Code, and other tax laws that were in effect during the audit period.
>
> . . . The Court found that the entities registered in territories with preferential tax rates and named in the RF Tax Ministry's Decision (Yu-Mordovia OOO, Alta-Trade OOO, Ratmir OOO, Mars XXII OOO, Jupiter XXIV OOO, ZAO Yukos-M, Saturn XXV OOO, Yuksar OOO, Siberian Transportation Company OOO, Quercus OOO, Muskron OOO, Nortex OOO, Grace OOO, Colrain OOO, Virtus OOO, Plast OOO, Mitra OOO, Vald-Oil OOO, Business-Oil OOO, Staf OOO, Petroleum-Trading OOO) were related to each other and dependent on OAO Yukos Oil Company. The relationship of all the entities and their dependence on OAO Yukos Oil Company, as one of the items of evidence of bad faith on the part of the Applicant which applied the illegal tax evasion scheme is also confirmed by the fact that the same individuals were the founders and (or) officers in the aforementioned entities.
>
> . . . The Court rightly found that control of the oil and oil-product transactions performed by the entities registered in territories with preferential tax rates was exercised OAO Yukos Oil Company by means of participation in the transactions as an intermediary or by means of involvement of other entities, dependent on OAO Yukos Oil Company, as intermediaries in the transactions. The entities registered in territories with preferential tax rates concluded agency agreements for the purchase of crude oil with OAO Yukos Oil Company. In turn, OAO Yukos Oil Company, acting on behalf of entities registered in territories with preferential tax rates, purchased oil from producing entities or from other suppliers. Thereafter, the crude oil purchased via the agent (OAO Yukos Oil Company) was sold to buyers (Russian or foreign) via this same OAO Yukos Oil Company (as the commission agent or the agent) or transferred for refining to refineries which were subsidiaries of OAO Yukos Oil Company. Apart from agency agreements, purchase and

sale agreements were drawn up for purchase of oil, according to conditions thereof, OAO Yukos Oil Company "sold" oil from the resources of its producing entities – OAO Yuganskneftegaz, OAO Samaraneftegaz, and OAO Tomskneft. Unlike OAO Yukos Oil Company and its producing companies, which according to the customs cargo declarations were shippers, the entities registered in regions with preferential tax rates were not mentioned in the export documents.

The dependence of entities, registered in territories with preferential tax rates, on OAO Yukos Oil Company and the control by OAO Yukos Oil Company of all transactions is also confirmed by the fact that the records of all transactions associated with the purchase and transfer of oil for refining, as well as with the sale of oil and oil products (including accounting records) were kept by Yukos-Invest OOO and Yukos-FBTs, which are dependent on OAO Yukos Oil Company. Furthermore, the entities registered in territories with preferential tax rates entered into production management service contracts with OOO Yukos RM, which is also dependent on OAO Yukos Oil Company. The financial statements and tax filings were submitted to the tax authorities by post from the address at which OAO Yukos Oil Company was located according to the invoices. Furthermore, this address was the mailing address of OOO Yukos-Moscow, which is the executive body of OAO Yukos Oil Company.

The accounts of all entities are opened with the same banks, i.e. OAO Trust Investment Bank, OAO Bank Menatep St. Petersburg and Bank Solidarnost, where OAO Yukos Oil Company was a shareholder.

In addition to concluding agreements on the purchase and sale of oil and oil products, these entities also conducted activities involving the purchase and sale of promissory notes, which they used in settlements with one another and with OAO Yukos Oil Company for oil and oil products. Or by purchasing and selling promissory notes, these entities returned to OAO Yukos Oil Company funds supposedly earned for oil they sold. Therefore, the business of these entities related to the purchase and sale of promissory notes is a business related to the purchase and sale of oil and oil products. Therefore, the Court lawfully and justifiably rejected the Applicant's argument that the entities registered in territories with preferential tax rates engaged in business activities other than the sale of oil and oil products.

The Applicant's assertion that the determination of bad faith is possible exclusively in the instances of payment of taxes through insolvent banks is unfounded, as the finding that it is necessary for the tax authorities to conduct audits and determine bad faith was made by the Constitutional Court of the Russian Federation based on the interpretation of Article 3(7) of the RF Tax Code, i.e. the presumption of the taxpayers' good faith. From this follows the obligation of taxpayers to act in good faith when conducting any actions associated with the discharge of their tax liability and the right of the tax authorities to determine bad faith on the part of taxpayers committing actions (inaction) intentionally aimed at tax evasion.

In light of the foregoing circumstances, the Court rightly found that the owner of the oil and oil products was OAO Yukos Oil Company. The purchase and transfer of the oil for refining and the sale of oil and oil products were actually carried out by OAO Yukos Oil Company as the owner.

. . . The Constitutional Court of the Russian Federation, in Ruling No. 138-O of 25.07.2001, points out that, according to the tenor of Article 3(7) of the RF Tax Code, the presumption of good faith on the part of taxpayers is in effect in the area of tax relations. For the purpose of determination of bad faith on the part of taxpayers, the tax authorities have the right—in order to ensure a balance between State and private interests—to carry out the necessary audit and to file with the arbitrazh courts claims that ensure the receipt of taxes into the budget. In light of the above, in order to ensure a balance between State and private interests, the tax authorities have the right to conduct audits for the purpose of

> determination of the actual owner of sold property and for determination of bad faith on the part thereof, expressed in the application of a tax evasion scheme.
>
> The fact that OAO Yukos Oil Company had the rights of possession, use and disposal with respect to the oil and oil products, and at its own discretion performed with respect thereto any actions, including alienation, transfer for processing, etc. through sham entities dependent on OAO Yukos Oil Company was established by the legally effective judicial acts in Case No. A40-17669/04-109-241.
>
> The Court therefore rightly does not accept the argument of the Applicant and the third party regarding the non-compliance with law and the factual circumstances of the assessment of taxes to OAO Yukos Oil Company as the owner of the oil and oil products.
>
> . . .The circumstances established by the Court concerning the transactions of OAO Yukos Oil Company associated with the purchase and sale of oil and oil products and in their interconnection and collectively indicate bad faith on the part of OAO Yukos Oil Company, which is reflected in the intentional actions aimed at tax evasion by means of application of illegal schemes, as a result of which the RF Tax Ministry lawfully held OAO Yukos Oil Company liable pursuant to Article 122(3) of the Russian Federation Tax Code, for the intentional failure to pay or an incomplete payment of tax as a result of reduction of the tax base, other incorrect tax calculations, or other unlawful actions (inaction), in the form of a fine in the amount of 40 percent of the unpaid tax amount, as established by the judicial acts in Case No. A40-17669/04-109-241.
>
> . . .Therefore, the Moscow Arbitrazh Court in its decision legally and justifiably found that RF Tax Ministry Decision No. 14-3-05/1609-1 of 14.04.2004 to Hold the Taxpayer Fiscally Liable for a Tax Offense is legal and well-founded in part and complies with the Russian Federation Tax Code, federal laws adopted pursuant to the RF Tax Code, and other tax laws that were in effect during the audit period (the Russian Federation Law No. 2116-1 of 27.12.91 "On Corporate Profit Tax", the Russian Federation Law No. 1759-1 of 18.10.1991 "On Road Funds in the Russian Federation", the Russian Federation Law No. 2118-1 of 27.12.1991 "On Fundamentals of the Tax System", the Russian Federation Law No. 2030-1 of 13.12.1991 "On Corporate Property Tax" and the Russian Federation Law No. 1992-1 of 06.12.1991 "On Value Added Tax").[622]
>
> [emphasis added]

588. The Tribunal will discuss the key elements of this decision, notably its endorsement of the assessment of taxes against Yukos on the basis that Yukos was the "actual owner" of the oil and oil products, in Section VIII.B.5 below.

(b) VAT

589. As shown in the table below, for the tax years 2000 to 2004, the tax authorities imposed a demand for the payment of VAT (including interest and fines) ranging from USD 1 billion to USD 4 billion per year, for a total of **USD 13.59 billion**. This represents some 56 percent of

[622] Resolution of the Ninth Arbitrazh Court of Appeal, Case No. 09AP-4078/04-AK, 16 November 2004, Exh. C-147.

the total tax claims levied against Yukos in the reassessments for those years. The breakdown by individual tax year is as follows:[623]

		2000	2001	2002	2003	2004	Total	%
VAT	Tax Arrears	0.49	0.99	1.24	1.93	1.73	6.38	26.39
	Interest & Fines	0.59	1.40	1.50	1.97	1.75	7.21	29.82
	Sub-total	**1.08**	**2.39**	**2.74**	**3.90**	**3.48**	**13.59**	**56.2**
Other taxes	Tax Arrears	1.19	0.75	1.91	1.16	0.16	5.17	21.38
	Interest & Fines	1.21	0.96	2.11	1.05	0.10	5.42	22.46
	Sub-total	2.40	1.71	4.02	2.21	0.26	10.59	43.8
TOTAL		3.48	4.10	6.76	6.11	3.74	24.18	100

590. The reasoning of the tax authorities for the imposition of VAT payments did not change from year to year. For purposes of this chapter, the Tribunal will therefore consider solely the documents relating to the 2000 tax year.

591. But before turning to the reasoning for the imposition of VAT payments on Yukos, the Tribunal will review some features of the VAT regulations of the Russian Federation.

592. In Russia, VAT is a federal tax levied at uniform rates throughout the Federation. As a result, all companies pay VAT regardless of the region where they are registered, under identical terms and conditions. There are accordingly no additional VAT benefits for companies incorporated in low-tax regions. The applicable rate of VAT to oil and oil products was 20% in 2000 to 2003 and 18 percent in 2004.[624]

593. If the products were exported, they were either exempt from VAT (2000) or subject to a zero percent VAT rate (2001 onwards).[625] The zero percent rate is not automatic, but available when the taxpayer files a monthly or quarterly VAT return.[626] It is common ground between the

623 Figures derived from Details of Yukos' Alleged Tax Reassessments, Exh. C-593; *see also* Claimants' Opening Slides, pp. 62–63.

624 First Konnov Report ¶ 56. *See also* Articles 165(9) and 164(3), Russian Tax Code, Exhs. R-1484 and R-1483.

625 As a result, exporting companies did not charge VAT to their foreign customers and were entitled to the refunds on the VAT charged by their own suppliers. *See* Dubov WS ¶ 37; *see also* Memorial ¶ 319.

626 First Konnov Report ¶¶ 53–58.

Parties that, in the years 1999 to 2003, the Yukos trading companies filed the VAT returns for their exports of oil.[627]

594. The 2000 Decision notes that Yukos failed to reflect revenue from the sale of products "arising from the use of an unlawful scheme involving evasion of tax through artificial creation of sham companies in the oil and oil product movement chain, which were registered in territories with a beneficial tax regime."[628] The 2000 Decision then states:

> The aim of using this scheme was non-payment of corporate profit tax value added tax, road users tax, tax on sales of fuel and lubricants (hereinafter referred to as F&L) and housing support tax on the sum of revenue (income) received from the sale of oil and oil products.[629]

595. The VAT at issue was the VAT in relation to which the Yukos trading companies had already obtained an exemption or zero percent rate, not VAT that could be said to arise from new or additional transactions or from a finding that the oil or oil products had not actually been exported. During his cross-examination at the Hearing, Mr. Konnov explained that the reasoning behind the imposition of VAT on Yukos is very clear from the original Russian-language version of the decision. The 2000 Decision states (in the Russian language original) that it is Yukos, as the actual exporter, which must file the VAT return in order to get the VAT tax benefit which had earlier been granted to its trading entities. Mr. Konnov explained:

> A. And then there is a sentence which I don't see in the English text, which says:
>
> > "Based on the foregoing, the actual export operations were conducted by OAO NK Yukos and tax claim were provided to ZAO Yukos-M."
>
> And that's the sentence on the point; for some reason it's not in the English text.
>
> So I agree maybe it's not a detailed sentence, but what it clearly tells to any tax lawyer, or to Yukos, I think: that Yukos – sorry, Yukos-M claimed the tax benefits and was provided the tax benefits, and the actual exporter who must file the return is Yukos.[630]

596. In other words, while it was the trading companies that were set up in Yukos' tax structure as the entities exporting oil and oil products to purchasers abroad that filed VAT returns to claim the exemption or zero percent rate that applies to export transactions, and in spite of the fact

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627 Memorial ¶¶ 320–21. *See also* Decision No. 23 on partial refusal to refund/offset VAT (Alta-Trade), 15 June 2000, Exh. C-1110; Decision No. 48 to deny refunding (offset) VAT (Alta-Trade), 29 October 2001, Exh. C-1116; Decision No. 53 on partial refusal to refund/offset VAT (Mars XXII), 27 December 2004, Exh. C-1117.

628 2000 Decision, p. 1, Exh. C-104.

629 *Ibid*.

630 Transcript, Day 14 at 236.

that the trading companies had already qualified for the exemption or zero percent rate on the basis of duly submitted VAT returns, the tax authorities subsequently determined that Yukos itself was the "actual exporter", and that it was Yukos, instead of the trading entities, that had to qualify for the exemption or zero percent rate. Since Yukos had not filed the returns itself, it was deemed to have failed to file the VAT returns required to benefit from the exemption or zero percent rate.

597. The judgment of the Moscow Arbitrazh Court that confirmed the decision for the 2000 tax year rejected Yukos' appeal against the VAT assessments:

> The court does not accept the arguments of OAO Yukos Oil Company regarding unlawfulness of the RF Tax Ministry Decision No. 14-3-05/1609-1 of 14.04.2004 relating to assessment of the value added tax. It follows from the RF Tax Ministry Decision that the tax authority assessed VAT reimbursed to entities registered in the territories with preferential tax rates upon their applications on export transactions. Pursuant to Law No. 1992-1 of 06.12.1991 "On Value-Added Tax," effective during that period, exemption from payment of value-added tax when exporting goods (work, services) was a benefit. In order to use its right to the benefit, the taxpayer had to declare its right and confirm its right by documents in accordance with the current legislation. The taxpayer – OAO Yukos Oil Company – did not declare its desire to use its benefit either in 2000 or later.[631]
>
> [emphasis added]

598. At the Hearing, Mr. Konnov described as follows "the essence" of the reasoning in the decision and subsequent judgment:

> [T]hat Yukos did not file tax return, and in the absence of the tax return it is not eligible for a 0% VAT rate.[632]

Mr. Konnov also confirmed at the Hearing that the same reasoning was applied for subsequent tax years.[633]

4. The Fines Assessed Against Yukos

599. As shown in the table below, for the tax years 2000–2004, the tax authorities imposed fines against Yukos ranging from USD 670 million to USD 2.5 billion per year, for a total of

631 Decision of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241, 26 May 2004, p. 19, Exh. C-116.

632 Transcript, Day 14 at 240

633 *Ibid.* at 240–51.

USD 8.5 billion. This represents some 35% of the total tax claims levied against Yukos in the reassessments for those years. The breakdown by individual tax year is as follows:[634]

	2000	2001	2002	2003	2004	Total	%
Tax Arrears	1.68	1.74	3.15	3.09	1.90	11.55	47.73
Interest	1.13	0.97	1.10	0.54	0.38	4.13	17.14
Fines	**0.67**	**1.39**	**2.51**	**2.47**	**1.46**	**8.50**	**35.13**
TOTAL	3.48	4.10	6.76	6.10	3.74	24.18	100

600. Article 122 of the Russian Tax Code establishes a taxpayer's liability for "non-payment or underpayment of taxes." Pursuant to paragraph 1 of this provision, the sanction is a 20 percent fine on the unpaid amount of taxes. Under paragraph 3 of this provision, this fine can be increased to 40 percent of the unpaid amount if the offense is committed intentionally. This fine has been referred to in this case as the "willful offender" fine. Under Articles 110(2) and 110(4) of the Russian Tax Code, the intention of a company requires, *inter alia*, that the awareness of the company's executives of the unlawful nature of their actions (or failure to act) be established. Finally, under Articles 112(2) and 114(4) of the Russian Tax Code, the fines can be increased to 80 percent, concretely, be doubled, in cases of so-called "repeat" offenses, *i.e.* offenses committed by "a person, which has been previously held liable for a similar tax offense."[635] This fine has been referred to in this case as the "repeat offender" fine.

601. Yukos was assessed both the "willful offender" and the "repeat offender" fines by the authorities.

602. The Tax Ministry, referring to Article 110(2) of the Russian Tax Code, claimed that for the year 2000, "[Yukos] deliberately committed the acts aimed at evading payment of taxes, and its officers were aware of the unlawful nature of such actions."[636] On this basis, the fines on

634 Figures (in USD billions) derived from Details of Yukos' Alleged Tax Reassessments, Exh. C-593. The fines levied in relation to unpaid VAT alone account for a total of some USD 4.8 billion for the tax years 2000–2004, with the balance of USD 3.7 billion levied in relation to all of the other types of taxes (the majority—USD 3.3 billion—of the remaining amount being levied in relation to profit tax).

635 Russian Tax Code, Part I, Exh. C-401.

636 2000 Decision, p. 8, Exh. C-104.

Yukos were doubled from the standard rate of 20 percent to 40 percent. Yukos was thus charged, by reference to Article 122(3), with a 40 percent fine on the amount of its alleged tax arrears.[637] The same reasoning was used by the tax authorities to impose fines on Yukos for the years 2001–2004.[638]

603. The Tax Ministry then doubled the fines once more for the years 2001 to 2004 (the year 2000 being considered as the first "offense"), in order to reach an 80 percent fine on the alleged tax arrears. This was done on the basis of Articles 112(2) and 114(4) of the Russian Tax Code regarding repeat tax offenses.[639]

5. Parties' Arguments and Tribunal's Observations

604. In Chapter VIII.A of the present Award, the Tribunal has found that Yukos had run afoul of the tax authorities prior to December 2003 in some of the low-tax regions, notably in the ZATOs (Lesnoy and Trekhgorny) and in Kalmykia. The Tribunal noted earlier that Yukos had wound up its trading entities in Lesnoy and Trekhgorny, and merged them into two separate companies based outside of the ZATOs. These companies later merged to form Investproekt, based in yet another region of Russia. The shuffling of these companies, as the Tribunal observed in Chapter VIII.A, while completed before any decisions were issued against the companies for being shams and for their use of promissory notes to pay (and even overpay) its tax bills, does raise troubling questions which were never answered to the satisfaction of the Tribunal. It suggests that Yukos was aware of the vulnerability of its tax optimization scheme and took steps to minimize its exposure when elements of the scheme were being investigated. This evidence has been thoroughly reviewed and commented upon by the Tribunal in Chapter VIII.A.

605. In principle, therefore, both Yukos and members of its management were exposed to further findings of civil and/or criminal liability in connection with these activities as there is no evidence in the record that any tax payable as a result of the investigation of the trading entities in the ZATOs was ever paid. It is in this context that the Russian Federation charged

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637 *Ibid*.

638 2001 Decision, p. 157, Exh. C-155; 2002 Decision, p. 166, Exh. C-175; 2003 Decision, p. 144, Exh. C-190; 2004 Decision, pp. 89–90, Exh. C-200.

639 2001 Decision, pp. 163–64, Exh. C-155; 2002 Decision, pp. 165–66, Exh. C-175; 2003 Decision, p. 144, Exh. C-190; 2004 Decision, p. 89, Exh. C-200.

Messrs. Khodorkovsky and Lebedev with tax offenses, and reassessed taxes against Yukos as of December 2003.

606. In this section, the Tribunal considers the Parties' specific arguments in respect of each element of the tax assessments that began in December 2003 and continued at a very rapid pace throughout 2004 (covering the tax years 2000 through 2004). As described in the earlier subsections of the present chapter, these elements included assessments for profit tax and other revenue-based taxes, VAT and fines. While the Tribunal considers the Parties' arguments for each discrete element of the tax assessments, ultimately its conclusions are based on a consideration of the tax assessments as a whole as well as the two trials and convictions of Messrs. Khodorkovsky and Lebedev. The Tribunal adopts this totality-of-the-evidence approach for several reasons.

607. Firstly, the Parties' arguments regarding the tax assessments rest on all-or-nothing propositions. On the one hand, Claimants argue that the tax assessments *as a whole* were conceived and crafted to fabricate debt "under the guise of taxes," and in amounts deliberately large enough to bankrupt Yukos. Respondent, on the other hand, insists that the tax assessments were *entirely* legitimate, and that Yukos' demise was self-inflicted.

608. Secondly, the discrete elements of the tax assessments are, in fact and in law, closely intertwined. For example, as explained in greater detail below, the enormous liability imposed on Yukos for non-payment of VAT (and for the multiple fines associated with their non-payment) was made possible only because the revenues of Yukos' trading entities were "re-attributed" to Yukos itself. It would therefore be artificial to deal with the complexity of this case by deconstructing the various elements of the tax assessments without, in the end, taking the broader perspective that is required to properly appreciate each one of them.

(a) Profit Tax and Other Revenue-Based Taxes

i. Introduction

609. Claimants submit that the revocation of regional tax benefits on revenue-based taxes (principally the regional and local shares of profit tax) was the first step in the Russian Federation's fabrication of taxes targeting Yukos. Claimants argue that the revocation of these benefits was arbitrary because (a) such benefits were expressly provided for in Russian federal and regional legislation with which the Yukos entities complied, and (b) the tax benefits were

known to and approved by the relevant authorities (with whom, in some cases the trading entities entered into tax investment agreements).[640]

610. Respondent submits that the Russian Federation's revocation of the tax benefits was a legitimate and appropriate response to Yukos' tax optimization scheme under Russia's anti-abuse doctrine. Respondent contends that all of the Yukos trading entities were sham letter-box companies, with no assets, employees or operations of their own, that were managed by Yukos itself.[641]

ii. Was the "Bad-Faith Taxpayer" Doctrine Available at the Time of the Yukos Tax Assessments to Challenge a Tax Evasion Scheme?

611. As an initial matter, the Tribunal notes that it has already confirmed, in Chapter VIII.A of the present Award, that the "bad-faith taxpayer doctrine" existed in the Russian Federation at the time of the issuance of the 2000 Tax Audit in December 2003 and, therefore, at the time of subsequent audits as well.[642] Indeed, even Claimants acknowledged the existence of the doctrine.[643]

612. Claimants cannot, therefore, impugn the Russian Federation's revocation of the benefits related to profit tax solely on the basis that the low-tax regions were competent to grant such tax benefits under that applicable legislation, and that "no breach of that legislation has been alleged."[644] However, such an argument does not seem to take account of the impact of Russia's anti-abuse doctrine or "bad-faith taxpayer" doctrine which, as the Tribunal has already concluded, may constitute a ground for the reassessment of a party's tax liabilities.

613. The Tribunal recalls however that, at the time of the tax assessments against Yukos, the "business purpose" doctrine (a variant of the "substance over form" and "bad faith taxpayer" doctrines) had not yet been explicitly adopted into Russian law. As noted earlier in Chapter VIII.A, the "business purpose" doctrine was not adopted until October 2006, in Resolution No. 53 dated 12 October 2006 of the Plenum of the Russian Supreme Arbitrazh Court. As also mentioned in Chapter VIII.A, Russian tax scholars and practitioners appear

640 Claimants' Opening Statement, pp. 49–80; Claimants' Post-Hearing Brief ¶¶ 7–11.

641 Respondent's Opening Statement, pp. 11–22.

642 *See* above at paragraph 497.

643 Reply ¶¶ 219–28.

644 Claimants' Post-Hearing Brief ¶ 7.

divided as to whether Resolution No. 53 represented a break with the doctrines that existed at the time of the Yukos assessments, or was a natural evolution of those doctrines.

614. The Tribunal, recalling that Mr. Pepeliaev alluded to something akin to the "business purpose" doctrine in his commentary on Constitutional Court Ruling 138-O (published in 2002), is of the view that it was open to the Russian authorities and the courts to rely on the "bad faith taxpayer" doctrine to challenge a tax evasion scheme at the time of the Yukos tax assessments, whether based on "substance over form" or "business purpose." Although this was an area of the law that was evolving at the time, this alone cannot be determinative. Indeed, the anti-abuse doctrine was a judicial doctrine, and the Tribunal does not consider it appropriate to criticize the Russian Federation only because such a doctrine had not yet fully crystallized. To the contrary, the circumstances surrounding Yukos' tax optimization scheme suggest to the Tribunal that this is precisely the kind of case in which the doctrine could be relied upon by the authorities and the judiciary. Nevertheless, Claimants argue that the decision to revoke the profit tax benefits was illegitimate because of the manner in which the "bad-faith taxpayer" doctrine was applied. In particular, Claimants submit that the "re-attribution" of the trading companies' revenue to Yukos was unprecedented and had no basis in law. Further, Claimants submit that there were glaring violations of due process throughout the tax assessment and tax enforcement proceedings. The Tribunal addresses each of those arguments in turn.

iii. Was "Re-attribution" an Appropriate Remedy to Apply to Yukos?

615. Claimants argue that the authorities should have applied the transfer-pricing rules of Articles 20 and 40 of the Russian Tax Code to address any concerns about Yukos' avoidance of tax in the low-tax regions. Instead, the authorities "re-attributed" to Yukos the revenues of all of its trading companies. According to Claimants, this remedy was unprecedented, had no basis in law and was obviously another ploy in the Russian Federation's fabrication of taxes against Yukos.[645]

616. As mentioned, Claimants submit that the proper decision, and indeed the only decision, that the tax authorities should have issued would have been to apply the transfer-pricing provisions of Articles 20 and 40 of the Russian Tax Code. In this context, in their Post-Hearing Brief, Claimants argue as follows:

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645 Claimants' Opening Slides, p. 60.

> 11. Similarly, the Respondent's attempt to dismiss the relevance of the ubiquitous references to Yukos in the tax authorities' documentation relating to the trading companies ignores the realities of the Russian context. There was no domestic market for crude oil in Russia, and as Dresdner observed, "[o]il sales on the Russian internal market consist[ed] mainly of internal sales between the sister companies of the large integrated Russian oil companies". In this context, when conducting a tax audit of a company whose activities consisted of trading crude oil produced by Yukos' production companies, it would have been natural for the tax authorities to examine whether the trading company and the production company were "interdependent" under Article 20 of the Tax Code, and if so, whether the sales transactions complied with the transfer pricing provisions of Article 40. This is precisely what the tax authorities did, finding no violations of Article 40 prior to the December 2003 Audit Report.[646]

617. Claimants add:

> Mr. Konnov has conceded that the transfer pricing provisions of Articles 20 and 40 were available to the tax authorities and, although cumbersome to apply, could have fully dealt with any allegedly improper tax savings, yet as he has confirmed, the tax authorities never offered any explanation as to why they did not use Article 40 and instead invented a re-attribution theory. As Mr. Savseris has written, referring specifically to the Yukos case, it was wholly inappropriate for the tax authorities to resort to judicial doctrines to address a situation covered by these express statutory provisions, noting that "[i]f the generally established principles in the West for the application of judicial doctrines were respected, this would have been impossible".[647]

618. During the Hearing, Respondent asserted that re-attribution "is an entirely appropriate application of the 'substance over form' anti-abuse doctrine."[648] Respondent referred to what it called "pre-December 30, 2003 cases" (*Bashkirian refineries* case (2003–2005); Lukoil (2002) and VAT cases) as well as what it called "post-Yukos authorities" (*Korus-Holding* (2005–2006), *MIAN* (2007–2008) and *Syktyvkarsky Milk Factory* (2008–2009)).[649]

619. However, Mr. Konnov, when asked a specific question by the Chairman of the Tribunal, had great difficulty in explaining the existence of a pre-Yukos precedent for the re-attribution that was imposed on Yukos with the assessments. Claimants recall this incident in their Post-Hearing Brief in the following words:

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646 Claimant's Post-Hearing Brief ¶ 11 (citing Transcript, Day 15 (Konnov) at 177:6-180:7; Accounts Chamber of the Russian Federation, Analytical Note "On the Economic and Financial Situation of Natural Monopolies", 2003, p. 183 (noting "the absence of a full-fledged domestic market of crude oil in the Russian Federation"), Exh. C-416; ZAO Dresdner Bank Valuation Report of Yuganskneftegaz, 6 October 2004, p. 95, Exh. C-274 (hereinafter "Dresdner Valuation Report"); Table: Field tax audits of Yukos' trading companies in Mordovia, April 2002–October 2003 (noting that audits of Fargoil and Mars XXII in 2003 found no violations of Art. 40), Exh. C-1758).

647 Claimant's Post-Hearing Brief ¶ 40 (citing Transcript of Mr. Konnov's cross-examination in the *Quasar* arbitration, 24 October 2011, pp. 55–56, 58–59, Exh. C-1697; S.V. Savseris, "Bad Faith of the Taxpayer as Judicial Doctrine Against Tax Evasion" (2005), p. 5, Exh. C-1748).

648 Respondent's Closing Slides, p. 105.

649 *Ibid*. pp. 105–15. *See also* First Konnov Report ¶¶ 50–51.

> *First*, as the Tribunal will recall, when asked point blank by the President to identify a precedent for reattribution, Mr. Konnov was unable to do so. The next day Mr. Konnov sought to "correct" this answer by referring to cases involving the "Bashkirian oil refineries" and a Lukoil assessment that never went to court. However, Mr. Konnov then corrected the correction by noting, with respect to the Bashkirian cases, that "the court decisions . . . are not particularly helpful because the lower court decided in favour of the taxpayer, and only in 2005 the court decided in favour of the tax authorities."[650]

620. Having reviewed the decisions cited by Respondent, the Tribunal concludes that none of them is truly apposite to Respondent's argument:

(1) the "*Bashkirian refineries* case": in this case (cases, actually), the tax authorities did "re-attribute" sales revenue from a Baikonur entity to the three selling oil refineries, and they did so by assessments dated 16 July 2003. However, these assessments were overturned, in each of the three cases, by the first instance arbitrazh court in November 2003, and the tax authorities' appeals in early 2004 were initially unsuccessful. It was only in 2005 that the Supreme Arbitrazh Court overturned the lower court decisions, and upheld the July 2003 assessments (Exhibits R-1488, 1489, and 1490). Thus, this case cannot serve as a pre-Yukos precedent.

(2) the "*Lukoil* case": this case involved the invalidation of a lease between OAO Lukoil-Ukhtaneftepererabotka and a Baikonur shell, and the resulting claim against the former for taxes. While the court decisions (first instance, appellate and cassation levels) all date back to 2002, they do not show that the taxes of the Lukoil entity were "re-attributed" to Lukoil. In the view of the Tribunal, therefore, this case does not support Respondent's re-attribution theory.

(3) the "VAT cases": Respondent argues that "[b]oth before and after the Yukos assessments, the Russian tax authorities routinely assessed VAT on purchasers with respect to revenues representing value that had been added by their suppliers, rather than the purchasers themselves."[651] Respondent points to one pre-Yukos example in the record, a decision that dates from 22 September 2003 (Exhibit R-3372). On the Tribunal's reading of this decision, it is difficult to make out the re-attribution from seller to purchaser, since the

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650 Claimant's Post-Hearing Brief, ¶ 38 (citing Transcript, Day 14 at 221–23 (Mr. Konnov) ("I don't think I can give you any reference to the pre-Yukos precedent where attribution was applied in an identical way."); Transcript, Day 15 at 83–84 (Mr. Konnov); Transcript, Day 15 at 215 (Mr. Konnov)). Claimants cite their Reply ¶ 233 to note that: "Moreover, these alleged precedents involved alleged evasion of excise taxes rather than alleged abuses of profit tax incentives, and were decided on entirely different legal grounds)." *Ibid*. n.85.

651 Respondent's Closing Slides, p. 110.

Court's attention is quite definitely on the purchaser in its analysis of the transaction. In any event, it is not a situation which is at all analogous to the Yukos case.

621. By contrast, the *Korus-Holding* case appears to be on all fours with the Yukos case, in terms of the re-attribution remedy, but it was decided in 2006, well after the assessments against Yukos in 2003 and 2004.

622. The Tribunal notes another factor that supports Claimants' position, namely the contrast between the first and second decisions involving Investproekt. In the first decision, dated 2 April 2002,[652] the tax authorities refused to impose any tax liability on Investproekt for the past tax offenses of Business-Oil, Vald-Oil, Forest-Oil and Mitra. In the second decision, dated 8 August 2003,[653] Investproekt was held liable for those offenses. The Tribunal observes that the basis for reversing, in August 2003, the earlier decision of April 2002, was not explained in the August 2003 decision,[654] and the latter decision followed soon after the arrest of Mr. Lebedev on 2 July 2003. Moreover, neither of these earlier assessments purported to re-attribute the tax burden to Yukos, but rather to the successor entity of the trading companies—Investproekt.

623. Regarding the transfer-pricing provisions of the Russian Tax Code as a proposed alternative remedy for whatever mischief is connected to the use of the Yukos trading entities, Respondent in its Rejoinder argues:

> 701. Claimants suggest that the "proper course of action" for the authorities "would have been to pursue" Yukos' trading shells as opposed to Yukos. But the tax authorities looked to the economic substance and concluded that Yukos was the real taxpayer. That was both legally proper and practically sensible. As illustrated by the authorities' inability to collect unpaid taxes from the Lesnoy trading shells, Yukos deliberately engineered its scheme so that its trading shells, if they were ever audited and reassessed, would have no assets with which to pay any such assessment, with the result that Yukos' fraudulent scheme would have enjoyed *de facto* impunity. Yukos was at all times the real party in interest in the challenged transactions. It was thus entirely appropriate for the tax authorities to pursue their claims against it, instead of the trading shells it had created to evade taxes.
>
> 702. Equally unavailing is Claimants' reliance on Article 40 of the Tax Code. The Yukos "tax optimization" scheme was not an ordinary "transfer pricing" scheme, but rather a tax evasion scheme involving the abusive exploitation of the low-tax region program through dozens of sham entities which had no genuine business operations. It was therefore entirely appropriate for the authorities to challenge that scheme by reference to anti-abuse rules, rather than the transfer pricing rules set forth in Article 40, insofar as

652 Decision No. 02-11/1/1, 2 April 2002, Exh. R-303.

653 Decision No. 2.6-23, 8 August 2003, Exh. R-305.

654 *Ibid*.

> Yukos had deliberately constructed its tax evasion scheme so as to circumvent the application of Article 40, including by (a) using chains of shells which increased the likelihood that, if audited, each link in the chain could avoid an assessment under the 20% "safe harbor," and (b) owning most of the trading shells through call options, offshore companies, and other devices, which would make it more difficult for the authorities to establish an "interdependence" within the technical meaning of Article 40 between Yukos and its trading shells.[655]

624. During the Hearing, Respondent argued that the "substance over form" doctrine would be illusory if re-attribution were precluded, since it would permit tax evasion with impunity as the taxpayer could simply cause the relevant income or revenues to be recorded, on paper, in the books of a judgment proof domestic affiliate or a foreign affiliate that was solvent but territorially beyond the reach of any enforcement measure.[656] Respondent also referred to other jurisdictions where a "general anti-avoidance provision" allows the tax authorities to allocate "any income" to "any person" in connection with "an avoidance transaction".[657]

625. The Tribunal sees some merit, in principle, to Respondent's argument that the "anti-abuse" doctrine would be eviscerated if the tax authorities were unable to attribute income to the person responsible for the wrongdoing. The Tribunal also notes with interest Respondent's reference to the anti-avoidance provisions of other countries, such as the United States, France, Germany, Canada and Australia, which grant the taxation authorities similar powers, as well as to some decisions from other jurisdictions.[658] In the Russian context, however, it is clear to the

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655 Rejoinder ¶¶ 701–702 (citing ¶¶ 599, 597–600 of Rejoinder; Second Konnov Report ¶¶ 19, 24–25 and 63). Respondent also notes: "This also confirms the lack of merit in Claimants' contention that Respondent's "multiple allegations about non-arm's length pricing […] contradict" Respondent's "concession that Yukos' alleged tax liabilities [are] not premised on any violation of transfer pricing rules" [citing Reply ¶ 214]. In reality, there is no such contradiction, because it is well-settled in Russian tax law that the transfer pricing rules set forth in Article 40 of the Tax Code are not the exclusive remedy available to the Russian tax authorities to combat abusive tax practices based on price manipulations (*see* First Konnov Report ¶¶ 40–44). In other countries too, the general view is that the existence of specific statutory anti-avoidance rules does not prevent the authorities from deploying their anti-abuse arsenal, including general anti-avoidance rules, whether enacted by statute (as is the case, for instance, in Germany) or developed by the judiciary (as is the case, for instance, in the United States) . . . .

In the Yukos case, the authorities' reliance on alternative theories of liability was not only proper but particularly appropriate, because the Yukos tax evasion scheme was deliberately engineered so that Yukos, through its trading shells, could circumvent the transfer pricing rules, which require an under- or over-statement of prices of more than 20 percent of the market price. Yukos evaded those rules by running inventories through chains of multiple trading shells in a series of nominally independent transactions, none of which individually exceeded the 20 percent threshold. *See* Protocol of Witness Interrogation of Vladislav P. Brazhkov (15 February 2008), 4, 6 (Exh. R-3370)." *Ibid*. n.1098

Respondent further notes: "Yukos' internal communications confirm that it was a "headache" for Yukos' employees to ensure that the transactions among the trading shells were structured to prevent detection of the scheme by the tax authorities. [citing Counter-Memorial ¶ 304 and e-mail from A.V. Brazhkov to A.P Kuchusheva, 9 October 2001, Exh. R-325]." *Ibid*. n.1099.

656 Respondent's Closing Slides, p. 115.

657 *Ibid*. p. 118.

658 Respondent's Opening Slides, pp. 95–103.

Tribunal that there was no precedent for re-attribution at the time that the tax assessments and related decisions were issued in respect of Yukos.

626. Moreover, the Tribunal could have been persuaded to accept Respondent's argument if the tax authorities had only imposed revenue-based taxes against Yukos on the basis of re-attribution. However, and as already noted, the tax authorities attributed to Yukos the trading companies' revenues while, at the same time, refusing to attribute to Yukos the trading companies' VAT refunds and it did so for purely technical reasons. This leads the Tribunal to the conclusion that the authorities used the "re-attribution" formula not only so as to be able to collect the revenue-based taxes, but also so as to establish a basis for imposing the massive VAT liability and excessive fines that followed.

627. In short, the Tribunal accepts the following conclusion, as expressed in paragraph 41 of Claimants' Post-Hearing Brief:

> The obvious explanation for the Respondent's use of a novel and arbitrary re-attribution theory rather than correctly applying existing law on interdependence and transfer pricing is that this was not a *bona fide* exercise of taxation powers; instead, the novel re-attribution theory provided a pretext to impose US$ 13.59 billion in VAT claims that, as Mr. Konnov confirmed, could not have been made in the absence of the unprecedented re-attribution of revenues.[659]

iv. Did the Russian Federation Violate Due Process?

628. Claimants submit that the Russian Federation violated due process by (a) ensuring that the courts were obedient and did not question the legality of the tax assessments; (b) ensuring that Yukos could not present its case; and (c) ensuring that neither the trading companies nor the Mordovian authorities could participate in the proceedings.

629. Regarding the legality and legitimacy of the tax assessments which Claimants say the courts should have scrutinized, the Tribunal recalls its finding in Chapter VIII.A that, during the period relevant for the tax assessments against Yukos (2003–2004), the "bad faith taxpayer" doctrine included the following principles:

- The good faith (honesty) of the taxpayer is presumed.
- The tax authorities have the burden to prove the taxpayer's bad faith (dishonesty), and in doing so "may not construe the concept of 'good faith taxpayers' as imposing on the taxpayer additional obligations which are not provided for in the legislation."

659 Claimant's Post-Hearing Brief ¶ 41 (citing Transcript, Day 15 at 94–95).

630. In the view of the Tribunal, questions can be asked about whether the tax assessments disclose a record establishing that the tax authorities discharged their burden of proving Yukos' bad faith in respect of all the trading entities said to be an integral part of its tax evasion scheme. Some of these questions were raised by Yukos' tax lawyers immediately after the 2000 tax assessment was issued. They commented:

> The act of inspection of OAO NK YUKOS contains the amounts of revenues of each company however it is absolutely unclear what control actions produced this information and what documents confirm it, etc.[660]

631. This question was developed in the Objections against the tax assessment filed by Yukos on 12 January 2004. Under objection no. 6 ("Breach of the procedure for conducting an audit"), Yukos complained that the auditors referred to materials from the criminal case, but did not indicate "what specific documents of the criminal case confirm the fault of the taxpayer."[661] Yukos' detailed objection continued:

> Attention should also be paid to the failure to analyze and indicate taxation objects on additionally assessed taxes for all re-assessments under 17 companies. Furthermore, audit materials do not contain any source documents (waybills, statements, commercial invoices, etc.) and does not contain contracts for sale and purchase of goods and information about payment for goods. At the same time the auditors concentrated only on the matter of unlawfulness of tax benefits' application, although does not review at all the basic matter that shall be proved in the course of tax audit - the value of taxation objects of these 17 companies. It should be mentioned that it is impossible to state the fact of non-payment of taxes without analysis of business operations and economic results obtained thereunder (revenues, profits). However, the auditors do not bother themselves with study of business operations, under which billions of Rubles are imputed to OAO NK YUKOS for payment.
>
> This directly contradict to Article 100 of the Tax Code of the Russian Federation, which indicates that the Audit Report must contain information about tax offense confirmed by the documents and Instruction of the Ministry of Taxes and Levies the Russian Federation No. 60 of 10.04.2000 "On Procedure for Compilation of Field Tax Audit Report and Proceedings in the Case of Violation of the Legislation on Taxes and Levies", according to which the Audit Report must contain references to source accounting documents (with indication, in case of necessity, according transactions and order for reflection the respective operations in the accounting registers) and other evidences confirming the fact of violation. The Instruction also stipulates that the Report must be based on results of audit of <u>all</u> documents that may be related to the stated facts, and on results of performance of all other actions necessary for exercising tax control.
>
> According to this Instruction, the following must be attached to the Audit Report:
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> • clarified calculations by types of taxes (levies) drawn up by the auditors in connection with the discovered tax offence (except for the cases when the specified calculations are presented in the body text of the report). Calculations must be signed by the

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660 S. Pepeliaev, *Summary of the tax inspection of OAO NK Yukos*, p. 2, 5 January 2004, Exh. C-1128.

661 Objections against Report No. 08-1, p. 13, 12 January 2004, Exh. R-335.

> auditor (the auditors), the head of the company or private entrepreneur or their representatives; and
>
> • materials of cross audits (in case these were performed).
>
> However, these requirements are not met and source documents and tax returns of 17 companies mentioned in the Report are not attached to the Report, which virtually deprives OAO NK YUKOS of opportunity to assess accusations of tax offence brought against it.
>
> It is also necessary to mention that in violation of the requirements of the abovementioned Instruction about fairness and reasonableness of the reflected facts, the Audit Report was written in obviously biased manner, with accusative tendency and starts with conclusions on presence of a certain tax evasion "scheme". The obvious prejudice of the auditors does not allow to consider the Audit Report as the evidence of committed tax offence.[662]

632. The Tribunal notes that Article 100(2) of the Russian Tax Code requires a tax audit to contain "documentarily attested references to facts of tax offenses revealed during the audit . . . ."[663]

633. The Russian Tax Code also requires the Director of the Tax Authority to consider the taxpayer's objections prior to issuing a decision (which may hold, or not hold, the taxpayer liable for a tax offense, or direct further tax control measures).[664] Article 101(3) provides:

> 3. The decision to hold the taxpayer liable for a tax offense shall indicate the circumstances of the committed tax offence, how they were established by the audit, the documents and other evidence, which attest to these circumstances, arguments presented by the taxpayer for his defense and the results of their verification, the decision to hold the taxpayer for specific tax offenses with a reference to the articles of this Code providing for such tax offenses and liability incurred.[665]

634. The 2000 Decision summarizes Yukos' objections, but selectively so. Notably, Yukos' specific objection regarding the tax authorities' failure to document the facts allegedly underpinning the conclusions in the tax audit is omitted from the description in the Decision of Yukos' objection no. 6.[666] Moreover, while the decision contains responses or comments regarding some of Yukos' other objections, it does not contain any response to this specific objection.[667]

635. The court decisions that affirmed the legality of the decision, both in first instance and on appeal, used similar wording to dismiss Yukos' objection based on breach of procedure for conducting an audit:

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662 *Ibid*. at 14–15.

663 Art. 100(2), Russian Tax Code, Exh. C-1704.

664 Art. 101(1) and (2), Russian Tax Code, Exh. C-1704.

665 Art. 101(3), Russian Tax Code, Exh. C-1704.

666 2000 Decision, pp. 86–87, Exh. C-104.

667 *Ibid.*, pp. 87–90.

> Results of the audit and the Decision were formalized in compliance with requirements of Articles 100 and 101 of the Russian Federation Tax Code. The Decision indicates its subject, essence and features of the tax offense imputed to the taxpayer, with reference to Article 122(3) of the Russian Federation Tax Code. Demand for the payment of tax arrears, interest and fines indicated in the Decision of the Russian Federation Ministry of Taxes and Levies No. 14-3-05/1609-1 of 14.04.2004 are well-founded, comply with the current legislation and are supported by the primary documents of audit materials, presented by the Russian Federation Ministry of Taxes and levies to the Court for substantiation of its claim.[668]

636. The Ninth Arbitrazh Court of Appeal added that "[Yukos'] reference to a lack of documents and information confirming bad faith on the part of the taxpayer is unfounded."[669] The Tribunal observes, however, that neither court identifies any specific documents in coming to these conclusions; nor did Respondent submit to the Tribunal the record that was before those courts, or present a witness who could attest to it. This makes it impossible for the Tribunal to assess whether the tax authorities did indeed discharge their burden against Yukos in issuing and defending their tax assessments.

637. Claimants sum up their argument on this important point in their Post-Hearing Brief with the following submission. The Tribunal notes that these crucial allegations of Claimants were never rebutted by Respondent:

> In addition, the December 29, 2003 Audit Report did not comply with the requirements of the Russian Tax Code, including, in particular, by failing to document the factual allegations made and by relying on unidentified and undisclosed documents from the criminal investigation against Mr. Khodorkovsky. Continuing this flagrant breach of due process, the tax authorities refused to allow Yukos access to the documents upon which the purported claims were based, making it impossible for Yukos to defend itself. Notwithstanding the fact that the results of the court cases were determined in the Kremlin and it therefore could not possibly have made any difference how Yukos presented its defense, this refusal even to subject the purported claims to the scrutiny of Yukos' lawyers attests to the Russian authorities' complete lack of belief in the validity of those claims and their determination to destroy the company at a rapid pace.[670]

638. Respondent avers that "the unbroken thread of Yukos' tax evasion" demonstrates that the Russian Federation's assessments against Yukos were entirely proper, and marshalled a

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668 Resolution of the Ninth Arbitrazh Court of Appeal, Case No. 09AP-4078/04-AK, 23 November 2004, p. 5, Exh. C-147; *see also* Decision of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241, 26 May 2004, p. 21, Exh. C-116.

669 *Ibid*., p. 9.

670 Claimants' Post-Hearing Brief ¶ 24.

substantial amount of evidence that suggests that Yukos was abusing at least some of the low tax regions prior to 2003.[671]

639. However, the Tribunal observes that nearly all of the evidence on this point relates to the entities in Lesnoy and Trekhgorny. The Tribunal has not found any evidence in the massive record that would support Respondent's submission that there was a basis for the Russian authorities to conclude that the entities in Mordovia, for example, were "shams". Indeed, instead of pointing to any specific evidence on which the tax authorities might have based their finding that the Mordovian entities were shams, Respondent reversed the burden and asserted that "there is no evidence that the Mordovian shells ever had any greater substance than the Lesnoy shells";[672] and that "[f]actually, Yukos did not even attempt to demonstrate that any genuine trading activities had ever been conducted in Mordovia."[673] While the incomplete record before the Tribunal may not, in point of fact, establish that the Mordovian trading companies conducted genuine trading activities in Mordovia, the Tribunal notes that the Russian courts systematically denied Yukos' motions to join to the proceedings its trading companies and the Government of the Republic of Mordovia. This leads the Tribunal to conclude that the Russian courts may have prevented Yukos from adducing evidence bearing on the nature of its activities in Mordovia.[674] The record, insofar as the Tribunal has been able to find, does not reveal reasons, still less persuasive reasons, for denial by the Russian courts of joinder of the Mordovian government and the trading companies.

640. In the specific context of determining whether, in relation to the tax assessments against Yukos, the tax authorities discharged their own burden of proving Yukos' bad faith so as to be able to rely on the "bad-faith taxpayer" doctrine, the Tribunal makes two observations. Firstly, the tax authorities failed to address at the time of the 2000 Decision, Yukos' reasoned objection based on the absence of specific documents in the tax audit. Secondly, Respondent failed to identify during the Hearing any satisfactory evidence that the abuses found in the trading firms operating in Lesnoy and Trekhgorny were also found in the trading companies operating in Mordovia and all the other low-tax regions where Yukos entities were present. While it is true, and suggestive, that Claimants did not introduce evidence at the Hearing showing that trading

671 Respondent's Closing Slides, pp. 3–35.

672 *Ibid*. p. 33.

673 *Ibid*. p. 98.

674 *See* Reply ¶ 286.

companies which operated in Mordovia were not "shams", it is first and foremost the conduct of the tax authorities that the Tribunal must examine in the context of the tax assessments that these authorities imposed on Yukos. Focusing exclusively on Claimants' failure to demonstrate that the Mordovian entities were not "shams" would empty of meaning the important principle that the tax authorities had the burden of proving the taxpayer's bad faith under Russian law. On this point, the following extract from the *Pribrezhnoye* decision issued by the Federal Arbitrazh Court for the North-Western District on 5 June 2002 (well before the tax assessments against Yukos) is instructive:

> In addition, the IMNS's reference to the absence of presentation of evidence by the Company on the conduct of its business in the ZATO territory, which was supported by the court, is erroneous.
>
> Pursuant to Article 53 (part one) of the Arbitrazh Procedure Code of the Russian Federation in considering disputes on the invalidity of acts of State authorities, local self-government authorities and other authorities; it is up to the relevant authority to prove the circumstances, which provided the grounds for issuing the said acts. Due to the fact that the disputed tax benefit had been granted to the defendant by a competent ZATO authority, and that the IMNS issuing the challenged non-regulatory decision found the granting of the benefit unlawful, the courts erroneously imposed the burden of proof on the Company.[675]
>
> [emphasis added]

641. Looking at the tax assessments themselves, the Tribunal observes that, if there is an "unbroken thread" running through the tax authorities' analysis of Yukos' tax optimization scheme, it is the consistent and uniform finding that each trading entity is "interdependent" with Yukos. But that interdependence in the view of the Tribunal of itself does not establish bad faith on the part of all the trading entities.

642. In its objections to the Tax Audit (objection No. 1: "Illegal conclusions concerning legal definition of interdependent persons"), Yukos complained about the authorities' reliance on interdependence as the principal factor motivating their conclusion that Yukos' tax optimization scheme was a tax evasion scheme, noting that interdependence has a specific meaning under the Russian Tax Code (in Article 20), and with strictly determined legal consequences (under Article 40).[676] These provisions allow authorities to disregard prices used in transactions between interdependent persons when those prices deviate by more than 20 percent from the market price, and to assess additional taxes and interest calculated as if the

675 *Pribrezhnoye*, p. 5, Exh. C-1278.

676 Objections against Report No. 08-1, pp. 1–5, 12 January 2004, Exh. R-335.

transactions were concluded at the market price. Again, the Tribunal notes that this objection was not directly addressed in the 2000 Decision.[677]

643. The Tribunal notes that the relevant audit reports and decisions do refer generally to various factors that would seem to be relevant to a finding that the legislation in low-tax regions was being abused by Yukos. For example, they refer to the absence of trading activity in the regions and the absence of sufficient or even of any investment by the trading entities in the low tax regions. However, a close analysis of the tax assessment for 2000, for example, reveals that it was not established by the tax authorities that each of the trading entities which it labelled as a "sham" had no trading activity whatsoever, as opposed to just being "interdependent" on Yukos or not having physical facilities to handle oil and oil refining.

644. The Tribunal agrees with Claimants (and apparently also with Mr. Konnov) that it is nonsense to require a trading company to demonstrate physical interaction with the goods or commodities that it is trading, especially in the era of electronic communications. In this sense, the Tribunal is highly skeptical of the reasoning in the 2000 Audit Report (and subsequent reports) that the absence of physical movement of oil in and out of the low-tax region where the respective trading entity is located is evidence of a sham. The Tribunal observes that the reasoning on this point in the 2000 Audit Report is also inconsistent with the decision in the *Pribrezhnoye* case.

645. In that case, the Federal Arbitrazh Court for the North-Western District reversed decisions of lower courts that had accepted the tax authorities' efforts to impose additional eligibility requirements on a ZATO-based oil trading company beyond those laid out in the ZATO law. It explicitly noted that:

> Under these circumstances the examination of whether the Company had fixed assets for oil products storage and transportation in the ZATO territory is beyond the scope of this case, because operations of trade in oil products, i.e. conclusion of contracts of sale, do not require the Company to own such fixed assets or for the oil products to be present within the ZATO territory.[678]

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677 2000 Decision, pp. 87–90, Exh. C-104. There is also only a minor reference to the objection in the Decision of the Moscow Arbitrazh Court, Case No. A40-17669/04-109-241, 26 May 2004, p. 19, Exh. C-116. ("The court considers unfounded the Respondents' arguments that the status of interdependent entities has legal importance solely for the possibility of applying market prices to determine the results of the transactions for tax purposes. Interdependence of entities in this case is one of the circumstances by which the tax authority substantiates bad faith of the taxpayer.").

678 *Pribrezhnoye*, p. 3, Exh. C-1278

646. The court added

> The references by the courts to the facts that transfer and acceptance of crude oil occurred outside the ZATO territory; that [the manager of a customer company was in a different ZATO when the transfer was signed]; that the phone numbers of the rented office premises are recorded to the name of a person other than the Company; and that the defendant had not paid the office electricity bills are equally unfounded. The said circumstances per se do not refute the fact that the Company was doing business as a trade company in the territory of the ZATO, and they have no relevance for the case because they are not taken into account by tax legislation in determining eligibility for tax benefits.
>
> The examination of the said circumstances by the first instance court and the court of appeal reveals their misinterpretation of Article 5(1) of the ZATO Law, in that the court went beyond the eligibility criteria for tax benefits that are explicitly set forth in this provision. In violation of Article 3(7) of the TC, the first instance court and the court of appeal regarded the absence of any criteria on doing business in ZATO territory other than fixed assets, workers on payroll and salary payments as grounds for the independent establishment of such criteria by a tax authority or a court.[679]
>
> [emphasis added]

647. Finally, the Tribunal agrees with Claimants that the criterion of "proportionality" seems to be difficult to apply as a stand-alone basis to invalidate the structure in the low-tax regions. This is due to the fact that the proportion between the tax savings and the investment in the low-tax region should have been readily apparent to the tax authorities on the face of the tax filings and related tax documents. On the other hand, where properly evidenced, a grossly disproportionate arrangement combined with an "empty shell" structure could, in the Tribunal's view, validly attract the attention of the authorities under the "anti-abuse" doctrine.

648. To conclude, it thus appears to the Tribunal that the Tax Ministry, in its assessments against Yukos, painted all of the Yukos' entities in the low tax regions with the same brush, even though it marshalled little, if any, documented evidence that all, and not only some, of the trading entities were abusing the low tax regime in which they had respectively been constituted. On the one hand, the Tribunal accepts that, if Claimants had evidence of genuine business activity of the trading companies in the low-tax regions, they would have introduced it or referred to it orally. Accordingly, resolution of these critical issues is not free from doubt. But on the other hand, and on balance, where neither side was able to demonstrate the facts, but where Yukos' files were in the hands of Respondent, the Tribunal feels justified in holding Respondent bound by the burden of proof. Respondent failed to meet that burden. Moreover, it refused to join Mordovian authorities and the trading companies to the litigation. Furthermore, the re-attribution remedy was unprecedented at that time in the Russian

679 *Ibid*., p. 4.

Federation. Respondent's resort to re-attribution appears to be linked to its determination to impose a massive VAT liability on Yukos.

(b) VAT

i. Introduction

649. Claimants argue that the imposition of VAT by the tax authorities, and more specifically their refusal to attribute to Yukos the trading companies' VAT returns and refunds, is arbitrary because (a) it is undisputed that the goods at issue in the underlying transactions were exported and that the trading entities timely and duly filed VAT returns (and thus that the transactions benefited from the exemption from VAT or zero percent rating, depending on the year);[680] (b) the refusal to attribute the trading companies' VAT returns and refunds to Yukos is inconsistent with Respondent's attribution to Yukos of the trading companies' revenues for purposes of calculation of tax (be it profit tax or VAT or any of the other taxes); and (c) Yukos' refilings of VAT returns were rejected on the basis of technicalities, thus demonstrating that Respondent had no intention of treating Yukos in good faith.[681]

650. Respondent takes the position that the VAT assessments against Yukos were perfectly proper, and consistent with the corporate profit tax assessments. In both cases, Respondent argues, the assessments were based on the application of Russian tax law to the true situation, established by the tax authorities, that Yukos was the "real taxpayer" and "actual exporter" in the various transactions that the trading companies had entered into. Respondent's position is also based on its assertions that under Russian law, the granting of a zero percent VAT rate is subject to compliance with stringent documentary requirements; and that it is undisputed that Yukos itself never filed regular VAT returns or proper amended VAT returns in relation to the transactions in question.[682]

651. The Tribunal observes that there was no element in Yukos' tax scheme that enabled Yukos to benefit improperly or illegally from a VAT exemption or a zero percent rating. As noted earlier

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680 *See* Second Konnov Report ¶ 84, n.137. Mr. Konnov explains: "Prior to entry into force on January 1, 2001 of Chapter 21 of the Russian Tax Code governing VAT, VAT was governed by Law of the Russian Federation No. 1992-1, On the Value Added Tax, December 6, 1991 (the 'VAT Law'). Under the terminology of the VAT Law, exports were 'exempt' from VAT whilst under the Russian Tax Code they are subject to 0% VAT rate. In substance, exemption from VAT on exports was similar to the 0% tax regime." *Ibid.*

681 Claimants' Opening Slides, p. 63.

682 Respondent's Opening Slides, p. 111.

in this Award, VAT is a uniform federal tax that benefits from an exemption or a zero percent rating if the transaction involves an export to a foreign purchaser. In other words, even if Yukos' tax scheme was entirely unlawful (or unlawful in some respects), and the authorities were justified in attributing the trading companies' revenues to Yukos for tax purposes, there is no suggestion by Respondent that the trading companies (or Yukos) did anything "wrong" vis-à-vis VAT with their tax scheme. The Tribunal must consider the propriety of the multibillion dollar VAT assessments against Yukos in this context.

652. The Tribunal addresses the specific questions arising on the topic of the VAT assessments in the following subsections.

ii. Was the Imposition of VAT Payments on Yukos Inconsistent with the Attribution to Yukos of the Trading Companies' Revenues?

653. Claimants assert that when the Russian Tax Ministry reattributed to Yukos all of the revenues (including the export revenues) of its trading companies, it should have attributed to Yukos the VAT refunds previously obtained by the trading companies with respect to their exports. Instead, in what Claimants characterize as a "contradiction with its own theory," the Tax Ministry chose to impose the amounts on Yukos, justifying the VAT payment demands on the failure by Yukos, as the "real taxpayer", to file on time "the documentation required to validate the VAT exemption or the 0% VAT rate".[683]

654. Claimants sum up their argument in their Memorial as follows:

> This formalistic position, systematically challenged by Yukos before the arbitrazh courts, but endorsed without any thorough analysis by these courts, was obviously circular: the trading companies, not Yukos, had exported oil and oil products and filed all the necessary documentation; under the applicable laws, Yukos did not have to file and could not have filed such documentation at the relevant times. The fact that, even when Yukos attempted to submit the updated VAT returns in its own name to satisfy the Tax Ministry, its submissions were simply rejected as improper and untimely, amply shows the Tax Ministry's bad faith and true intentions.[684]

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683 Memorial ¶ 321–22.

684 Memorial ¶ 322 (citing as regards Yukos' tax reassessment for the year 2000, Decision of the Moscow Arbitrazh Court of 26 May 2004, 28 May 2004, p. 19 of the Russian original, Exh. C-116; as regards Yukos' tax reassessment for the year 2001, Resolution of the Ninth Arbitrazh Court of Appeal of 9 February 2005, 16 February 2005, p. 23 of the Russian original, Exh. C-167; as regards Yukos' tax reassessment for the year 2003, Decision of the Moscow Arbitrazh Court of 21 April 2005, 28 April 2005, p. 59 of the Russian original, Exh. C-196, and Resolution of the Federal Arbitrazh Court for the Moscow District of 18 November 2005, 5 December 2005, p. 17 of the Russian original, Exh. C-197; as regards Yukos' tax reassessment for the year 2004, Resolution of the Ninth Arbitrazh Court of Appeal of 11 August 2006, 18 August 2006, p. 35 of the Russian original, Exh. C-336; as regards Yukos' tax reassessment for the year 2002, Transcript of the hearing held at the Moscow Arbitrazh Court on 14–16 December

655. In its Counter-Memorial, Respondent asserts that the tax authorities were justified to treat Yukos itself as the real party in interest, "which for VAT purposes, meant treating it as the real exporter. This approach simply reflected reality."[685] As such, Respondent argues, Yukos could have benefited from exemption (or "zero-rating") only if, as "the true exporter", it had timely filed "the requisite documentation in the correct manner."[686]

656. Claimants reaffirm their position in their Reply, stating that Respondent's position on VAT "was wholly inconsistent with the entire re-attribution theory upon which all of the other purported tax claims were premised."[687] In short, Claimants argue that "it was arbitrary and contradictory for the authorities to re-attribute the trading companies' oil, revenues, profits, tax liabilities and activities to Yukos but to refuse to re-attribute to Yukos those companies' entitlement to VAT refunds."[688]

657. More specifically, Claimants note that "there is no support in Russian law for the tax authorities to conclude that the 'true exporter' could be someone other than the legal owner as reflected in the relevant documentation."[689] In particular, Claimants assert that neither Article 165 of the Russian Tax Code nor the decision of the Constitutional Court[690] affirming the constitutionality of Article 165, on which Respondent relies, say anything about "true exporters".[691]

658. The Tribunal notes that, in audit reports and decisions prior to the reassessments in December 2003, there are frequent references to the trading companies' use of export agents. For example, in Decision No. 23 in respect of Alta-Trade, the decision notes that "Oil products are being exported through commission agent OAO NK Yukos and ZAO Trading House Angarsk-Nefto."[692] To prove that exports in fact took place, more than ten commission agreements were provided to the authorities, along with

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2004, p. 21 of the Russian original, Exh. C-183; as regards Yukos' tax reassessment for the year 2003, Decision of the Moscow Arbitrazh Court of 21 April 2005, 28 April 2005, p. 59 of the Russian original, Exh. C-196).

685 Counter-Memorial ¶ 1073.

686 *Ibid*. ¶ 1074.

687 Reply ¶ 244.

688 *Ibid*.

689 Reply ¶ 245.

690 Resolution of the Constitutional Court of the Russian Federation No. 12-P, 14 July 2003, Exh. R-1501.

691 Reply ¶ 246.

692 Decision No. 23 on partial refusal to refund/offset VAT (Alta-Trade), 15 June 2000, p. 1, Exh. C-1110

> "certificates of transactions entered into by the commission agent, bank statements evidencing crediting of funds to the commission agent's accounts, bank statements evidencing crediting of funds to OOO Alta-Trade's accounts, commission agents reports, copies of complete custom freight declarations and shipping documents confirming export of goods by sea outside the CIS member states[,] . . . complete customs freight declarations [with] the necessary notes made by customs authorities – "clearance allowed", "goods exported", and also notes made on shipping documents – "loading allowed" on loading instructions, notes made on marine bills of lading concerning acceptance of cargos for transportation.[693]

659. The Tribunal also notes that, in these audits, the taxation authorities did not appear to be concerned with these relationships. Several other audit reports and decisions also mention the use of export agents.[694]

660. In its Rejoinder, Respondent maintains its position regarding the propriety of the VAT assessments and their consistency with the profit tax assessments against Yukos. Respondent explains why Claimants are wrong, in its view, for characterizing the VAT assessments as being arbitrary and contradictory:

> Once again, Claimants are wrong. The authorities' approach with respect to Yukos' VAT liability was consistent with their approach to Yukos' corporate profit tax liability. In both instances, they treated Yukos as the actual owner and exporter of the oil and oil products, and therefore the actual entity responsible for both profit tax and VAT. Thus, the authorities found that:
>
> (i) Yukos was the real party in interest in the challenged transactions.
>
> (ii) The profit generated through those transactions was Yukos' own profit, which Yukos had fictitiously allocated to the trading shells for no purpose other than to evade taxes which it otherwise was obligated to pay.
>
> (iii) Yukos, not its trading shells, was the real exporter of the oil and oil products that were the subject matter of those transactions.
>
> The inescapable conclusion from these findings is that Yukos, not its trading shells, should have filed the requisite documents to claim a 0% VAT rate, which as discussed below Yukos did not do properly. The VAT was thus due from Yukos and the Yukos VAT assessments were proper.[695]

661. Claimants sum up their position in their Post Hearing Brief:

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693 *Ibid.*

694 *See* Decision No. 48 to deny refunding (offset) VAT (Alta-Trade), 29 October 2001, p. 1, Exh. C-1116; Decision No. 53 on partial refusal to refund/offset VAT (Mars XXII), 27 December 2004, p. 1, Exh. C-1117; Field Tax Audit Report No. 02-52, 19 April 2002 ¶ 1.7, Exh. C-1120; Field Tax Audit Report No. 02/105, 3 March 2003 ¶ 1.10, Exh. C-1124; Field Tax Audit Report No. 02-126, 22 October 2003, p. 3, Exh. C-1125; and Exh. C-1121, p. 3, which notes Article 165 of the Russian Tax Code, and states "No offense were discovered during the audit as to whether the value added tax actually paid to suppliers for materials acquired/booked, work performed or services provided, to the extent they were used to produce export goods, has been properly refunded/credited; whether OOO Ratmir had documents to support actual exports of such goods, and whether it properly assessed tax on domestic sales of goods."

695 Rejoinder ¶¶ 706–7.

> If the tax authorities had authority to reassign items from the debit side of the trading companies' taxpayer accounts to the debit side of Yukos' taxpayer account, then they must also have had the corresponding authority to transfer the entries on the credit side – particularly in light of the tax authorities' own prior determinations that the 0% export VAT rate applied to all of the transactions in question.[696]

662. During his cross-examination of Mr. Konnov, Professor Gaillard recalled that the revenue of the trading companies was attributed to Yukos:

> Q. So can we agree that the revenues were found in the books of separate legal entities, which were the trading companies; can we agree on that?
>
> A. I think you already asked that question, and I said that, yes, the tax authorities used the books of the domestic offshore companies to get the figures.
>
> Q. Right. And they took this amount and deemed this amount to be revenues of the Yukos; correct?
>
> A. That is correct: they treated that revenue as revenue of Yukos.[697]

663. Similarly, Mr. Konnov confirmed that if there had been no attribution of revenue to Yukos the VAT issue would not have arisen:

> Q. I may disagree with you on some aspects of that, but I'm not reopening that. I am just talking about VAT.
>
> If the tax authorities had decided that the trading companies themselves had violated, say, the Mordovian Law, or the Law which is applicable to them, or the Federal Anti-Abuse Law, or whatever Law, but they have violated that Law; and if the tax authorities had said, "Okay, they abused, so all these tax benefits which they had, they should never have had these benefits, because there is no proportionality, because it's form over substance", whatever reason, "So they should pay, they should reimburse all these benefits", and possibly pay interest, fines, whatever -- okay? -- if that had been the case, would the VAT issue have arisen at all?
>
> A. No.
>
> Q. You are with me on that?
>
> A. Yes.
>
> Q. So it would not. And the VAT issue arises only because it's Yukos which has been deemed to be the person having the revenues, and hence not having declared those revenues, and hence not having paid the VAT corresponding to the sales which generated those revenues; correct?
>
> A. To be more specific, the VAT issue arises because VAT returns were not refiled.
>
> Q. No, because they were not filed in the first place, right?
>
> A. No, because they were not refiled by Yukos. So the basis is not attribution; the basis is failure to file VAT returns.

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696 Claimant's Post-Hearing Brief ¶ 43 (citations omitted).

697 Transcript, Day 13 at 85–86.

THE CHAIRMAN: That's not the question. If there had been no reattribution, if the trading companies had been assessed the profit tax, et cetera, there would not have been a VAT issue.

A. Right. But I think I responded to that.

THE CHAIRMAN: Yes.

A. I responded to that. That's correct.[698]

664. Mr. Konnov acknowledged that the trading companies had filed their VAT returns and had claimed the VAT refunds as required:

> Q. Right. Do you agree with me that it's not disputed that the trading companies themselves have filed properly the VAT returns, and have requested and they have been granted the 0% rate because the goods were exported? Correct? Do we agree on that?
>
> A. I agree, they were. As we discussed earlier today, there were a few minor issues. But apart from these minor issues, this is correct: the domestic companies filed VAT returns, claimed refund, and obtained refund.[699]

665. Mr. Konnov confirmed that Yukos was assessed the massive VAT liability because it failed to file in its own name VAT returns in respect of the trading entities' exports, since it had been found by the tax authorities to be the true exporter:

> PROFESSOR GAILLARD: Okay, the next question is: is it your understanding of what happened that when the VAT issue did arise for Yukos, because Yukos was deemed to be the person having received the revenues from the sales, when it did arise, is it your understanding of the case that the reason why they had to pay this massive amount of VAT is from the outset because they were criticised for not having submitted themselves the tax returns in time? Is that your understanding of what happened?
>
> A. Right: VAT returns primarily, and the documents that need to be attached to that. But the main issue relates to the failure of Yukos to file the VAT returns with respect to these exports.
>
> . . .
>
> A. I thought I had responded to that in my reports. But in essence the Tax Code requires VAT returns to be filed by the exporter. There is a formalistic procedure. Tax authorities have historically applied the law very formally. They said that Yukos had to refile. There is nothing difficult in refiling, and Yukos did not refile.
>
> So therefore the basis for VAT assessment is not failure of Yukos to export, as we agreed; <u>but the basis is failure of Yukos to file the documentation in its own name</u>.[700]
>
> [emphasis added]

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698 Transcript, Day 14 at 227–28.

699 *Ibid*. at 230.

700 *Ibid*. at 229 and at 230–31

666. However, Mr. Konnov did not perceive any inconsistency between the attribution of revenue to Yukos and the position of the tax authorities and the courts that Yukos itself needed to file the VAT returns:

> Q. Do we agree that for the revenues themselves, the authorities applied a substance over form principle? Do we agree on that?
>
> A. The tax authorities applied substance over form for both profits tax and VAT purposes.[701]

667. In his First Report, Mr. Konnov explains his position in the following terms:

> At the outset, I should note that the tax authorities and courts were fully consistent in treating YUKOS for profit tax and VAT purposes. Revenue of the Domestic Offshore Companies was recognized as revenue of YUKOS for both profit tax and VAT purposes.[702]

668. The Tribunal observes that while the approach taken by the Tax Ministry was consistent in the sense that revenue was recognized as revenue of Yukos for both profit tax and VAT purposes, it was inconsistent in that, while the burden of the substance over form doctrine was imposed on Yukos, its corresponding benefit was not. Put another way, while technicalities and formalism are said to preclude the attribution of the VAT filings of the trading entities to Yukos, it does not appear that the Tax Ministry was concerned with technicalities and formalism when it came time to attribute their revenue to Yukos.

669. A member of the Tribunal put the pertinent question to Mr. Konnov. The following exchange with the witness is important:

> JUDGE SCHWEBEL: In substance, Russian courts treated the activities of the trading companies as the activities of Yukos itself, while at the same time they did not attribute to Yukos a critical element of those activities, namely their filing for VAT refunds.
>
> In the interests of obvious justice, why did not the Russian courts treat the filings for VAT by the trading companies as filings by Yukos?
>
> A. If I may, I see two aspects in your question. First, I do not think that Russian tax authorities -- as I think was suggested in your question -- treated the activities of trading companies as the activities of Yukos. I think it would be more correct, if I may, to say that they established that trading companies conducted no activity, and therefore they simply ignored that for tax purposes.
>
> As regards . . . the substance of your question, the reason is very simple: is that, as I mentioned, in order to get the tax benefit, you need to comply with the substance and with the documents. And here the documentary requirement was not burdensome; it was not difficult to refile the VAT return. The tax authorities did

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701 *Ibid*. at 231.

702 First Konnov Report ¶ 54

> look at the substance, but simply said, "You need to comply with the documentary requirement," and consistently Yukos failed to comply with that.
>
> So I don't see contradiction.[703]

670. Respondent relies on both Article 165 of the Russian Tax Code and Constitutional Court Resolution No. 12-P. Neither of these texts, however, appears to the Tribunal to provide a clear basis for the authorities' refusal to attribute to Yukos the VAT filings that had been made by the trading entities when they were considered the taxpayer. On the other hand, they do support the basic proposition that the Russian Tax Code requires the VAT return to be filed by the "taxpayer."[704]

671. In the view of the Tribunal, the jurisprudence of the Russian courts does not support the imposition of VAT payments on Yukos as happened in this case. In particular, the *Energomashbank* decision of the Russian Constitutional Court stands for the proposition that courts must not limit themselves to a purely formalistic analysis in assessing tax claims by the State, but rather must examine the actual facts in order to respect the taxpayer's right to a fair opportunity to defend itself against the claim.[705]

iii. Would any Illicit Conduct by a Taxpayer Justify the Denial of a VAT Exemption, Irrespective of Whether the Illicit Conduct was Connected to VAT, and without any Regard to Proportionality?

672. In its Counter-Memorial, Respondent raises an additional argument in support of the authorities' denial of the VAT exemption to Yukos. Respondent asserts that, in any event, "the denial of [a] VAT exemption is appropriate when the exporter, like Yukos, has been involved in flagrantly illicit conduct."[706] In support of its argument, Respondent relies on what it characterizes as the practice in many countries to deny "the benefit of exemption or 0% rating, even where documentary requirements have been punctually satisfied, if the relevant export transaction is tainted by illegality (as was the case with Yukos) or even simply by

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703 Transcript, Day 15 at 231–32.

704 Second Konnov Report ¶ 89.

705 Resolution of the Russian Constitutional Court No. 14–P ¶ 4, 28 October 1999, Exh. R-293 (the right to judicial defense is infringed when courts fail to investigate actual facts and limit themselves to establishing "formal conditions for the application of the law"). *See also* Reply ¶ 236 and Second Konnov Report ¶ 72.

706 Counter-Memorial ¶ 1076.

impropriety."[707] In particular, Respondent relies on the decision of the ECJ in *R. v. Germany*.[708]

673. Respondent summarizes the *R. v. Germany* decision as follows in its Counter-Memorial:

> More recently, the European Court of Justice, in the case of R. v. Germany,upheld the imposition of VAT by the German tax authorities on export transactions that had been carried out by an individual who had made fraudulent misrepresentations in his applications for exemption from German VAT, notwithstanding the fact that the fraud had not deprived Germany of any tax revenues, since the goods in question had effectively been exported out of Germany and therefore—but for the fraud in the attendant documentation—would have been unquestionably entitled to full exemption from German VAT. The ECJ rejected the argument that imposition of VAT on the exporter would violate "principles of fiscal neutrality or legal certainty, or . . . legitimate expectations," holding that none of those principles can "legitimately be invoked by a taxable person who has intentionally participated in tax evasion. . ." This was true, the court held, even though the tax evaded was not one that the taxpayer himself would normally have had to pay, and even though the result was that Germany ended up with a windfall, collecting a tax that, in the absence of fraud, it would never have been able to assess.[709]

674. In their Reply, Claimants contend that this decision is of no assistance to Respondent, because it "does not suggest that the tax authorities may deny VAT exemptions because of allegations of illegality unrelated to actual compliance with the VAT law."[710] Indeed, contrary to the *R. v. Germany* decision (in which, Claimants assert, the ECJ expressly rejected a punitive approach), Claimants argue that the "staggering demands for VAT payment—plus fines and interest—made by the Tax Ministry"[711] constitute an entirely disproportionate response to the alleged

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707 *Ibid*. ¶ 1206.

708 *R. v. Germany*, ECJ, Case C-285/09, Judgment, 7 December 2010, Exh. R-1401 (hereinafter "*R. v. Germany*").

709 Counter-Memorial ¶ 1208 (citing *R. v. Germany* ¶ 22). Respondent notes: "In fact, as made clear by the ECJ, the German taxpayer had not himself evaded any tax for which he might have been liable, because the sole purpose and effect of his fraudulent conduct had been to assist unrelated third parties—his foreign customers—to evade taxes in their home country of Portugal." *Ibid*. n.1878.

Respondent adds further: "The ECJ stated that "[t]hose principles cannot legitimately be invoked by a taxable person who has intentionally participated in tax evasion and who has jeopardized the operation of the common system on VAT". *Ibid*. ¶ 54. The ECJ also summarily dismissed the argument that imposition of VAT on an exporter (who, as had been pointed out by the Advocate General, would probably never be able to recover it from his customer) would violate the general EU principle of proportionality. The court held that the exporter's involvement in the third party's tax evasion scheme was "decisive" in this regard. Specifically the court stated that "[a]s regards the principle of proportionality, it must be observed that this does not preclude a supplier who participates in tax evasion from being obliged to pay VAT subsequently on this intra-community supply, inasmuch as his involvement in the evasion is a decisive factor to be taken into account in an assessment of the proportionality of a national measure. . . .") *Ibid*. n.1879.

710 Reply ¶ 248.

711 *Ibid*. ¶ 249.

defects in the paperwork submitted by Yukos, and are evidence of "the tax authorities' manifest bad faith on this issue."[712]

675. According to Respondent, however, the decision is directly applicable to the present case because, in that case, the ECJ held "that it is entirely appropriate for a State to deny VAT refunds (or exemptions) to an exporting company whose conduct, like Yukos', involves '*evasion, avoidance or abuse,*' even though the scheme did not deprive that State of any VAT or other revenues."[713] Respondent asserts that Claimants' attempt to distinguish the *R. v. Germany* decision on the grounds that, in that case, the scheme involved an attempt to evade VAT charges, whereas Yukos' fraud was designed to evade a tax on profits, is "sophistic."[714] Respondent explains:

> What makes the European Court of Justice's decision relevant to these arbitrations is its holding that, because the export transactions in that case were part of an abusive scheme, Germany was entitled to levy VAT on those exports, notwithstanding the fact that no German tax (of any kind) had been evaded. Reasoning by analogy, Russia's VAT assessments against Yukos were appropriate *a fortiori*, since Yukos' fraudulent scheme—unlike the one in *R v. Germany*—most assuredly involved a revenue loss for Russia, to wit, the loss of huge amounts of corporate profit tax that the Yukos tax evasion scheme was engineered to evade.[715]

676. In its Post-Hearing Brief, Respondent again invokes the ECJ's decision in *R. v. Germany*.[716] Claimants, in their own Post-Hearing Brief, reiterated that "Yukos' tax optimization structure was not aimed at, and indeed could not possibly achieve, any reduction in VAT liabilities."[717] Claimants conclude that this decision is of no assistance to the Tribunal.

677. The Tribunal is not persuaded that the Russian Federation's imposition of massive VAT liabilities on Yukos can be excused or justified on the basis of the *R. v. Germany* decision. Firstly, no element of Yukos' tax optimization scheme could be said to constitute an abuse of the VAT system. In the *R. v. Germany* case, however, the taxpayer who was denied the VAT exemption was convicted on two counts of tax evasion by means of which he had evaded more that €1 million of VAT in 2002 and more than €1.5 million of VAT in 2003. Secondly, the Tribunal considers the imposition of VAT on Yukos to be a disproportionate response to

712 *Ibid*. ¶ 252.

713 Rejoinder ¶ 709 (emphasis in original) (citing *R. v. Germany* ¶ 51, Exh. R-1401).

714 Rejoinder ¶ 710.

715 *Ibid*.

716 Respondent's Post-Hearing Brief ¶ 42.

717 Claimants Post-Hearing Brief ¶ 42.

whatever abuse took place in the low-tax regions, considering that the tax authorities had already imposed all of the revenue-based taxes deemed to be owed by the trading entities on Yukos. In the *R. v. Germany* decision, the ECJ reminded Member States that they

> must observe the general principles of law that form part of the European Union legal order, which include, in particular, the principles of legal certainty and proportionality and the principle of protection of legitimate expectations (see, to that effect, Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 *Molenheide and Others* [1977] ECR 1-7281, paragraph 48; Case C-384/04 *Federation of Technological Industries and* others [2006] ECR 1-4191, paragraphs 29 and 30; and Case C-271/06 *Netto Supermarkt* [2008] ECR 1-771, paragraph 18). As regards, in particular, the principle of proportionality, the Court has already held that, in accordance with that principle, the measures which the Member States may thus adopt must not go further than is necessary to attain the objectives of ensuring the correct levying and collection of the tax and the prevention of tax evasion (see, in particular, Case C-188/09 *Profaktor Kulesza, Frankowski Jóźwiak, Orlowski* [2010] ECR 1-0000, paragraph 26).[718]

678. In the present case, with respect to the denial by the Russian tax authorities of the VAT exemption to Yukos, the Tribunal finds that the Russian Federation did go much further than was necessary to attain a legitimate objective of collecting taxes.

iv. Did Yukos Contribute to its Own Demise by Failing to File Proper VAT documentation, or Does the Evidence Suggest that Any Efforts by Yukos to Minimize its Liability would have been Thwarted by the Authorities?

679. In its Counter-Memorial, Respondent also contends that Yukos acted self-destructively in relation to VAT, in as much as:

(a) Yukos could have avoided further VAT assessments "easily and at no cost, simply by having Yukos itself (or one of the other genuine companies of the Yukos group) acknowledge its status as the real exporter and file the requisite documentation itself".[719]

(b) Yukos, when it belatedly filed amended VAT returns for some prior periods, "submitted those returns in a format that was incapable of being processed by the authorities' computer, with the result that, as any tax expert would have predicted, they were rejected."[720]

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718 *R. v. Germany* ¶ 45, Exh. R-1401.

719 Counter-Memorial ¶ 1078.

720 *Ibid*. ¶ 1079.

680. In relation to the format for filing the VAT returns, Respondent, in its Counter-Memorial, wrote:

> For an unexplained reason, Yukos belatedly filed yearly VAT returns, whereas quarterly or monthly returns were required. See Konnov Report, ¶ 58. See Article 163 of the Tax Code, providing with respect to VAT that "1. Tax period shall be established as a calendar month, unless otherwise provided by paragraph 2 of this Article (this applies to taxpayers performing the obligations of tax agents, hereinafter referred to as tax agents). 2. For taxpayers (tax agents) whose monthly revenues from the sale of goods (works, services) within a quarter, excluding the tax and sales tax, do not exceed one million rubles, the tax period shall be established as a quarter." With effect from Jan. 1, 2004, Article 163 was amended to read: "1. Tax period shall be established as a calendar month, unless otherwise provided by paragraph 2 of this Article (this applies to taxpayers performing the obligations of tax agents, hereinafter referred to as tax agents). 2. For taxpayers (tax agents) whose monthly revenues from the sale of goods (works, services) within a quarter, excluding the tax, do not exceed one million rubles, the tax period shall be established as a quarter." [Exh. R-1502]. Not surprisingly, the courts have rejected such returns. See, e.g., Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9/ A40-7780/05-98-90 (Apr. 28, 2005), 59 [Exh. C-196] ("The tax return submitted by OAO Yukos Oil Company for value added tax for 2003 cannot be considered, since it does not meet the requirements of tax legislation regarding submission of a VAT tax return for each tax period, which is a month or quarter").[721]
>
> [emphasis added by Respondent]

681. For Claimants, the particular format of the VAT filings was just a pretext by the tax authorities for refusing to credit Yukos for the VAT refunds obtained by the trading companies:

> The Respondent accuses Yukos of having "acted self-destructively" by filing yearly VAT returns instead of quarterly or monthly returns and, by way of support, refers to the Decision of the Moscow Arbitrazh Court regarding the alleged tax reassessment for the year 2003. However, the monthly reporting requirement relates solely to the periodicity at which, in the ordinary course of events, companies are required to file VAT returns. In circumstances where the documentation was being submitted four years after the fact, it would have made no sense—and would likely have generated unnecessary additional work for the tax authorities—to disaggregate the annual information into monthly data.[722]
>
> [emphasis in original]

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721 Counter-Memorial ¶ 1079, n.1707

722 Reply ¶ 250. Claimants note that: "The Respondent is unable to make up its mind as to whether the documents needed to be filed on a monthly or quarterly basis or whether either is permissible, a position whose vagueness cannot be reconciled with the purported certainty with which it affirms that yearly submissions were improper. [citing Counter-Memorial ¶ 1079, n.1707.]" *Ibid*. n.440.

Claimants add further: "The Respondent offers no support for its assertion that the returns submitted by Yukos were "incapable of being processed by the authorities' computer", an assertion which is implausible on its face, particularly in light of the Respondent's own uncertainty as to whether monthly or quarterly submissions were required, and was in any event not relied on as a basis for the original rejection." *Ibid*. n.442.

682. Claimants add in their Reply that "the text of Article 165 of the Russian Tax Code seriously undermines this pretext in that it imposes no timing restrictions whatsoever in relation to the submission of the required documentation for obtaining a VAT refund."[723]

683. Respondent disagrees:

> Equally meritless is the allegation that the "monthly reporting requirement relates solely to the periodicity at which, in the ordinary course of events, companies are required to file VAT returns" and is not applicable when "the documentation is being submitted four years after the fact." Contrary to Claimants' suggestion, the Russian Tax Code does not contemplate any exception for non-"ordinary course" filings, and in particular allows no derogation from the requirement that filings be made on a monthly (or, in cases not relevant to Yukos, quarterly) basis. Rather, it clearly provides what a taxpayer must file to claim a 0% VAT rate on exports, and neither Yukos nor any other taxpayer is entitled to decide for itself whether or not to comply with the law based on "convenience".[724]

684. In his Second Expert Report, Mr. Konnov refers to the strict formalism of Russian tax legislation with respect to VAT and cites, in support of the decision of the tax authorities, a decision of the Russian Supreme Arbitrazh Court issued in 2011:

> 86. The strict formalism of Russian tax legislation with respect to VAT was recently confirmed in the *Forward* VAT case (unrelated to YUKOS) which has reached the Russian Supreme Arbitrazh Court. *Forward* was a construction company. In relation to the construction of a residential building in the city of Bryansk, it was collecting investment contributions. *Forward* failed to assess VAT on its remuneration when due. Based on a field audit, the tax authorities assessed VAT (and profit tax) on *Forward*. The taxpayer claimed input VAT credit in court. Neither the amounts of input VAT, nor the payment made by the suppliers was disputed by the tax authorities. The taxpayer submitted to the court documents evidencing input VAT, but failed to file an amended VAT return claiming the respective amounts of input VAT. Even though the amount of the input VAT paid by the taxpayer was undisputed, the court denied the input VAT credit solely on the basis that the taxpayer failed to file an amended VAT return.
>
> 87. The Supreme Arbitrazh Court concluded that, in accordance with the Russian Tax Code and the prevailing court practice, input VAT credit had to be claimed by a taxpayer in accordance with the relevant provisions of the Russian Tax Code, and that the tax authorities were not obliged to identify and credit undeclared input VAT on their own:
>
> > "The fact that documents confirming, in the taxpayer's opinion, a right for tax credit are available without reflecting (showing, claiming) the amount of the tax credit in a tax return is not a ground for reduction of VAT payable to the

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723 Reply ¶ 251 (citing Russian Tax Code, Article 165, Exh. R-1484 ("In the event that no documents (copies thereof) referred above are provided by the taxpayer within 180 days after the expiry of 180 days of the date of the release by the regional customs authority under export or transit customs procedure, said transactions involving the sale of goods (performance of works, provision of services) shall be taxed at a rate of 10 percent or 18 percent accordingly. In the event that subsequently the taxpayer submits to the tax authorities any documents (copies thereof) proving eligibility of the zero percent tax rate application, the tax paid shall be refunded to the taxpayer in the manner and on terms and conditions expressly provided by article 176 of this Code.").

724 Rejoinder ¶ 719(iii) (citing Reply ¶ 250–51, stating that "Claimants also rely on Article 165 of the Tax Code in making this argument, but Article 165 had nothing to do with the period (*i.e.*, monthly or annual) that Yukos' VAT filing should have covered." and also citing Second Konnov Report ¶ 93).

> budget for a tax period. Availability of documents confirming the right for VAT credit does not replace an obligation to claim it in a tax return."
>
> 88. The Supreme Arbitrazh Court unequivocally confirmed that, as concerns VAT, Russian tax legislation is very formal and no VAT benefit can be allowed if it was not properly claimed by a taxpayer in a tax return.[725]

685. When he gave evidence, Mr. Konnov also offered a practical justification for the monthly/quarterly requirement:

> But secondly, you cannot simply amend VAT law to allow annual return, because there are a few corresponding provisions. For instance, there is a provision on the chamber audit, on which I was questioned by Professor Gaillard: it is three months. And what that means: that if one taxpayer is on a monthly VAT return and the other one is on a quarterly return, the three months are sufficient for the tax authorities to do a counter-audit with respect to all the suppliers and other interested parties.
>
> If, however, you simply introduce annual return, and without corresponding changes to other provisions in the Tax Code, the tax authorities -- basically the VAT law will not function properly. So you can do that, but that would mean not only allowing acceptance of annual return, but redrafting the whole VAT chapter of the Tax Code to work it properly.[726]

686. The Tribunal observes that while this practical justification does seem to support the monthly/quarterly filing requirement when the tax authorities are auditing the underlying transactions, it is more difficult to understand how that justification applied to Yukos' attempts to obtain credit for the trading companies' VAT refunds, in a situation where those VAT refunds had already been vetted and approved by the authorities at the time they had been claimed (for the first time) by the trading entities.

687. In their Reply, Claimants assert that there was no reason to believe that, if Yukos had disaggregated the VAT data into monthly submissions as Respondent suggests it should have done the tax authorities would have accepted the filings:

> Indeed, the Claimants note that if such resubmissions were a genuinely available option, the Respondent offers no explanation as to why, once Yukos' allegedly self-destructive management had been replaced with a bankruptcy receiver, that receiver, Mr. Rebgun, failed to resubmit the VAT returns in the allegedly required format, given that if such an option had existed, Mr. Rebgun's fiduciary duties to the creditors would have required him to take advantage of it.[727]

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725 Second Konnov Report ¶¶ 86–88 (citing Resolution of the Presidium of the Supreme Arbitrazh Court of the Russian Federation No. 23/11, 26 April 2011, Exh. R-3270).

726 Transcript, Day 15 at 199.

727 Reply ¶ 252 (citing Counter-Memorial ¶¶ 1079, 1105(viii), 1237(vii), 1272, 1279(vii), 1322(vii)).

688. In respect of this point, Professor Gaillard opined that the Russian authorities, including the courts, would certainly have found another reason to deny Yukos the VAT exemption if Yukos had filed monthly amended returns. Professor Gaillard referred Mr. Konnov to the following extract from the Moscow Arbitrazh Court's decision relating to the 2003 tax year:

> "The tax return submitted by … Yukos Oil Company for value added tax for 2003 cannot be considered, since it does not meet the requirements of tax legislation regarding submission of a VAT tax return for each tax period, which is a month or quarter, and documents were not submitted at these times confirming the sale of goods for export and tax deductions . . . "[728]

689. Professor Gaillard then put the following question to Respondent's expert:

> Q. Simply, Mr Konnov, when you look at this sentence which the Chairman directed you to, do you also see that the court says that the tax return cannot be considered because:
>
> "... documents were not submitted at these times …"
>
> Do you see that?
>
> A. Yes, I do.
>
> Q. So the reason the court is articulating is that: (1) it's not monthly or quarterly; and (2) it was not submitted at the right time. Correct?[729]

690. Mr. Konnov disagreed with Professor Gaillard's interpretation:

> No, no. It says that you need to submit supporting documents, which are in Article 165, with your VAT return. Article 165 says VAT return and supporting documents.[730]

691. Earlier in his evidence, Mr. Konnov had also supported the court's reasoning in the following words:

> And this is exactly the reason I explain in my report, I believe, that Yukos had to file monthly returns, and there is no such thing as an annual return. And the document that is in the record suggests that Yukos filed an annual return by even using a pen, I believe, or one way or another just crossing out and filling in the form the way it electronically cannot be done. And the court addresses it here, and says that, "What you filed is not a proper VAT return."[731]

692. The Tribunal finds the following exchange between Professor Gaillard and Mr. Konnov of particular interest. Professor Gaillard asked Mr. Konnov for his reaction to another reason

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728 Transcript, Day 14 at 259 (referring to Decision of the Moscow Arbitrazh Court, Case Nos. A40-4338/05-107-9 and A40-7780/05-98-90, 28 April 2005, p. 59, Exh. C-196).

729 *Ibid.* at 260.

730 *Ibid*. at 261.

731 *Ibid.* at 259.

which could have been invoked by the Russian authorities/courts to deny the VAT refunds to Yukos even if it had filed "proper" monthly VAT returns:

> Q. Okay. Do you see the sentence pursuant to which the court [the Moscow Arbitrazh Court rejecting Yukos's VAT argument in relation to the 2002 tax year] says:
>
> > "The court did not accept the argument of … YUKOS [Oil Company] that tax returns submitted to tax authorities by the said organisations [*i.e.*, the trading entities] shall be deemed as tax returns of … YUKOS [Oil Company] since such returns were signed by persons who had no powers to submit tax returns on behalf of … YUKOS [Oil Company]."
>
> Do you see that?
>
> A. Right.
>
> . . .
>
> PROFESSOR GAILLARD: So what interests me is this sentence which we read, the court saying that they:
>
> > "... did not accept the argument of … Yukos that tax returns submitted … by the [trading companies] shall be deemed as tax returns of … YUKOS [Oil Company] since such tax returns were signed by persons who had no powers to submit tax returns on behalf of … YUKOS [Oil Company]."
>
> Can you confirm that this is a correct translation of the Russian original?
>
> A. I think it is. And I think, again, as you have read out, the court responds to "the argument of … Yukos". So this sentence suggests that Yukos argued that they should be deemed as if they were filed by Yukos. And probably the question was: how can someone act on behalf of Yukos? And the court said, "Look, they cannot be accepted as Yukos tax returns, at least because someone who signed them, in the name of Yukos-M here, could not act on behalf of Yukos."
>
> Q. But conversely the papers themselves would say that Ratibor -- or Yukos-M, in this example -- is the exporter. The documentation they could file would say Yukos-M, Ratibor, Fargoil, whatever, has sold abroad. So the documents are not going to bear the name of Yukos, are they?
>
> A. Absolutely.
>
> Q. Right. So Yukos loses one way or the other, because either the documents do not say that they are the exporter, or they are not deemed to be the beneficiaries of the revenues, right?
>
> A. No, Yukos wins one way: it simply refiles.[732]

693. According to Respondent, Claimants' submission that there was no reason to believe that, had Yukos made proper filings, the tax authorities would have accepted them, is "gratuitously self-

[732] *Ibid.* at 248–250.

serving".[733] According to Respondent, "Russian law clearly indicates what Yukos should have done, but inexplicably failed to do."[734]

694. The Tribunal is of the view, having considered the evidence and arguments canvassed above, that the Russian Federation was determined to impose the VAT liability on Yukos, and would have done whatever was necessary to ensure that the VAT liability was imposed on Yukos. The Tribunal observes that this determination of the Russian Federation to do whatever it deemed necessary to impose massive tax liabilities on Yukos is also evidenced by the second trial and conviction of Mikhail Khodorkovsky. After having been convicted of various tax-related crimes in May 2005,[735] largely stemming from his leadership of Yukos, for which he was sentenced to a term of nine years of imprisonment, Mr. Khodorkovsky was implausibly convicted of money laundering and theft of oil in December 2010.[736] This second verdict, for which Mr. Khodorkovsky was sentenced to an additional thirteen years and six months in prison, was based on essentially the same circumstances surrounding Yukos that led to the original conviction for tax evasion. This shows how far the Russian Federation was willing to go to keep Mr. Khodorkovsky imprisoned, and supports the Tribunal's conclusion that it was Respondent's intent to impose VAT liability on Yukos no matter what Yukos did.

695. The Tribunal also heard submissions from the Parties on the responsibility of the bankruptcy trustee (Mr. Rebgun) for his failure to file VAT forms in the proper format.

696. On this issue, Respondent contends as follows:

> Finally, while the Russian Federation does not speak for Mr. Rebgun or know the circumstances of his treatment of the VAT issue, it is specious for Claimants to attempt to blame Mr. Rebgun for Yukos' failure to file proper amended VAT returns for 2000-2003 (or any amended VAT return at all for 2004). Mr. Rebgun took office only in August 2006. Until then, Yukos had been managed by a team that Claimants themselves had appointed. That team, as noted above, had submitted non-processable amended VAT filings for years 2000-2003 in August 2004, and had done nothing in the ensuing two-year

733 Rejoinder ¶ 719(iv).

734 *Ibid.* (citing Decision of the Moscow Arbitrazh Court, Case No. A40-4338/05-107-9 and A-40-7780/05-98-90, 28 April 2005, p. 59, Exh. C-196 ("The tax return submitted by OAO Yukos Oil Company for value added tax for 2003 cannot be considered, since it does not meet the requirements of tax legislation regarding submission of a VAT tax return for each tax period, which is a month or quarter[.]"); Resolution of the Ninth Arbitrazh Appellate Court, Case No. 09AP-7979/05-AK, 16 August 2005, p. 60, Exh. R-251 ("The court legally and reasonably indicated that the value added tax return of OAO NK YUKOS for 2003 provided by OAO NK YUKOS shall not be accepted as it did not comply with the requirements of the tax legislation connected with filing of VAT returns for each tax period which was a month or a quarter.").

735 Judgment of the Meshchansky District Court for the City of Moscow, 16 May 2005, Exh. R-379.

736 Verdict of the Khamovnichesky Court of Moscow, Case No. 1-23/10, 27 December 2010, Exh. C-1057.

> period to correct those errors. As for the 2004 tax year, the managers appointed by Claimants failed to submit any amended returns at all. Accordingly, Claimants and their appointees bear sole responsibility for Yukos' mishandling of the VAT filings. Mr. Rebgun cannot be blamed, if only because by the time he finally took office (a) the 2000-2004 tax assessments had already been issued and become due and payable for all five of the relevant years, (b) the court rulings that had upheld the 2000-2003 tax assessments had become *res judicata*, and (c) in any event, the three-year time limits to file amended VAT returns had already expired for the whole of the 2000, 2001, and 2002 tax years, as well as for more than half of the 2003 tax year. In any event, as established at paragraphs 388-395 above, it is clear as a matter of public international law that the Russian Federation is not responsible for acts or omissions of bankruptcy receivers such as Mr. Rebgun.[737]

697. To conclude this subsection, the Tribunal will now quote the following exchange between a member of the Tribunal and Respondent's expert Mr. Konnov, in respect of Yukos' VAT liability.

> JUDGE SCHWEBEL: Is it right, then, to infer from your testimony—particularly what you've just said—that the management of Yukos, or its counsel, in not filing full VAT returns monthly, committed an astounding error worth more than $13 billion?
>
> A. Right. It's absolutely clear to me—whether you call it "error" or whether that was intentional action, I don't know—but the defect in the VAT return was so apparent for not only a professional tax advisor and not only for Yukos, which, as we know, had a big tax team and was filing and processing this VAT return on a routine basis, but we also -- I think I referred to documents, correspondence by Golub where she admitted that it should be monthly and they required it monthly.
>
> So I think I have absolutely no doubt that they perfectly understood that the amended returns cannot and will not be accepted.
>
> JUDGE SCHWEBEL: And can you find any rational explanation for such behaviour?

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[737] Rejoinder ¶ 719(v) (citing Reply ¶ 252; Second Konnov Report ¶ 95; *Kotov v. Russia*, ECtHR, Appl. No. 54522/00, Judgment (3 April 2012) ¶ 107, Exh. R-3371, noting that: "It would appear that the liquidator, at the relevant time, enjoyed a considerable amount of operational and institutional independence, as State authorities did not have the power to give instructions to him and therefore could not directly interfere with the liquidation process as such. The State's involvement in the liquidation procedure resulted only from its role in establishing the legislative framework for such procedures, in defining the functions and the powers of the creditors' body and of the liquidator, and in overseeing observance of the rules. It follows that the liquidator did not act as a State agent. Consequently, the respondent State cannot be held directly responsible for his wrongful acts in the present case. The fact that a court was entitled to review the lawfulness of the liquidator's actions does not alter this analysis.")

Respondent further notes: "In particular: (a) the 2000 tax assessment became final and irreversible on 30 December 2005, when the Federal Arbitrazh Court of the Moscow District dismissed Yukos' appeal of the Ninth Arbitrazh Appellate Court decision in proceedings upon Yukos' challenge of the 2000 tax assessment. *See* Resolution of the Federal Arbitrazh Court of the Moscow District, Case No. KA-A40/12571-04, 30 December 2005, Exh. R-1555; (b) the 2001 tax assessment became final and irreversible on 20 February 2006, when the panel of three judges of the Supreme Arbitrazh Court dismissed Yukos' application for supervisory review of the 2001 tax assessments. *See* Ruling of the Supreme Arbitrazh Court, Case No. 7801/05, 20 February 2006, Exh. R-589; (c) the 2002 tax assessment became final and irreversible on 12 October 2005, when the panel of three judges of the Supreme Arbitrazh Court dismissed Yukos' application for supervisory review of the 2002 executive enforcement proceedings. *See* Ruling of the Supreme Arbitrazh Court, Case No. 11868/05, 12 October 2005, Exh. R-593; and (d) the 2003 tax assessment became final and irreversible on 22 February 2006, when the Supreme Arbitrazh Court dismissed Yukos' application for supervisory review of the 2003 tax assessment. *See* Ruling of the Supreme Arbitrazh Court, Case No. 12304, 22 February 2006, Exh. R-1565." *Ibid*. n.1134.

A. I have difficulties finding the rational behaviour, and there is nothing in the record. My only guess, and that would only be a guess: that what Yukos was trying to do, it was trying to take a position that in its view will not compromise its position with respect to the profits tax.

In other words, if Yukos—Yukos clearly would not follow my advice, and my advice, as you have seen, will be to refile both. If they refiled proper VAT return without refiling—sorry, if they refiled proper—if they refiled proper VAT returns without refiling proper profit tax return, I think they were—my guess, my speculation, is they thought that court would look at that and would see that as them taking an inconsistent position for VAT and profits tax purposes.

So therefore my guess, again, is that they filed something—which I would not call even maybe a VAT return, but something that they knew was apparently not acceptable—just to take procedural actions. But, as came during the cross-examination by Professor Gaillard, I think I mentioned that they file in August and they don't even refer to these returns till the—till late 2005—till 2005.

So that's my only guess: that they tried to put in—to file something with the tax service which could later on be used in argument, but would not compromise, in their view, their position on the profits tax.

JUDGE SCHWEBEL: Could the Trustee in Bankruptcy, who was charged with maximising the resources available for creditors, himself have filed the monthly forms for VAT return?

A. Yes, he could have refiled, subject to the three-year limitation that I referred to previously. So you look at the date when he came to power, if I may say, and for the previous three years he could have refiled.

…

THE CHAIRMAN: Should he be criticised for that?

A. I would say so. But it's easy now to criticise, when I look back. So I would say I would—

Yes, I would say I would criticise him [738]

v. Extracts from Other Yukos-Related Awards

698. The *Quasar* tribunal, citing the *RosInvestCo* tribunal's holding, traversed the VAT issue in the following words and concluded without any hesitation that Respondent's position on this issue was indefensible:

D) The rejection of the VAT refund

80. The unattractiveness of the Respondent's position in this connection is readily apparent. The amounts involved were vast – in excess of $13.5 billion. The export sales in question undoubtedly qualified for VAT refunds. The trading company sellers had duly applied for them. But once the tax authorities had invalidated the transactions by which the sellers had come into possession of the goods, they concluded that Yukos was the true original owner and therefore should be deemed to be the true export seller. If this was so, one would expect that by a parity of reasoning under their basic premise, the tax authorities should have held that the true applicant for the refund was also Yukos – and that Yukos

738 Transcript, Day 15 at 232–35.

was therefore entitled to the VAT credit in the same way as it was assigned the debit for the profit tax. To try to have it both ways would surely bespeak unprincipled hostility towards the taxpayer.

81. Yet that is precisely what the tax officials did – with the subsequent endorsement of the courts.

82. Unsurprisingly, *RosInvest* viewed this conduct in the harsh light it deserves:

> "The extremely formalistic interpretation of the VAT lax law regarding Yukos and its trading companies to the effect that, though exports were undisputedly not subject to VAT, the documentation also undisputedly submitted by the trading companies could not be used in relation to Yukos and thus Yukos was liable far more than US$ 13.5 billion in VAT related taxes is difficult to accept as a justification for a tax liability the size of which was sufficient to lead Yukos into bankruptcy." (¶452)

The present Tribunal entirely endorses this conclusion, and agrees with the Claimants that the ECHR appears, in ¶¶601-602, to have entirely missed the point being made, namely that if the tax authorities were going to attribute to Yukos the transactions carried out in the names of its trading companies, they should also have attributed to Yukos the submission of normal VAT documentation by the trading companies. Given that the export transactions in question were indisputably zero-rated for VAT purposes, the refusal to do so can only seem confiscatory to a degree which comes close to validating the claims in their entirety on this basis alone.[739]

[emphasis added]

699. The following extract from the judgment of the ECtHR, which found in favour of the Russian Federation on this issue is of interest:

> 601. The Court notes that both Section 5 of Law no. 1992-1 of 6 December 1991 "On Value-Added Tax" governing the relevant sphere until 1 January 2001 as well as Article 165 of the Tax Code applicable to the subsequent period provided unequivocally that a zero rate of value-added tax in respect of exported goods and its refund could by no means be applied automatically, and that the company was required to claim the tax exemptions or refunds under its own name under the procedure set out initially in Letter no. B3-8-05/848, 04-03-08 of the State Tax Service of Russia and the Ministry of Finance and subsequently in Article 176 of the Tax Code to substantiate the requests in order to obtain the impugned refunds (see paragraphs 326-336). In view of the above, the Court finds that the relevant rules made the procedure for VAT refunds sufficiently clear and accessible for the applicant company to able to comply with it.
>
> 602. Having examined the case file materials and the parties' submissions, including the company's allegation made at the hearing on 4 March 2010 that it had filed the VAT exemption forms for each of the years 2000 to 2003 on 31 August 2004, the Court finds that the applicant company failed to submit any proof that it had made a properly substantiated filing in accordance with the established procedure, and not simply raised it as one of the arguments in the Tax Assessment proceedings, and that it had then contested any refusal by the tax authorities before the competent domestic courts (see paragraphs 49 and 171, 196, 196 and 216). The Court concludes that the applicant company did not receive any adverse treatment in this respect.[740]

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739 *Quasar* ¶¶ 80–82, R-3383.

740 ECtHR Yukos Judgment ¶¶ 601–602, Exh. R-3328.

700. In the view of this Tribunal however, far from not receiving "any adverse treatment in this respect" as the ECtHR held, Yukos received some thirteen billion dollars worth of adverse treatment by reason of the imposition on it of VAT liabilities earlier excluded by the undisputed export of the oil in question.

(c) Fines

i. Introduction

701. Claimants contend that neither the "willful offender" nor the "repeat offender" fines should have been assessed, and that "the animating, confiscatory purpose behind the Respondent's actions is palpable."[741] Claimants also assert that the imposition of fines for the year 2000 was barred by the statute of limitations, and that the authorities' reliance on what Claimants characterize as a new, retroactive, and judicially-created exception to the statute is further demonstration of its expropriatory intent.[742]

702. Respondent insists that the authorities' conduct was proper, that the Russian courts properly rejected Yukos' arguments against the fines, and that the Tribunal should do the same here in the present arbitration.

703. The following questions with respect to fines arise from a review of the Parties' written and oral submissions:

- Were the fines levied in relation to the 2000 tax year barred by the statute of limitations?;
- Were the "willful offender" fines properly imposed?;
- Were the "repeat offender" fines properly imposed?;
- Could Yukos have avoided the fines?; and
- Was the quantum of the fines reasonable, in terms of both the rate and the absolute amount?

741 Claimants' Post-Hearing Brief ¶ 47.

742 *Ibid*. ¶ 45.

ii. Were Fines Levied in Relation to the 2000 Tax Year Barred by the Statute of Limitations?

704. Article 113 of the Russian Tax Code establishes a three-year statute of limitations for all tax offenses.[743] In respect of the 2000 tax year, Yukos had argued before the Russian courts that it was improper for the authorities to levy any fine because their assessment was not issued until 14 April 2004, *i.e.*, a few months after the posited expiration of the statute of limitations for fines. Yukos' argument was considered by Russia's courts and ultimately rejected on the ground that the statute of limitations had been tolled by Yukos' "interference" with the authorities' following the December 2003 tax audit.

705. The Tribunal notes that after the 2000 Audit Report was issued, Mr. Pepeliaev, in his first opinion to his client Yukos, on 5 January 2004, concluded that:

> The Russian tax law envisages a legal process to collect fines. However the fine cannot be actually collected in 2004 due to the expiration of the 3-year limitation period.[744]

706. In a later opinion, Mr. Pepeliaev wrote:

> In accordance with the currently applicable procedure set out in Art. 101 of the Tax Code of the Russian Federation, a decision to hold the company liable pursuant to the Inspection Report of December 29, 2003 may be passed no earlier than in 2004. Moreover, by virtue of art. 113 of the Tax Code of the Russian Federation no one may be held liable for a tax offence if three years have expired (limitation period) from the date of this tax offence or from the date following the end date of the tax period in which this offence was committed. In breach of this rule of law, the Inspection Report says that YUKOS should be held liable for the activities of 17 companies that took place in 2000.[745]

707. Respondent, in its Counter-Memorial, objects that Claimants did not raise the statute of limitations argument in their Memorial. In any event, Respondent submits, the argument is meritless. Respondent adopts the reasoning of the Russian Courts.[746] Respondent adds: "[T]he statute of limitations provided a windfall to Yukos, insofar as the tax authorities never disturbed

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743 Russian Tax Code, Article 11(1), Exh. C-1276. Mr. Konnov opines, in his Second Expert Report, that, under Russian law, the statute of limitations applies to fines only, and does not apply to tax arrears or default interest. Second Konnov Report, ¶ 109.

744 S. Pepeliaev, *Summary of the tax inspection of OAO NK Yukos*, p. 1, 5 January 2004, Exh. C-1128.

745 S. Pepeliaev et al., Opinion regarding compliance with legislation of Inspection Report No. 08-1/1 of 20 December 2003 issued by the Tax Ministry of Russia, 15 January 2004, p. 3, Exh. C-1129.

746 *See also* Respondent's Skeleton Argument, 1 October 2012 ¶ 13 (hereinafter, "Respondent's Skeleton") ("no taxpayer—in Russia or elsewhere—could legitimately claim to be surprised that it may not invoke a limitations period that has expired only because of its own obstruction of tax audits.").

Yukos' abuses of the low-tax region regime prior to 2000. Yukos thus obtained a 'free ride' for the frauds it perpetrated in 1999, which involved significant amounts."[747]

708. In their Reply, Claimants invoked the limitations period. They argue that it was unlawful for the tax authorities to seek to collect fines in relation to 2000 because "the decision of the Russian tax authorities to hold Yukos liable in respect of alleged tax offenses committed in 2000 was issued on 14 April 2004, several months after the three-year statute of limitations had expired in relation to the year 2000 (*i.e.*, after 31 December 2003)."[748]

709. Claimants respond to Respondent's reliance on the decisions of the Russian courts in the following words:

> The Respondent's assertion (see Respondent's Counter-Memorial on the Merits, April 4, 2011, footnote 1708) that the Russian courts approved its circumvention of the statute of limitations against Yukos is unavailing given that, as discussed below, the ECtHR has found the Russian courts' decisions to violate the principle of legality embodied in Article 1 of Protocol No. 1 to the European Convention on Human Rights, notwithstanding the extraordinary broad deference it accords to States under that provision.[749]

710. Claimants assert that the tax authorities were able to circumvent the statute of limitations only because the Constitutional Court "creat[ed] for the first time an exception to the statute of limitations for any taxpayer who 'resisted' tax inspection, so long as an audit report was issued before the end of the limitations period."[750]

711. Respondent resists Claimants' submission that the Constitutional Court's resolution allowing tolling of the statute of limitations in cases of taxpayer obstruction was "*tailor-made*" for Yukos.[751] In its Rejoinder, Respondent argues that Claimants' submission is unsupported by any evidence and contradicted by the fact that this exception has been applied to numerous taxpayers, all unrelated to Yukos.[752] As to the specific Constitutional Court Resolution No. 9 P,

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747 Counter-Memorial ¶ 1081, n.1708. Claimants reply that the 1999 audit report relating to Investproekt (Exh. R-304) was issued with ten months remaining on the statute of limitations, but that no Decision or Tax Payment Demand was issued (or, at least, none is in the record of this arbitration). *See* Claimants' Post-Hearing Brief ¶ 63, n.36.

748 Reply at ¶ 258 (emphasis in original).

749 *Ibid*., n.453

750 *Ibid*. (referring to Resolution of the Russian Constitutional Court No. 9–P, Exh. C-1141).

751 *Ibid*.

752 Rejoinder ¶ 725.

Respondent says that it was issued in response to two different complaints, only one of which was related to Yukos.[753]

712. In his Second Expert Report, Mr. Konnov explains that the Constitutional Court ruled, in Resolution No. 9-P, as follows:

> a. if a taxpayer obstructs tax control and tax audits, the arbitrazh court may rule that the tax authority was justified in acting after expiration of the limitations period; and
>
> b. in any event, the limitations period for tax offenses ends at the moment of execution of a tax audit report summarising documented facts of tax offenses identified in the course of the audit.[754]

713. Mr. Konnov addresses Claimants' argument on this point:

> The Claimants' allegation (Claimants' Reply on the Merits, para. 258) that the Russian Constitutional Court created an "exception to the statute of limitations for any taxpayer who "resisted" tax inspection, so long as an audit report was issued before the end of the limitations period" is misleading (emphasis added). The Constitutional Court made two separate conclusions not dependent on each other. The Claimants' contention that the "tax audit report" rule was "tailor-made" for YUKOS is not correct either. The tax authorities would have nonetheless been deemed within the statute of limitations period under the obstruction of the audit limb of the Resolution.[755]
>
> [emphasis in original]

714. Mr. Konnov also adds:

> The ruling of the Constitutional Court issued in July 2005 is described by the Claimants as "tailor-made" to YUKOS and in conflict with the ruling of the Constitutional Court issued in January 2005. I cannot agree. There is no inconsistency between these two rulings. Rather, in the July 2005 ruling, the Constitutional Court analyzed, in particular, the impact on the limitations period resulting from obstruction of the audit, an issue which was not addressed in any way in the January 2005 ruling.
>
> The Claimants' reliance on the dissenting opinions in the July 2005 ruling is incomplete. The Claimants refer only to two dissenting opinions relating to the July 2005 ruling. However, they fail to mention the third dissenting opinion to the same ruling in which Judge G.A. Gadzhiev has taken an approach which, in my opinion, is even harsher than the approach taken by the Constitutional Court. In the view of Judge G.A. Gadzhiev, the statute of limitations should be applied differently depending on the amount of the tax arrears at issue. He believes that the non-differentiated statute of limitation, as it is provided in the tax legislation, contradicts the constitutional principle of equality before the law.[756]

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753 *Ibid.* ¶ 724, n.1151.

754 Second Konnov Report ¶ 111.

755 *Ibid*., n.177.

756 *Ibid.* ¶¶ 112–13.

715. Finally, Respondent adds in its Rejoinder on this point:

> It is also worth reiterating that, as noted above, the Russian authorities' long-standing position, including when the Yukos cases were being argued in the Russian courts, has been that the three-year limitation period runs from the end of the taxable period in which payment was due (because this is the period when the tax offense actually occurred), and not from the end of the taxable period in which the relevant income or revenue accrued (and therefore, here, that the statute of limitations expired on December 31, 2004 rather than December 31, 2003). While this position was rejected by the courts in the Yukos case, it was upheld in other cases, and ultimately endorsed by the Supreme Arbitrazh Court. As a result, if the Yukos case were before the Russian courts today, it would be undisputable that the fines for tax year 2000 were assessed in a timely manner.[757]

716. In their Post-Hearing Brief, Claimants assert that "it is factually untrue that alleged obstruction by Yukos caused the tax authorities to miss the statute of limitations: the audit was completed in just 3 weeks and before the limitations period had expired."[758]

717. In its Post-Hearing Brief, Respondent asserts that "Yukos unquestionably obstructed the field tax audit leading to the 2000 assessment, and it was completely foreseeable that Russian law would not allow Yukos to invoke a limitations period so as to benefit from its own obstruction."[759]

718. The Tribunal concludes, on the basis of the record, that Respondent has made a credible argument regarding Yukos' obstruction of the field tax audit leading to the 2000 assessment.[760] However, the Tribunal agrees with Claimants, and with the ECtHR, that the retroactive application of Resolution 9–P violated a fundamental principle of legality.[761] The Tribunal concludes that the fines levied in relation to the 2000 tax year were therefore barred by the statute of limitations.

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757 Rejoinder ¶ 731 (citing Resolution of the Presidium of the Supreme Arbitrazh Court No. 4134/11, 27 September 2011, Exh. R-3298, interpreting a rule on calculation of the statute of limitations in Article 113 that was identical to the one in effect in 2003–2004. As Mr. Konnov points out "the panel of three judges when transferring the case to the Presidium of the Russian Supreme Arbitrazh Court noted that courts had previously issued inconsistent rulings on this subject."; Second Konnov Report ¶ 121).

758 Claimants' Post-Hearing Brief ¶ 45 (emphasis in original).

759 Respondent's Post-Hearing Brief ¶ 45 (citations omitted).

760 Counter-Memorial ¶ 355; Rejoinder ¶¶ 723–30

761 Reply ¶ 258; ECtHR Yukos Judgment, Exh. R-3328.

iii. Were the "Willful Offender" Fines Properly Imposed?

719. Claimants contest the imposition of the "willful offender" fines for the years 2000 through 2003 because "for Yukos' executives to be 'aware of the unlawful nature of such actions', there must have existed an enforceable decision of the tax authorities to that effect."[762] Such a decision, Claimants note, did not come until 14 April 2004, and thus only *after* Yukos filed its tax returns for the years 2000, 2001, 2002 and 2003.[763] Consequently, for the years 2000 through 2003, Yukos' executives could not have been "aware" of the alleged "unlawful nature of the[ir] actions."[764]

720. In respect of the 2004 tax year, Claimants have a different argument:

> As regards the 2004 tax reassessment, the regional and local tax benefits that these companies had enjoyed were significantly reduced by the federal legislator as from January 1, 2004. With the change in legislation, the alleged tax offenses for which Yukos was held liable with respect to the year 2004 could therefore not have been considered similar to those which had allegedly been committed by Yukos in 2000-2003 under the former legislation. In this context, the reference made by the Moscow Arbitrazh Court in 2006 to the 2000, 2001, 2002 and 2003 Decisions in order to justify the 40% fines for the year 2004 appear to be nothing less than a manifest misapplication of the law to Yukos.[765]

721. In response, Respondent asserts, in its Counter-Memorial, that "'willfulness' does not require criminal *mens rea*: it is sufficient that the taxpayer's underassessment indicate a degree of awareness of the potential unlawfulness of its conduct."[766] Nor does Respondent accept Claimants' argument that, in order for a violation to be deemed "willful", the taxpayer must already have been found liable. Respondent counters that:

> Even if Yukos, *quod non*, had been transparent and subjectively in good faith with respect to its "tax optimization" scheme, the very complexity of its scheme made it unavoidable that it would, at a minimum, be deemed "willful": one does not create a network of trading companies carelessly or as a result of honest mistake. In any event, . . . Yukos' managers knew perfectly well that their scheme was illegal when they first implemented it -- an aggravated form of "willfulness."[767]

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762 Memorial ¶ 330.

763 *Ibid*.

764 *Ibid*.

765 *Ibid*. ¶ 331 (citing Decision of the Moscow Arbitrazh Court of 2 October 2006, 4 October 2006, confirming lawfulness of fines imposed on Yukos with respect to its tax reassessment for the year 2004, p. 31, Exh. C-201). Claimants note that "[a]s from 1 January 2004, the benefits on corporate profit tax that the regions were authorized to grant to taxpayers out of the regional and local shares of this tax were limited to four percent."

766 Counter-Memorial ¶ 1082. *See* Konnov Report ¶ 72.

767 Counter-Memorial ¶ 1082.

722. Mr. Konnov supported Respondent's position with the following observations in his First Report:

> At the time, YUKOS was one of the major Russian companies with substantial tax, legal and accounting departments. It knew that: (i) its tax minimization practices in ZATO Lesnoy had been investigated and challenged since late 1999; and (ii) its Sibirskaya Domestic Trading Company had been challenged by the tax authorities in 2001 and had lost its tax case in 2002. It also must have known that Russian authorities have been regularly challenging transactions involving other taxpayers aimed at tax evasion, including by means of abuses of companies registered in low-tax jurisdictions, and that Russian highest courts had introduced anti-abuse doctrines, including "bad faith." Accordingly, in my view, YUKOS was a clear target for assessment of a "wilful offender fine," which would have been justified even under far less extreme circumstances.[768]

723. In their Reply, Claimants argue that Respondent is wrong in its contention that the Tax Ministry was merely required to show a "degree of awareness of the potential unlawfulness of Yukos' conduct."[769] Claimants contend that Respondent's theory is "refuted by the plain text of the provision itself as well as the Respondent's own expert, who accepts that the statute requires the Authorities to prove that the offender 'was aware of the unlawful nature of his action (or inaction)'."[770] Claimants contend that Respondent's position requires it to "attempt to rewrite the statute."[771]

724. Claimants take particular issue with the imposition of fines in respect of the VAT refunds:

> [A]s a general point, the imposition of fines in circumstances where no violation of statutory law has been alleged is a matter of dubious legitimacy. Particularly improper was the imposition of fines in relation to the revocation of VAT refunds. In circumstances where it was not alleged that any tax was owed, much less unpaid or underpaid, there was no statutory basis for such fines.[772]

725. Claimants elaborate this argument in their Post-Hearing Brief:

> Particularly egregious is the imposition of such inflated fines in relation to VAT, where it is not even alleged that there was any intent to evade VAT nor any actual evasion of VAT. In any case, as set out above, Yukos was not, and could not possibly be "aware of the unlawful nature of its actions".[773]

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768 First Konnov Report ¶ 76 (citations omitted).

769 Reply ¶ 260

770 *Ibid*. (citing First Konnov Report ¶ 72).

771 Reply ¶ 260.

772 *Ibid*. ¶ 257 (citations omitted).

773 Claimants' Post-Hearing Brief ¶ 46 (citations omitted).

726. In its Rejoinder, Respondent reiterates its argument that the relevant inquiry for purposes of the "willful offender" fine is whether Yukos' management was aware of the illegality of its tax scheme.[774] Respondent states that Yukos did not implement the tax optimization scheme by accident, and that it knew that the scheme was unlawful. In support of its submission, Respondent raised several arguments:

> - Yukos masked its affiliation with the trading shells and falsely denied to the Russian authorities and courts that it had any knowledge of their documents or officers
> - Yukos knew from its experience with its sham Lesnoy trading shells that its scheme was unlawful
> - Yukos's senior management was warned at least twice that the authorities would have challenged Yukos' "tax optimization" scheme if they had known the names and details of Yukos' trading shells and their affiliation with Yukos
> - No legal counsel ever provided Yukos with an opinion that its "tax optimization" scheme was lawful
> - Yukos lied about its affiliation with its sham trading companies to the Russian tax authorities and courts, the ECtHR, and PwC
> - Yukos had access to the case law and commentaries published by its own tax counsel, which confirmed its scheme was unlawful.[775]

727. Finally, Respondent argues:

> The Tribunal should reject Claimants' contention that the willful offender fines were improper because Yukos' tax practices were purportedly based on the trading shells' investment agreements with local tax authorities, which as Mr. Konnov opined - without contradiction - were not sufficient to establish compliance with federal anti-abuse doctrines.[776]

728. The Tribunal is of the view that the willful offender fines were clearly improper insofar as they related to VAT. This follows necessarily from the Tribunal's findings that there was no valid basis to impose the VAT liability on Yukos.

729. On the totality of the evidence, the Tribunal is also of the view that the willful offender fines as they related to the revenue-based taxes were improperly assessed against Yukos. The Tribunal recalls its findings, above, that those taxes, considering all of the evidence, were not properly assessed against Yukos.

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774 Rejoinder ¶ 734.

775 Respondent's Opening Slides, p. 130.

776 Respondent's Post-Hearing Brief ¶ 44 (citations omitted).

730. Moreover, while he did not appear at the Hearing, the contemporaneous quote from Mr. Kasyanov to journalists in January 2004 shows just how unlikely it was that Yukos could have been certain that its tax optimization plan was illegal:

> [Question:] The Tax Ministry claimed from Yukos to pay an additional 98 billion rubles, which the company allegedly saved on taxes in 2000 with the help of the schemes, which was also used by other companies. Until autumn 2003, neither the Ministry of Finance nor the Tax Ministry, though criticizing the schemes, had challenged their legality. How do you react to the fact that the tax optimization is retroactively declared unlawful?
>
> [Answer:] If lawful actions for tax optimization are declared unlawful retroactively, then I react to that negatively. For the simple reason that there were loopholes in the law allowing the optimization of payments. The Tax Code did not forbid Yukos and other companies to conduct transactions through domestic offshore zones.[777]
>
> [emphasis added]

731. The opinion of Mr. Kasyanov, the Prime Minister at the time the assessment was made, is persuasive. It confirms the conclusion of the Tribunal that, even if the legality of Yukos' tax optimization scheme was, in certain regions and respects, questionable and vulnerable to attack by the tax authorities, it could not be characterized as a "willful offense".

732. The Tribunal also recalls Claimants' position as to the governing statutory provision in the Russian Tax Code:

> Whereas the Tax Code clearly provides that fines may be increased for willfulness only "if the person who committed it was aware of the unlawful nature of his actions (inaction) and intended or consciously allowed the harmful consequences of such actions (inaction)" the Respondent claimed that such fines could be imposed if the taxpayer had "a degree of awareness of the potential unlawfulness of its conduct". The Respondent's position is obviously not the law.[778]
>
> [emphasis in original]

733. The Tribunal agrees. Respondent's interpretation of the standard is inconsistent with the Russian Tax Code. The strict language of the Russian Tax Code makes it difficult for the Tribunal to conclude that Yukos should have been assessed the willful offender fines, even if there were a basis to conclude (as the Tribunal has held earlier) that some of the revenue-based taxes could legitimately have been imposed against Yukos.

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777 Memorial ¶ 330 (quoting Alexander Bekker, Vladimir Fedorin, *Interview: Mikhail Kasyanov, Prime Minister of the Russian Federation*, Vedomosti, 12 January 2004, p. 5, Exh. C-677).

778 Claimants' Post Hearing Brief ¶ 46 (citations omitted).

iv. Were the "Repeat Offender" Fines Properly Imposed?

734. Claimants contend that the 100 percent increase of the fines imposed on the basis of the "Repeat Offender" provision of the Russian Tax Code was even less justified than the imposition of the "Willful Offender" fine:

> [T]he plain wording of Article 112(2) of the Russian Tax Code directs that such increase be only permitted in cases in which a taxpayer has been held liable for a similar tax offense *prior* to the commission of the disputed offense. The Presidium of Highest Arbitrazh Court of the Russian Federation has been unequivocal in considering that the previous similar offense must not only be committed, but also be *detected and sanctioned*. No such sanction came before April 14, 2004. As a result, in declaring that the tax offenses allegedly committed by Yukos in 2001, 2002 and 2003 were repeat offenses triggering a further 100% increase, both the Russian tax authorities and the Russian courts grossly misapplied Article 112(2). As regards the 2004 fines, their 100% increase was all the more egregious that the tax offenses purportedly committed by Yukos in 2004 were not similar to those allegedly committed in 2000-2003.[779]

735. Claimants also rely on the Resolution of the Presidium of the Highest Arbitrazh Court of the Russian Federation No. 15557/07 of 1 April 2008 (Annex (Merits) C 415) for the proposition that, in order for a taxpayer to be considered a "Repeat Offender", the taxpayer's previous similar offence must have been "detected and sanctioned" before the commission of the repeat offence. Respondent takes issue with Claimants' reliance on this decision adopted in 2008, "years after Yukos' appeals against the assessments at issue had run their course."[780] Respondent contends that the jurisprudence prior to 2008, at the time that the authorities imposed the "Repeat Offender" fines, supported the authorities' approach:

> Prior to the issuance of the 2008 Resolution, there had been a number of cases, unrelated to Yukos, in which the courts had upheld the assessment of repeat offender fines in the same manner as was done in the Yukos cases. Thus, when the tax authorities levied repeat offender fines against Yukos -- an egregious repeat offender if there ever was one -- they were not deviating from established practice but rather, applying one of the interpretations of the relevant statute that was in current use at the time. As much was effectively conceded by Yukos' own lawyer who, while urging that Yukos not be assessed a repeat offender fine, noted the "unclarity" of the law.[781]

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779 Memorial ¶ 332 (citing Resolution of the Presidium of the Highest Arbitrazh Court of the Russian Federation No. 15557/07, 1 April 2008, Exh. C-415).

780 Counter-Memorial ¶ 1084.

781 *Ibid*. (citing First Konnov Report ¶¶ 77–82; Article 112(2) of the Russian Tax Code, Exh. R-2248). Respondent also points to the following in support of its position: First Konnov Report ¶¶ 79–80; Resolution of the Federal Arbitrazh Court of the Far-Eastern District, Case No. F-03-A73/05-2/244, 14 March 2005, Exh. R-1506; Resolution of the Federal Arbitrazh Court of the Povolzhsky District, Case No. A65-7415/04-CA1-32, 5 October 2004, Exh. R-1504); Resolution of the Federal Arbitrazh Court of the North-Western District, Case No. A44-498/ 2006-8, 21 August 2006, Exh. R-3282; Resolution of the Federal Arbitrazh Court of West-Siberian District, Case No. F04-5193/2007 (36847-A75-43), 3 August 2007, Exh. R-3377; Resolution of the Federal Arbitrazh Court of the West-Siberian District, Case No. F04-1778/2008 (2088-A27-25), 12 March 2008, Exh. R-1505.

736. Claimants contend, in their Reply, that Respondent's argument should be rejected. According to Claimants, Respondent does not contest the existence and significance of the 2008 decision, but merely contends that because this decision came in 2008, it should not be considered by the Tribunal. Claimants conclude:

> In other words, while the Respondent concedes that the repeat offender fines were unlawful under the correct interpretation of the provision, it seeks to justify the fines on the basis of an alleged uncertainty about the correctness of that interpretation.[782]

737. In their Post-Hearing Brief, Claimants also criticize Respondent's reliance on the pre-2008 jurisprudence:

> The Respondent and its expert concede that the imposition of repeat offender fines against Yukos was contrary to the interpretation of the Highest Arbitrazh Court issued in 2008. The Respondent's only defense is to argue that some other courts had previously applied the statute in the same (incorrect) way. Thus, notwithstanding the requirement in Article 3(7) of the Tax Code to resolve doubts in favor of the taxpayer, the Respondent insists it was appropriate for the tax authorities to apply an interpretation that was both incorrect and nearly US$ 4 billion less favorable to the taxpayer. The animating, confiscatory purpose behind the Respondent's actions is palpable.[783]

738. Mr. Konnov was cross-examined at length about the 2008 Arbitrazh Court decision.[784] Throughout, he maintained his support for the authorities' treatment of Yukos, prior to the 2008 decision. He did not concede that it was incorrect, but merely that it was a function of the uncertainty inherent in the provision.

739. Mr. Konnov had indeed referred to the "uncertainty" or ambiguity surrounding Article 112(2) of the Russian Tax Code in his First Expert Report:

> 77. The Claimants argue that the imposition of repeat offender fines on YUKOS was unjustified and ignored the plain language of the governing law and the Supreme Arbitrazh Court guidance. I cannot agree with the suggestion by the Claimants that the language of Article 112(2) of the Tax Code was "*plain*" and that there is only one possible interpretation of that provision. The relevant provision of the Tax Code reads as follows:
>
> > "Aggravating circumstance means commitment of a tax offence by a person previously held liable for an analogous violation".
>
> 78. YUKOS itself admitted during the court hearings related to the 2000 tax year there was more than one possible reading of Article 112(2) of the Tax Code. The minutes of the court hearing read as follows:

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782 Reply ¶ 261.

783 Claimant's Post-Hearing Brief ¶ 47 (citing Transcript, Day 15 at 20–23 (Mr. Konnov); Transcript, Day 18 at 101 (Respondent's closing)).

784 *See* Transcript, Day 15 at 5–23.

> [A representative of YUKOS] "... believes that there is unclarity in interpretation of Article 112 of the Russian Tax Code."[785]

740. Claimants assert that Respondent's position is untenable, given that "Article 3(7) of the Tax Code requires doubts as to the proper interpretation of its provisions to be resolved in favor of the taxpayer."[786]

741. In relation to Article 3(7) of the Russian Tax Code, Respondent makes the following final argument in its Post-Hearing Brief:

> Claimants' contention that purported ambiguities in the statute governing repeat offender fines had to be resolved in Yukos' favor is baseless (Claim. Reb., Day 20 Tr. 196:18:23; Konn. Test., Day 15 Tr. 33:14-33:25, 34:25-35:8). As Mr. Konnov explained without contradiction (Konn. Test., Day 15 Tr. 34:1-34:24), and as is confirmed in a 2004 article written by Mr. Zaripov (Exh. R-3223), only those doubts that courts cannot resolve must be decided in favor of the taxpayer. Here, however, the relevant Tax Code provision was interpreted consistently with prior caselaw, confirming that it did not give rise to any irresolvable doubts. Konn. Rep. 1, ¶ 79; Konn. Rep. 2, ¶ 102.[787]

742. Respondent has another defense for the "repeat offender" fines, namely that Yukos would have been deemed a repeat tax offender even under the approach adopted by the 2008 Resolution, because it had been subjected to fines for underpayment of taxes well before any of the assessments was issued. Respondent refers in this connection to paragraphs 81 and 82 of the First Konnov Report, which reads as follows:

> 81. Furthermore, there could have been additional grounds for imposition of repeat offender fines on YUKOS. Based on my experience, any Russian company of a size comparable to that of YUKOS at the end of 1990s and the beginning of this decade was regularly subject to tax audits. Almost all of these audits resulted in discovery of tax violations and imposition of fines, even though in some instances the amounts were relatively insignificant. The Nefteyugansk Tax Inspectorate imposed fines on YUKOS pursuant to Decision No. 289 dated June 9, 2003. Even before that, the tax authorities conducted a tax audit of YUKOS. The Report of the Nefteyugansk Tax Inspectorate No. 66, dated April 28, 2003, notes that on April 16, 2001 the Inter-Regional Inspectorate of the Tax Ministry for Operational Oversight of Problem Taxpayers issued a report No. 34-03-10/6. Although I have not been able to review that act, it would not be unreasonable to assume that fines were imposed on YUKOS based on that act. Moreover, the US GAAP financials produced by YUKOS suggest that in each of 1998, 1999, 2000, 2001, 2002 and 2003, YUKOS was subject to substantial fines and interest for tax violations.
>
> 82. In accordance with the prevailing court practice, a repeat offender fine may be levied so long as the prior fine involved the same provision of the Tax Code with respect to

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785 First Konnov Report ¶¶ 77–78.

786 Reply ¶ 261 (citing Russian Tax Code, Article 3(7), Exh. C-1276; Reply ¶ 231 and n.250).

787 Respondent's Post-Hearing Brief ¶ 46, n.140. For the exchange between Dr. Poncet and Mr. Konnov on the principle "*in dubio contra fiscum*," *see* Transcript, Day 15 at 37–42.

> the same taxes, even if the nature and the amount of the violations were different. Accordingly, even minor violations with respect to the same taxes imposed in connection with different arrangements would have sufficed to justify the repeat offender fines even under the approach taken by the 2008 Resolution.[788]

743. Claimants counter Respondent's alternative argument as follows:

> The Respondent's alternative theory, according to which any previous violation on profit tax, on whatever basis and in whatever amount, would be sufficient to justify these US$ 3.92 billion in repeat offender fines is far-fetched to say the least, relying on Mr. Konnov's dubious assertion as to the content of "prevailing court practice", his speculation that Yukos may have had a previous violation at some point in time and his assumption that that hypothetical violation involved the same provision of the Tax Code with respect to the same taxes. In any event, since by the Respondent's own admission its tax claims were not premised on alleged violations of any provision of the Tax Code, Mr. Konnov's theory has no conceivable application in relation to Yukos.[789]

744. On the issue of the "repeat offender" fines, the Tribunal is persuaded by Claimants' argument that these fines should not have been imposed.

v. Could Yukos Have Avoided the Fines?

745. In its Counter-Memorial, Respondent draws the attention of the Tribunal to Article 81(4) of the Russian Tax Code which allows taxpayers to avoid all penalties for past misdeeds provided only that they file amended tax returns before being formally notified of the onset of the audit relating to the relevant tax years. If the taxpayer takes advantage of Article 81(4) in a timely fashion, it needs to pay only the tax previously evaded (and interest), but no fine. This provision, combined with the Russian practice (followed in the Yukos case) of auditing "open" tax years (*i.e.*, tax years not time-barred by the statute of limitations) one after the other, rather than simultaneously, gives tax offenders an opportunity to eliminate their exposure to fines by filing last-minute amended returns.[790]

746. On the basis of this provision, Respondent contends that Yukos could have easily avoided the fines associated with the assessments for tax years 2001, 2002 and 2003, if only it had taken advantage of Article 81(4) of the Russian Tax Code:

> In Yukos' case, the authorities had made clear their complete condemnation of Yukos' scheme when they delivered their audit report for 2000 to Yukos, *i.e.*, on December 29, 2003. They did not, however, announce commencement of their audit of the next year

788 First Konnov Report ¶¶ 81–82 (citations omitted).

789 Reply ¶ 262 (citing Counter-Memorial ¶¶ 993, 1085).

790 Counter-Memorial ¶ 1087 (citing First Konnov Report ¶¶ 83–85).

> (2001) until March 23, 2004, *i.e.*, 84 days later. As a result, Yukos had a window of opportunity of nearly three months duration in which it could have legally avoided any penalty whatsoever for tax year 2001 (including a willful offender fine and a repeat offender fine), simply by filing amended returns and paying the respective taxes and interest. The authorities' audit for 2002 and 2003 did not start until August 9, 2004 and October 28, 2004, respectively, and Yukos could likewise have avoided all penalties simply by filing amended returns for 2002 and 2003 before those dates and paying the overdue taxes and interest. Instead, Yukos' managers recklessly squandered this opportunity.[791]

747. As an additional point for the tax year 2003, Respondent asserts that Yukos had only itself to blame "for filing a fraudulent annual return for that year, which ended on or around 28 March 2004, the filing deadline."[792] It is Respondent's position that instead of continuing to pretend that its scheme was lawful, some three months after the December 2003 audit, Yukos could have filed an amended return.[793]

748. Similarly, Respondent submits that Yukos could have filed a "lawful tax return" for the 2004 tax year. On the basis of this reasoning, Respondent sums up its position as follows:

> Had Yukos filed lawful tax returns beginning as of January 1, 2004 (*i.e.*, after its receipt of the December 29, 2003 tax audit report) and exercised in timely fashion its right to file amended returns for years 2001 and 2002, and paid the respective taxes and default interest, it would have reduced its overall tax liabilities in an amount that would have ensured that Yukos would have not faced bankruptcy proceedings, and that would in all likelihood also have avoided the need for the YNG auction.[794]

749. Claimants reject Respondent's suggestion that Yukos should have pre-emptively conceded the validity of the December 2003 tax audit for the 2000 tax year and filed amended tax returns for subsequent years prior to being notified of the audits for those years. Claimants assert that Respondent's position "confirms the Russian authorities' complete disregard for due process and fundamental rights of taxpayers."[795] According to Claimants, Yukos had every right to avail itself of its rights under Russian law to challenge these unlawful tax reassessments and fines in court, or even await the results of the tax authorities' own review of Yukos' objections and declaration of their final position in the decision to hold Yukos liable with respect to the

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791 Counter-Memorial ¶ 1088 (citing Field Tax Audit Report No. 30-3-14/1, 30 June 2004, p. 3, Exh. R-345; Field Tax Audit Report No. 52/852, 29 October 2004, p. 3 Exh. R-346; Field Tax Audit Report No. 52/907, 19 November 2004, p. 2, Exh. R-260; Counter-Memorial ¶¶ 353–65).

792 Counter-Memorial ¶ 1089.

793 *Ibid*.

794 *Ibid*. ¶ 1090.

795 Reply ¶ 264.

year 2000.[796] Claimants note that Respondent decided to carry out additional control measures and to review the 29 December 2003 audit report in light of Yukos' objections but communicated no information about this review prior to issuing its Decision to hold Yukos liable on 14 April 2004 when it dismissed Yukos' objections.[797]

750. The Tribunal does not accept that, if Yukos had acted as Respondent maintains, it would have been able to escape the imposition of fines. As with the issue of VAT liability, the Tribunal is convinced that had Yukos done so, the Russian Federation would still have found a way or a reason to impose the fines on Yukos.

vi. Was the Quantum of the Fines Reasonable, in Terms of Both the Rate and the Absolute Amount?

751. In its Counter-Memorial, Respondent compares the regime for fines in the Russian Federation with those that exist in other countries. Respondent notes that fines for taxpayers that have underpaid their taxes, whether or not associated with tax evasion, can lead to fines at rates ranging up to 300 percent of the evaded tax (this highest rate applies, according to Respondent, in Austria, the Netherlands, and Switzerland). On this basis, Respondent concludes: "It is clear from the foregoing that the fines levied on Yukos were not excessive by international standards."[798]

752. The Tribunal notes that Claimants did not address this last submission of Respondent. In any event, given the Tribunal's conclusions regarding the legitimacy of the willful and repeat offender fines imposed by the tax authorities on Yukos, it is unnecessary for the Tribunal to deal with this contention.

vii. Extracts from Other Yukos-Related Awards

753. In respect of the limitations period as it applied to the 2000 tax year, the ECtHR found, "notwithstanding the State's margin of appreciation", against the Russian Federation:

> 571. Turning to the facts of the case, the Court would note firstly that the rule which, in the present case, underwent changes as a result of the decision of 14 July 2005, was contained in Article 113 of Chapter 15 "General provisions concerning the liability for tax

796 *Ibid*.

797 *Ibid*., n.475.

798 Counter-Memorial ¶ 1224.

> offences" of the Tax Code (see paragraph 403) and thus formed a part of the domestic substantive law. Even though the rule in itself did not describe the substantive elements of the offence and the applicable penalty, it nevertheless constituted a *sine qua non* condition with which the authorities had to comply in order to be able to prosecute the relevant taxpayers in connection with the alleged tax offences. Accordingly, Article 113 of the Tax Code defined a crime for the purposes of the Court's analysis of lawfulness. It remains to be determined whether in the circumstances the decision of 14 July 2005 could be seen as a gradual clarification of the rules on criminal liability which "[was] consistent with the essence of the offence and could reasonably be foreseen" (see *Kafkaris*, cited above, § 141).
>
> 572. In this connection the Court may accept that the change in question did not change the substance of the offence. The Constitutional Court interpreted the existing rules on time-limits in relation to taxpayers who acted abusively. At the same time, the Court is not persuaded that the change in question could have been reasonably foreseen.
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> 573. It observes that the decision of 14 July 2005 had changed the rules applicable at the relevant time by creating an exception from a rule which had had no previous exceptions (see paragraphs 86 and 88). The decision represented a reversal and departure from the well-established practice directions of the Supreme Commercial Court (see, by contrast, *Achour*, cited above, § 52) and the Court finds no indication in the cases submitted by the parties suggesting a divergent practice or any previous difficulty in connection with the application of Article 113 of the Tax Code at the domestic level (see paragraphs 407-408). Although the previous jurisprudence of the Constitutional Court contained some general references to unfavourable legal consequences which taxpayers acting in bad faith could face in certain situations, these indications, as such, were insufficient to provide a clear guidance to the applicant company in the circumstances of the present case.
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> 574. Overall, notwithstanding the State's margin of appreciation in this sphere, the Court finds that there has been a violation of Article 1 of Protocol No. 1 on account of the change in interpretation of the rules on the statutory time-bar resulting from the Constitutional Court's decision of 14 July 2005 and the effect of this decision on the outcome of the Tax Assessment 2000 proceedings.
>
> 575. Since the applicant company's conviction under Article 122 of the Tax Code in the 2000 Tax Assessment proceedings laid the basis for finding the applicant company liable for a repeated offence with a 100% increase in the amount of the penalties due in the 2001 Tax Assessment proceedings, the Court also finds that the 2001 Tax Assessment in the part ordering the applicant company to pay the double fines was not in accordance with the law, as required by Article 1 of Protocol No. 1.[799]

754. On the issue of the "repeat offender" fines, the *RosInvestCo* tribunal held as follows against the Russian Federation:

> From the evidence on file, the Tribunal concludes that the interpretation of Articles 122 and 114 of the Tax Code used on Yukos was not used before or thereafter in any comparable cases. Again, this resulted in an extremely large liability in the range of US$ 3.8 billion.[800]
>
> . . .
>
> **Repeat offender fines:** The US$ 3.8 billion repeat offender fines on the basis of conduct pre-dating the tax audit again appears to the Tribunal as a departure from practice applied

[799] ECtHR Yukos Judgment, ¶¶ 571–75, Exh. R-3328.

[800] *RosInvestCo* ¶ 454, Exh. C-1049.

earlier and from that granted to other companies and thus to be one part of a cumulative effort to prevent Yukos' ongoing existence.[801]

(d) Concluding Observations

755. The Tribunal recalls that, at the outset of this chapter, it referred to the question put by Counsel for the claimant to the arbitral tribunal in the *Quasar* arbitration. "Why would Russia have treated Yukos as it did if its purpose was to collect taxes?"[802]

756. After having now traversed, at some length, the treatment of Yukos by Russian tax authorities, the bailiffs and the courts, and having considered the totality of the evidence, especially the VAT evidence, the Tribunal has concluded that the primary objective of the Russian Federation was not to collect taxes but rather to bankrupt Yukos and appropriate its valuable assets.

757. The principal reasons, discussed in this chapter, which lead the Tribunal to this conclusion include:

i) the attribution to Yukos of the revenues earned by its trading companies, even though there was no precedent in Russia for such attribution based on the theory of "actual owner", and the refusal at the same time to give Yukos any of the benefits of the VAT filings made by the trading companies, with the result that Yukos was assessed USD 13.5 billion or 56 percent of the total tax claims levied against Yukos;

ii) the imposition on Yukos of the "willful offender" fines, at the very least as they related to VAT;

iii) the refusal of the tax authorities to give Yukos the benefit of Article 3(7) of the Russian Tax Code to resolve doubts as to the interpretation of Article 112(2) of the Russian Tax Code in favor of the taxpayer, with the resulting imposition of nearly USD 4 billion in "repeat offender" fines; and

iv) the imposition of "repeat offender" fines on Yukos when the conduct that was punished occurred prior to the determination by the courts that the conduct was wrongful; for example, the "repeat offender" fine assessed against Yukos for the

801 *Ibid*. ¶ 620(c).

802 *See* above at paragraphs 504 and 579.

2001 tax year is based on the finding by the courts in 2004 that the conduct in 2000 was wrongful.

758. In reaching its conclusion, the Tribunal has also taken into account the fact that, in February 2007, before Messrs. Khodorkovsky and Lebedev had served half of their prison terms, the Prosecutor General's Office levelled new charges against them, this time for theft of oil and funds from Yukos, embezzlement and money laundering.

759. As will be seen in subsequent chapters of this Part VIII of the Award which now follow, the Tribunal is sustained in this central and all important conclusion by its analysis of other disturbing facets of the Yukos saga, including:

i) the campaign of harassment carried out by the Russian authorities under the cloak of "investigative activities" including arrests, interrogations, searches and seizures against Yukos senior executives, mid-level employees, in-house counsel, external lawyers and related entities;[803]

ii) Yukos' repeated, reasonable attempts to settle its tax debts with the Russian Federation, all of which proved futile;[804]

iii) the seizure of YNG, Yukos' main production subsidiary, and its auction in questionable circumstances for an inadequate price;[805]

iv) the way in which Yukos' bankruptcy proceedings were initiated and conducted;[806] and

v) the pressure brought to bear by the Russian authorities on PwC, which ultimately conduced to the withdrawal of PwC's audits of Yukos' financial statements.[807]

760. The Tribunal will determine later in this Award how these conclusions impact the liability of Respondent under the ECT.

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803 *See* Chapter VIII.C.

804 *See* Chapter VIII.E.

805 *See* Chapter VIII.F.

806 *See* Chapter VIII.G.

807 *See* Chapter VIII.H.

C. HARASSMENT, INTIMIDATION AND ARRESTS

1. Introduction

761. Claimants allege that Respondent carried out a campaign of harassment and intimidation of Yukos, its management, employees, external advisers and associates with a view to destroying the company and removing Mr. Khodorkovsky as a political threat:

> In what has been described as "a literal orgy of lawlessness", the Russian Federation instigated and conducted a campaign of terror aimed at depriving Yukos of its ability to run its business, and thus facilitating the destruction of the company. This was achieved through an escalating process of arrests, intimidation, harassment, searches and seizures. The breadth of the campaign, which targeted not only Yukos and its management but also entities and individuals associated with the company, and the flagrant violations of due process that characterized the actions of the Russian Federation, underscore both the ruthlessness with which the Russian Federation sought the destruction of Yukos and the coordinated nature of the attack.
>
> The undeniable effect of the actions described below was to undermine the viability of Yukos, placing the Russian Federation in a position to carry out the dismantling of the Company.[808]

762. Claimants allege that Respondent's harassment campaign has "continued throughout the time period at issue in these arbitrations and continues even today," most notably with a second round of charges in 2007 against Messrs. Khodorkovsky and Lebedev leading to a trial described as a "travesty of justice" that resulted in a sentence of a further thirteen and a half years in prison.[809]

763. Respondent for the most part does not question the facts underlying Claimants' allegations, though it does question the credibility of some of Claimants' witness accounts. Rather, the events described by Claimants as constituting a campaign of "harassment and intimidation" are, according to Respondent, better characterized as legitimate acts of law enforcement undertaken in full compliance with Russian law and Russian practices as well as standards of other countries.[810]

764. In any event, Respondent considers the events complained of to be largely irrelevant to the Tribunal's enquiry in these arbitrations. That is because Article 26 of the ECT limits the Tribunal's jurisdiction to disputes alleging the breach of an obligation under Part III of the ECT, of which Articles 10(1) and 13 are directed only to investments, and afford no personal

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808 Memorial ¶¶ 106–7. *See also* Memorial ¶¶ 65, 83–197; Reply ¶¶ 17–94; Claimants' Post-Hearing Brief ¶¶ 156–65.

809 Reply ¶¶ 17, 41.

810 *See* Counter-Memorial ¶ 673; Transcript, Day 18 at 113–21 (Respondent's closing).

protection for nationals. Respondent observes that "the alleged violations of the human rights of Messrs. Khodorkovsky, Lebedev and others . . . are outside the scope of this Tribunal's jurisdiction, unless Claimants can establish that any such violations directly impaired the management or operation of their investments."[811] Respondent argues Claimants have failed to do so,[812] and that the prosecutions of Messrs. Khodorkovsky and Lebedev did not destroy Yukos. To the contrary, Yukos exceeded its 2003 performance in 2004.[813]

765. The Tribunal recognizes that it is not a human rights court. Nevertheless, it is within the scope of the Tribunal's jurisdiction to consider the allegations of harassment and intimidation as they form part of the factual matrix of Claimants' complaints that the Russian Federation violated its obligations under Part III of the ECT. The Tribunal's task includes determining whether the Russian Federation "in any way impair[ed] by unreasonable or discriminatory measures [Claimants'] management, maintenance, use, enjoyment or disposal" of its investment, or subjected Claimants' investment to measures having the effect equivalent to an expropriation. In the context of that inquiry, the Tribunal will set out the evidentiary record with respect to the alleged "campaign of harassment and intimidation."

2. Chronology of Facts

(a) Yukos Grows; Mr. Khodorkovsky Becomes More Politically Engaged; Yukos Leaders Receive Warnings

766. Claimants allege that by early 2003 "Mikhail Khodorkovsky's participation in the social policy and political spheres in Russia, coupled with Yukos' growing economic power, came to be perceived as a threat by the Russian authorities."[814]

767. As already noted in Chapter VIII.B above, President Putin's former Chief Economic Advisor, Dr. Illarionov alleged in his witness statement that around late 2002, a "special unit was set up at the General Prosecutor's office, comprised of approximately 50 people and working exclusively on fabricating evidence against Mr. Khodorkovsky and Yukos."[815] The special unit

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811 Rejoinder ¶ 1335.

812 *Ibid*. ¶ 1331.

813 *Russia's Yukos says interim oil output up 5.3% on year in 2004*, Prime–TASS Energy Service (Russia), 21 March 2005, Exh. R-509.

814 Memorial ¶ 63.

815 Illarionov WS ¶¶ 35–36.

came up with approximately 15 possible theories to justify Mr. Khodorkovsky's arrest, amongst them "tax evasion schemes allegedly set up either for Mr. Khodorkovsky's personal benefit or for the benefit of Yukos."[816] Upon cross-examination, Dr. Illarionov declined to identify his source, a "high-placed official in the Russian Administration at the time" who still lives in Moscow, out of concerns for the official's safety.[817] Dr. Illarionov testified that the official told him the unit had "been created to 'zanyatsa' Khodorkovsky. . . 'take care of' Khodorkovsky . . which means one day some kind of security services and officers did receive an order so-called to solve the problem."[818]

768. The turning point, according to Claimants, was a meeting at the Kremlin between President Putin and the Russian Union of Industrialists and Entrepreneurs on 19 February 2003, to which the Tribunal has referred earlier, at which Mr. Khodorkovsky delivered a speech about corruption in Russia.[819] President Putin responded by alluding to some companies, including Yukos, having accumulated considerable wealth from non-payment of tax, and thus told Mr. Khodorkovsky that he was "passing the puck back to you."[820] At this point, according to Dr. Illarionov, the tone became "steely and menacing,"[821] and from then on, the "gloves were off."[822] The Tribunal has observed earlier in this Award that the Russian authorities, particularly in the ZATOs, were questioning the legality of Yukos' tax optimization scheme prior to the February 2003 meeting and that this meeting was not a "turning point" in terms of being the catalyst for challenging the Yukos tax scheme.[823] Nevertheless the record does show that from around the time of the February 2003 meeting, the Russian authorities escalated the intensity and extent of their investigations into Yukos and associated individuals and entities.

769. In the months following the February 2003 meeting, Mr. Khodorkovsky's financial support for

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816 *Ibid*.

817 Transcript, Day 7 at 156–57.

818 *Ibid*. at 158. As discussed below in Subsection 3(a), Respondent describes Dr. Illarionov's evidence as "rank hearsay" and a "lie", Transcript, Day 18 at 114–16.

819 Memorial ¶¶ 63, 86–91.

820 Excerpt of Television Report "Un milliardaire en Sibérie" broadcast on TF1 on 1 October 2006, Exh. C-590; Video recording and transcript of the meeting of the members of the Union of Industrialists and Entrepreneurs with President V. Putin held in the Ekaterininsky Hall, Kremlin, on 19 February 2003, Exh. C-1396.

821 Illarionov WS ¶¶ 31–32.

822 *Ibid*. Memorial ¶¶ 86–91. *See also* Statement of Prime Minister Mikhail Mikhailovich Kasyanov to the ECtHR, 8 July 2009, in *Khodorkovskiy v. The Russian Federation* (Application Nos. 5829/05, 11082/06 and 51111/07) ¶¶ 10–12, Exh. C-446.; Kovalev Report ¶ 53.

823 *See* above at paragraph 513.

opposition parties, including the Communist party, apparently was increasingly of concern to President Putin. For example, Mr. Dubov testified that President Putin had advised Mr. Khodorkovsky in April 2003 to restrict his political activities and not to finance the Communists.[824] Similarly, former Prime Minister Kasyanov testified to the ECtHR that a conversation with President Putin had left him in no doubt that "by funding the communists Khodorkovsky had crossed a line so far as Putin was concerned and that the criminal prosecution case of Yukos employees was started exactly because of the funding of political parties not sanctioned by Putin."[825]

770. Mr. Khodorkovsky's close business associate, Mr. Leonid Nevzlin, testified that in the Spring of 2003 the then Media Minister met him for lunch and informed him that "the decision had been taken to seize Yukos, and that [President Putin's deputy chiefs of staff] would not stop at anything in order to achieve that end, including arresting Khodorkovsky."[826] From this, Mr. Nevzlin received the message that Mr. Khodorkovsky should put an end to his criticism of President Putin and his administration, "otherwise he could lose everything." Mr. Nevzlin reported warnings from other sources at the time, including Sibneft's Roman Abramovich saying President Putin told him he "would like to see Mr. Khodorkovsky's bottom on a prison bench" and Federation Council members telling Mr. Nevzlin that Mr. Khodorkovsky "could face problems should he stay in Russia."[827]

(b) Prosecutor General Launches Investigations Involving Searches and Seizures

771. From June 2003, the Office of the Prosecutor General of the Russian Federation launched a series of investigations against various members of Yukos' management, most prominently among them Mr. Khodorkovsky and Mr. Platon Lebedev (GML director and close associate of Mr. Khodorkovsky).[828] Mr. Lebedev was arrested on his hospital bed on 2 July 2003 on charges of fraud, embezzlement and tax evasion.[829] Two days later, Messrs. Khodorkovsky and

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824 Dubov WS ¶ 69.

825 Statement of Prime Minister Mikhail Mikhailovich Kasyanov to the ECtHR, 8 July 2009, in *Khodorkovskiy v. The Russian Federation* (Application Nos. 5829/05, 11082/06 and 51111/07) ¶¶ 17–19, Exh. C-446.

826 Nevzlin WS ¶ 30.

827 *Ibid*. ¶¶ 31–33.

828 Memorial ¶ 108; 'Chronology', *Attack on Yukos*, Yukos Review, Special Issue, 2003, p. 5, Exh. C-22.

829 *Attack on Yukos*, Yukos Review, Special Issue, 2003, Exh. C-22; *Oil Executive is Arrested, and Russians Look for Putin's Role*, NY Times, 3 July 2003, Exh. C-637; *Yukos oil oligarch arrested in raid*, The Washington Times, 26 October 2003, Exh. C-658. Respondent points out that the ECtHR dismissed a complaint by Mr. Lebedev that the

Nevzlin were summoned for questioning in what Mr. Nevzlin described as an "absurd" investigation.[830] That same day, the Russian authorities raided the office of the registrar of Yukos' shares and confiscated documents.[831]

772. On 11 July 2003, the Russian authorities conducted the first large-scale raid on Yukos. Yukos' then Chief Financial Officer, Mr. Bruce Misamore, describes it as:

> an incredible scene full of armed, masked officers—during which they trawled through our computer records for approximately 17 hours. This was to begin a wave of raids on Yukos' Moscow headquarters and other companies affiliated with Yukos by investigative officers . . . sometimes accompanied by . . . heavily armed police officers.[832]

773. Yukos group Financial Controller, Mr. Frank Rieger, also recounts the raids on the accounting department, which started from July 2003. He describes how the staff was forced to stop work during the raid, that a Deputy Chief Accountant had been told by the authorities that they "knew that she had grandchildren, a dacha *etc* and that she had better tell them what they wanted to hear," another staff member resigned having been told by the prosecutors it would be best for him, and that the authorities regularly seized "lorry loads of documents" in an unsystematic fashion, without leaving copies or any record of the documents seized.[833]

774. According to Mr. Misamore, the loss of key documents "created great difficulties not only in managing the company, but in preparing the annual financial statements."[834] Mr. Misamore elaborated that "these raids with the guys in their balaclavas and their AK47s coming in and harassing our employees, taking original documents away from our offices, not leaving us with any copies, we couldn't even accomplish accounting . . . . We lost our entire U.S. GAAP consolidation accounting group by the end of 2004: they all left the company because they didn't want to be harassed."[835] Steven Theede, who joined Yukos as Chief Operating Office in August 2003 noted that by the end of 2003:

Russian Federation violated its human rights obligations with respect to his health in detention conditions, *Lebedev v. The Russian Federation* (No. 1) (Application No. 4493/04), ECtHR Decision of 18 May 2006, Exh. R-4000.

830 Nevzlin WS ¶ 34.

831 "Yukos Repurchases its Shares," Vedomosti, 7 July 2003, Exh. C-638.

832 Misamore WS ¶ 31. *See also* "Police raid Russian oil giant," BBC News, 11 July 2003, Exh. C-640; "Prosecutors Search Yukos Office for 17 Hours," The Moscow Times, 14 July 2003, Exh. C-641.

833 Rieger WS ¶¶ 27–28. *See also* Misamore WS ¶ 32.

834 Misamore WS ¶ 32.

835 Transcript, Day 4 at 244–45.

> It was obvious that . . . the Government was out to get us; it was that simple. The number of raids we had in the office, police coming and charging through our accounting department, knocking computers off desks, . . . tipping desks up on their side. I had four men in black masks outside my office with machine guns once, trying to get in.[836]

775. Following the arrest of Mr. Lebedev, the Board of Directors of Yukos set up a temporary *ad hoc* committee to assess the situation and potential risks related to the arrest, which was chaired by Mr. Jacques Kosciusko-Morizet, then chair of the Board's Audit Committee.[837] Mr. Kosciusko-Morizet testified (over Respondent's objection) about Mr. Khodorkovsky's appearance before the *ad hoc* committee in August 2003.[838] Although Mr. Khodorkovsky initially assured the Board that "everything is fine," Mr. Kosciusko-Morizet pressed him for "some explanation" and recounted his response to the Tribunal:

> He said the following, 'I'm in touch with generals from the FSB' [the successor of the KGB] . . . 'They want a kompromat.' . . . 'kompromat', which is a Soviet word . . . A kompromat is a document which gives you leverage on somebody, and practically forces him or her to follow whatever instructions he or she is given. And we asked, 'What kind of kompromat do they mean?' 'Well', he said, 'all I have to do is write two lines: I committed criminal deeds.' And then I said, 'And what will happen if you sign such a kompromat?' He said, 'Nothing. They will just keep it, and from time to time I'll receive a phone call asking me for some favour.' And I asked again, 'But for Yukos—so will you sign it?' . . . He said, 'No, I don't want to live like that with my children.' And then I said, 'But under the assumption that you would sign it, what would happen?' And his words were, 'Well, if I would sign such a two-line letter, the problems of Yukos would disappear faster than it takes to switch off the light in this room.' . . . And I did not leave this meeting in a very optimistic mood on future events. And indeed two months later he was in jail, in pre-trial detention. He did not sign the kompromat.[839]

776. Dr. Illarionov testifies that in September 2003 he met with Mr. Khodorkovsky to tell him he was in danger and it would be preferable for him to leave Russia. Mr. Khodorkovsky reportedly replied that he did not feel he had committed any offence and did not want to leave Russia.[840]

777. In early October 2003, the authorities conducted raids at the home of Mr. Lebedev, the offices of GML Management Services SA, and a boarding school for disadvantaged children sponsored by Yukos.[841] Further raids were conducted in the office of Mr. Lebedev's lawyer, a

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836 *Ibid*. at 9.

837 Kosciusko-Morizet WS ¶ 23.

838 Transcript, Day 4 at 226–28.

839 *Ibid*.

840 Illarionov WS ¶ 39.

841 Memorial ¶ 161, *Attack on Yukos*, Yukos Review, Special Issue, 2003, Exh. C-22; *Yukos Targeted in Three New Raids*, The Moscow Times, 6 October 2003, Exh. C-652.

move criticized by the Moscow Bar Association at the time.[842]

(c) Arrest and Trial of Mr. Khodorkovsky; Flight from Russia of His Associates

778. On 25 October 2003, Mr. Khodorkovsky was arrested at gunpoint by an armed special forces unit in a Siberian airport, and taken to Moscow where he was charged with economic crimes including fraud, tax evasion and embezzlement.[843] He was detained for over ten years until his much publicized release on 20 December 2013.[844] According to Claimants, the arrest "paved the way for the subsequent actions of the Russian Federation, which eventually resulted in the dismantling of Yukos."[845] The ECtHR, in its judgment of 31 May 2011, criticized the manner of Mr. Khodorkovsky's arrest, the denial of bail, violations of due process and attorney-client privilege, and the subjection of Mr. Khodorkovsky to inhuman and degrading treatment in his pre-trial detention.[846]

779. Mr. Yuri Schmidt, a criminal lawyer who has acted for Mr. Khodorkovsky, testifies that never before in his 50 years of experience had he "seen the Russian State undertake such coordinated, systematic and intense efforts, and deploy such huge resources, against a person accused of an alleged economic offense."[847] Respondent chose not to cross-examine Mr. Schmidt.

780. In response to a question from a member of the Tribunal, Dr. Illarionov testified about a conversation he had with President Putin shortly after the arrest of Mr. Khodorkovsky. According to Dr. Illarionov, President Putin explained that Mr. Khodorkovsky had "behave[d] badly" and stopped "cooperating," for example by negotiating with an American oil company about a possible merger and supporting the Communist Party in advance of the Duma elections.

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842 Memorial ¶ 161, *Lawyer Outcry: Yukos Raids Illegal*, The St. Petersburg Times, 14 October 2003, Exh. C-657.

843 Memorial ¶ 112, *Attack on Yukos*, Yukos Review, Special Issue, 2003, Exh. C-22; *Yukos oil oligarch arrested in raid*, The Washington Times, 26 October 2003, Exh. C-658.

844 The Parties agree that Mr. Khodorkovsky's release has no impact whatsoever on the present arbitration proceedings. *See* Claimants' Letter to the Tribunal of 24 January 2014 ("The Claimants submit that Mr. Khodorkovsky's pardon by the President of the Russian Federation and his release from prison . . . have no impact whatsoever on the present proceedings"); and Respondent's Letter to the Tribunal of 24 January 2014 ("Mr. Khodorkovsky's pardon itself has no effect on these proceedings"). Claimants further point out that the pardon entailed no admission of guilt by Mr. Khodorkovsky. Respondent further points out that the pardon had no effect on Mr. Khodorkovsky's criminal convictions or the findings by Russian courts with respect to tax evasion by Yukos. The Tribunal also notes that Mr. Lebedev was released after his sentence was reduced by the Russian Supreme Court on 23 January 2014. *See* Respondent's Letter to the Tribunal of 24 January 2014.

845 Memorial ¶ 122.

846 Reply ¶¶ 25–28. ECtHR, *Khodorkovskiy v. Russia* (Application No. 5829/04), Judgment of 31 May 2011 ¶¶ 193–95, (hereinafter "*Khodorkovsky v. Russia 1*", Exh. C-1300.

847 Schmidt WS ¶ 59.

Following these actions, President Putin decided to "step aside" and allow Mr. Khodorkovsky to fend for himself against "the boys."[848] Dr. Illarianov also recalled that there was wide "public outrage" in the mass media. The then Prime Minister, Mr. Mikhail Kasyanov, publicly disapproved of the arrest. Dr. Illarionov referred to President Putin's order that "I would ask everybody in the Government to shut up on Mr. Khodorkovsky's arrest," and it was very clear to him that this comment was addressed to Mr. Kasyanov, who was later removed from his position.[849]

781. Mr. Dubov testifies that a Kremlin official informed him on 27 October 2003 that his name had been struck off the list of candidates running for the Duma, at the direction of President Putin.[850] At the Hearing Mr. Dubov elaborated on the conversation he had with the Kremlin official, to whom he had asked "What will happen to Yukos?" Mr. Dubov received the answer "Yukos will be taken away from you gentlemen" and that there would be criminal claims against every single shareholder.[851] He was told President Putin had "gone berserk over Khodorkovsky." Upon advice from the official, Mr. Dubov left Russia that night and has never returned. Mr. Nevzlin also left Russia late in 2003 and has not returned since. Shortly thereafter Mr. Dubov, Mr. Nevzlin and Mr. Brudno were charged with embezzlement and money laundering.[852] International arrest warrants were issued in January 2004 for Messrs. Nevzlin and Dubov, the day after Mr. Nevzlin announced their joint support for a presidential candidate opposing President Putin.[853]

782. On 3 November 2003, Mr. Khodorkovsky resigned as CEO of Yukos. In that connection, Respondent submits that he resigned voluntarily and that, shortly thereafter, Yukos confirmed that it had "a strong management team in place", that it was "continuing to operate" and that it was "business as usual" following Mr. Khodorkovsky's resignation.[854] However, raids and arrests at the offices and homes of Yukos-connected personnel continued over the ensuing

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848 Transcript, Day 7 at 155.

849 *Ibid*. at 159–60.

850 Dubov WS ¶ 79.

851 Transcript, Day 5 at 182.

852 Decision to Deny Extradition of Mikhail Brudno to the Russian Federation, Prosecutor General's Office of Lithuania, 24 August 2007, Exh. C-469; Memorial ¶ 123; Dubov WS ¶¶ 79–81, Nevzlin WS ¶ 14.

853 Memorial ¶ 123, Nevzlin WS ¶ 14.

854 *Yukos Conference Call on Recent Developments – Final*, Financial Disclosure Wire, 5 November 2003 Exh. R-3991.

years, including on NGOs and service providers connected with Yukos.[855] Claimants also allege that Yukos' auditors, PwC, were targeted and harassed because of their association with Yukos,[856] an issue discussed in more detail below in Chapter VIII.H.

(d) Complaints of Further Harassment and Intimidation of Yukos Executives, Employees, Lawyers and External Advisers

783. Claimants have also referred the Tribunal to the interrogations and arrests of in-house and external lawyers for Yukos and Messrs. Khodorkovsky and Lebedev.[857] Their telephones were put under surveillance. In his witness statement, Mr. Schmidt recounts that the treatment of some lawyers acting for Yukos personnel included threats, harsh interrogations and beatings requiring hospitalization, leading some local and international bar associations to voice their deep concerns.[858] Mr. Schmidt himself recounts incidents of intimidation against him, including disbarment and libel suits.[859]

784. Mr. Schmidt observes that "the timing of the attacks on the lawyers acting for Messrs. Khodorkovsky and Lebedev and on Yukos' lawyers and personnel was always meticulously calculated to correspond to the critical stages in the dismantlement of Yukos."[860] Thus, at a time when Yukos was deeply engaged in its defense of tax proceedings brought against it, the Head of Yukos' Legal Department, Mr. Gololobov, was arrested and his computers and documents confiscated. In July 2004, at the time of the enforcement

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855 *Special forces raid Russian oil firm's headquarters*, The Daily Telegraph, 4 July 2004 Exh. C-690; *Yukos raided, banks declare it in default*, Gazeta, 5 July 2004, Exh. C-691; *Police Surround Yukos Headquarters*, The Moscow Times, 5 July 2004, Exh. C-692; *Police raid threatens Yukos oil production*, The Guardian, 5 July 2004, Exh. C-693; *Top Yukos executives flee threat of arrest*, The Financial Times, 25 November 2004, Exh. C-725; *Prosecutor General Gets Busy with Yukos Staff*, Kommersant, 17 December 2004, Exh. C-733.

856 Memorial ¶¶ 143–51.

857 *Russia Seeks To Prosecute Two More At Yukos*, NY Times, 19 November 2004 Exh. C-723; *Prosecutor General Gets Busy with Yukos Staff*, Kommersant, 17 December 2004 Exh. C-733; *Yukos Lawyer Shows Signs of Three Crimes*, Kommersant, 12 January 2005 Exh. C-747; *Moscow court upholds arrest warrant for Yukos lawyer*, RIA Novosti, 26 December 2005 Exh. C-788; *Yukos Lawyer, a Mother of Two, Gets 7 Years*, The Washington Post, 20 April 2006 Exh. C-800. *See also*, more recently, *Khodorkovsky v. Russia 2* ¶¶ 634–48, 931–32 and the Parties' respective submissions of 30 August 2013 on that judgment.

858 Schmidt WS ¶¶ 16–18; *Striving for Judicial Independence: A Report into Proposed Changes to the Judiciary in Russia*, International Bar Association Human Rights Institute Report, June 2005 Exh. C-601; Letter from the IBA Executive Director to General Procurator of the Russian Federation (undated) Exh. C-604; Witness Statement of Pavel Petrovich Ivlev of 15 March 2006 in *Mikhail Borisovich Khodorkovsky v. The Russian Federation*, ECtHR, (Application No. 11082/06), Exh. C-441; *Family of Yukos Lawyer Detained*, Kommersant, 9 February 2005, Exh. C-750.

859 Schmidt WS ¶¶ 20–22.

860 *Ibid*. ¶¶ 16(3) and 17.

proceedings by the court bailiffs for the tax assessments and the service by the Tax Ministry of the Field Tax Audit Report for 2001, an estimated 100 officials raided Yukos' headquarters on a Saturday afternoon, confiscating computer servers. At the time of the forced sale of YNG in December 2004, there were further raids on Yukos offices and personnel.[861] Searches were carried out in the offices of Yukos' external lawyers, ALM Feldmans, who also faced an extensive audit of their own after the search.

785. On 31 May 2005, the Meshchansky Court of the city of Moscow sentenced Messrs. Khodorkovsky and Lebedev to nine years in prison on charges of fraud and tax evasion, following a trial that was widely criticized for its lack of due process.[862] Mr. Schmidt, himself intimately involved with the trial, stated he had never seen "such a mockery of justice and violations of the most basic standards of due process and fundamental rights, including the right to a fair trial, at all stages of a case."[863] Similar observations were made by Russian and international media outlets and opposition parties within Russia.[864] Messrs. Khodorkovsky and Lebedev were transferred to Siberia to serve their sentences in remote penal colonies, and their sentences were reduced on appeal to 8 years, which Claimants maintain was in violation of Russian law at the time.[865]

786. Meanwhile, a number of Yukos associates who had fled Russia were subject to extradition requests from the Russian Federation, none of which were granted by the courts of the countries where they were residing. Mr. Nevzlin mentioned his trial *in absentia* and Israel's refusal to extradite him to Russia.[866] In 2005 and 2007, courts in the United Kingdom refused to extradite former financial and business managers of Yukos, on the basis that the prosecutions were "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."[867] Courts in Lithuania, Cyprus and the Czech Republic also refused to extradite

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861 Memorial ¶ 155.

862 Memorial ¶ 520–47, Reply ¶ 30.

863 Schmidt WS ¶¶ 16(4)(5), 23, 26. He recounted how Mr. Khodorkovsky's lawyers were denied the opportunity to meet with him in crucial weeks to prepare for the defence.

864 *Yukos verdict alarms Russia press*, BBC News, 1 June 2005, Exh. C-753; *Khodorkovsky sentenced, Russia Guilty*, International Herald Tribunal, 2 June 2005, Exh. C-754.

865 Reply ¶¶ 39–40.

866 Nevzlin WS ¶ 14, Transcript, Day 8 at 28.

867 Memorial ¶¶ 189–92, *The Government of the Russian Federation v. Dmitry Maruev and Natalya Chernysheva*, Bow Street Magistrates' Court, 18 March 2005, Exh. C-462. *See also The Government of the Russian Federation v. Alexander Vikotrovich Temerko*, Bow Street Magistrates' Court, 23 December 2005, Exh. C-464; *The Government of*

former Yukos managers or former Yukos service providers on the basis of the political dimensions of the underlying requests.[868]

787. In late 2003, most of the shares in Yukos held by Claimants Hulley and YUL were seized by the Russian courts and remained frozen until the liquidation of Yukos in November 2007.[869] The shares owned by Claimant Veteran, which were held in a Swiss bank account, were also subject to an asset freeze following a request for mutual legal assistance from the Russian Federation to Switzerland. However, in June 2004, the Swiss Federal Tribunal overturned the freeze orders and released the shares. Over the following years, the Swiss courts were also engaged in mutual legal assistance requests for searches and seizures of documents of various Yukos-related entities, culminating in the Swiss Federal Tribunal expressing the view that the case against Mr. Khodorkovsky was politically motivated and "orchestrated by the regime in power with a view to subordinating the class of rich 'oligarchs' and eliminating potential or sworn political opponents."[870]

788. By late 2004, many mid-level Yukos managers and employees had been arrested, questioned or put on wanted lists, generating an atmosphere of pressure. Several of the remaining senior executives decided not to return to Russia.[871] In August 2006, the Russian Prosecutor General's office announced criminal investigations against senior level executives, including Messrs. Misamore and Theede. Mr. Misamore, noting he had never been formally notified of the charges, considers that they were part of a "general campaign to intimidate those associated with Yukos."[872] Mr. Rieger also testified about being interrogated by the Russian Prosecutor General's Office, when he was presented with a series of questions for which the investigator had already prepared his answers. He described this as:

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the Russian Federation v. Ramil Raisovich Bourganov and Alexander Gorbachev, Bow Street Magistrates' Court, 17 August 2005, Exh. C-463; *The Government of the Russian Federation v. Andrei Borisovich Azarov*, City of Westminster Magistrates' Court, 19 December 2007, Exh. C-465.

868 Memorial ¶¶ 193–97, In the matter of the Application by the Russian Federation for the extradition of Kartashov Vlatislav Nicolay, Nicosia District Court, Cyprus, Judgment, 10 April 2008, Exh. C-460; Decision to Deny Extradition of Elena Vybornova to the Russian Federation, High Court of Olomouc, Czech Republic, 31 July 2007, Exh. C-461; Decision to Grant Refugee Status to Igor Babenko, Supreme Administrative Court of Lithuania, 16 October 2006, Exh. C-468; Decision to Deny Extradition of Mikhail Brudno to the Russian Federation, Prosecutor General's Office of Lithuania, 24 August 2007, Exh. C-469.

869 Memorial ¶ 167.

870 Judgment of the Swiss Federal Tribunal, 13 August 2007, *Mikhail Khodorokovsky v. Swiss Federal Prosecutor's Office* ¶ 4, Exh. C-477. For similar conclusions reached by courts in other mutual legal assistance cases, see Exhs. C-478–82.

871 Memorial ¶ 123.

872 Misamore WS ¶ 35.

> a kind of never expected story. And if I wouldn't have been the witness of such an event, I couldn't believe this: being called as a witness, arriving, and seeing, "Here, Mr Rieger, we'd like to talk to you today. These are the questions, and wouldn't you mind to look at this document? . . . . I think this is what you'd like to say to us."[873]

Mr. Rieger refused to sign and was kept for eight hours of questioning. The next morning, the German Embassy advised him to leave the country. He has not returned to Russia since May 2006.[874] Similarly, Mr. Theede was advised by the U.S. State Department that it was not safe for him to return to Russia.[875]

789. By the time bankruptcy proceedings had started against Yukos at the end of March 2006, approximately 35 senior managers, employees and in-house counsel of Yukos had been interrogated, arrested and/or sentenced.[876] At that time, Mr. Theede appointed Vasily Aleksanyan as Executive Vice President of Yukos to serve as the main point of contact for the bankruptcy.[877] Shortly afterwards, on 6 April 2006, Mr. Aleksanyan was arrested at home by masked and armed men and charged with embezzlement allegedly committed when he was head of the Yukos legal department.[878] A few months after his detention, he was diagnosed with lymphoma and AIDS. It is alleged that he was offered medical treatment and freedom in return for evidence against Messrs. Khodorkovsky and Lebedev, an offer which he refused.[879] He remained in pre-trial detention for almost three years in conditions described by Russia's own human rights council as "simply monstrous."[880] His treatment was criticized by the ECtHR, whose initial interim measures were ignored by the Russian Federation, but after the ECtHR issued a final judgment, the authorities released Mr. Aleksanyan on bail (for USD 1.8 million) and finally dropped charges against him due to the statute of limitations.[881] Claimants' expert witness on the independence of the Russian judiciary, Dr. Sergei Kovalev, whom

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873 Transcript, Day 6 at 69.

874 Rieger WS ¶¶ 32–35.

875 Transcript, Day 11 at 16.

876 *Ioukos, un deuxième président en prison*, Libération, 8 April 2006, Exh. C-798.

877 Theede WS ¶ 30.

878 *Top Yukos official Aleksanyan detained in Moscow*, RIA Novosti, 6 April 2006, Exh. C-796; *Arrest of Yukos Oil Company Executive Vice-President is a Brutal and Unjust Attack on the Company's Attempts to Secure a Fair Bankruptcy Process*, Yukos Press Release, 7 April 2006, Exh. C-797; *Ioukos, un deuxième président en prison*, Libération, 8 April 2006, Exh. C-798.

879 As described in his testimony to the Supreme Court of the Russian Federation, 22 January 2008, Exh. C-598.

880 Jonas Bernstein, *Aleksanyan's Plight: a case of the 'Legal Nihilism' Medvedev has vowed to fight?*, Eurasia Daily Monitor, Volume 5, Issue 21, 4 February 2008, Exh. C-880.

881 ECtHR, *Aleksanyan v. Russia* (Application No. 46468/06), Judgment, 22 December 2008, Exh. C-449.

Respondent chose not to cross-examine, described Mr. Aleksanyan's treatment as "[o]ne of the most glaring examples of pressure exerted on individuals associated with Mikhail Khodorkovsky and Yukos."[882] Mr. Theede testified that the plight of Mr. Aleksanyan (who after his release from prison died at age 39)[883] demonstrated the severe risks which other persons in Russia associated with Yukos faced constantly and stated that it had become extremely difficult to manage the company.[884]

(e) Second Trial of Mr. Khodorkovsky; Allegations of Continuing Harassment and Intimidation

790. In February 2007, before Messrs. Khodorkovsky and Lebedev had served half of their prison terms, the Prosecutor-General's Office levelled new charges against them, this time for theft of oil and funds from Yukos, embezzlement and money laundering.[885]

791. Claimants describe the second trial as a "travesty of justice," a view shared by international organizations and human rights NGOs such as the International Bar Association and Amnesty International.[886] Before the verdict was issued, President Putin responded to a question during his annual televised address that: "It is my conviction that a 'thief should be in jail.' . . . we must start from the fact that Khodorkovsky's guilt has been proved in court."[887]

792. On 27 December 2010, Judge Danilkin issued his verdict finding Messrs. Khodorkovsky and Lebedev guilty of charges of embezzlement and money laundering. He sentenced them to the maximum penalty requested by the prosecution, thirteen and a half years. The verdicts were

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882 Kovalev Report ¶ 60.

883 Reply ¶ 61.

884 Transcript, Day 11 at 39. *See also* Speech of Vasily Aleksanyan before the Supreme Court of the Russian Federation, 22 January 2008, www.khodorkovksy.ru, Exh. C-598; *Russia Closes Criminal Case Against Yukos Executive Aleksanyan*, Business Week, 24 June 2010, Exh. C-893; *Aleksanyan's Death 'Practically Murder'*, The Moscow Times, 5 October 2011, Exh. C-1458.

885 *Procuracy-General of the Russian Federation completes investigation of criminal case with respect to Mikhail Khodorkovsky and Platon Lebedev*, News, 16 February 2007, The Procuracy-General of the Russian Federation Website, Exh. C-423.

886 Reply ¶ 42. *The Khodorkovsky trial: A report on the observation of the criminal trial of Mikhail Borisovich Khodorkovsky and Platon Leonidovich Lebedev*, International Bar Association Human Rights Institute, March 2009 to December 2010, September 2011, Exh. C-1334. *Unfair trial concerns cast doubt on the integrity of the conviction of Mikhail Khodorkovsky and Platon Lebedev*, Amnesty International, Public Statement of 27 December 2010, Exh. C-1330.

887 *Transcript of a Conversation with Vladimir Putin*, 16 December 2010, Official Site of the Prime Minister of the Russian Federation, Exh. C-1435. Respondent avers that the comments were taken out of context and referred to the convictions after the first trial. *See* Rejoinder ¶ 1381.

widely criticized.[888] Judge Danilkin questioned over 90 fact witnesses and reviewed an extensive documentary record. His verdict focused on a holding that in the period 1996–2003, Messrs. Khodorkovsky and Lebedev "stole" the entire oil output of the Yukos production entities, concealed the fact that the oil was "stolen" both from Yukos' shareholders and the Russian tax authorities, orchestrated the "theft" through Lesnoy and Trekhgorny entities, which led to tax evasion, and then "laundered" the proceeds of the "theft." Judge Danilkin rejected all of Mr. Khodorkovsky's arguments, including those relating to double jeopardy.[889]

793. Within a few months, the 689-page verdict was upheld on appeal, a decision noted with concern by the European Parliament, which condemned "political interference with the trial."[890] Russia's own Human Rights Council reviewed the second criminal case at the request of then President Medvedev. The Council issued a report in December 2011 which concluded that the trial was unlawful and should be annulled. The author of the report told local media there was "no evidence or substance behind the accusations of embezzlement," and that Messrs. Khodorkovsky and Lebedev had received "punishment for carrying out legal activities."[891] Other members of the Council described the verdict as "profoundly unjust", "contradictory, arbitrary and malicious," "illegal," containing "numerous legal errors and inaccuracies" and selectively prosecuted.[892]

3. Parties' Arguments and Tribunal's Observations

794. As demonstrated above, the record of this case is replete with evidence pertaining to the events underlying the so-called campaign of harassment and intimidation. The following section

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888 Reply ¶ 48. Verdict of the Khamovnichesky Court of Moscow in the second criminal case against Messrs. Khodorkovsky and Lebedev, 27 December 2010, Exh. C-1057.

889 Verdict of the Khamovnichesky Court of Moscow in the second criminal case against Messrs. Khodorkovsky and Lebedev, 27 December 2010, p. 494, Exh. C-1057 ("Arguments of the defence that the charges of embezzlement of oil and tax evasion are the same crimes because taxes, as per their theory, were paid on the stolen oil, are unsustainable. Taxes were paid on profit, and the organized group participants stole property in the form of oil. Profit is not property because it is a calculated accounting value which is a difference between income and expenses. It is impossible to steal figures, which exist in accounting records, but it is possible to commit theft of oil, which is a material value, which is property. Relations concerning the making of tax payments (taxes) to the budget are the object of a tax offence (crime) . . . While relations concerning right, title, and interest in certain property are the object of embezzlement (theft) . . .").

890 European Parliament, Resolution of 9 June 2011 on the EU-Russia summit ¶ 16, Exh. C-1315.

891 *Rights Council: Free Khodorkovsky*, The Moscow Times, 22 December 2011, Exh. C-1463.

892 Report on the Results of Public and Scientific Analysis of the Materials of the Criminal Case against M. Khodorkovsky and P. Lebedev (Judged by the Khamovnichesky Court of Moscow, Which Rendered the Corresponding Verdict on 27 December 2010) (Unanimously approved by the Russian Presidential Council for Civil Society and Human Rights on 21 December 2011), Exh. C-1290. As to Respondent's position with respect to Mr. Aleksanyan, see paragraph 806 below.

addresses (a) the credibility of Claimants' allegations of a campaign of harassment and intimidation, (b) the characterization of such events in the context of the Russian Federation's law enforcement efforts against Yukos' tax optimization scheme and (c) the actual impact of the events on Claimants' investment.

(a) Are Claimants' Allegations about a Campaign of Harassment Credible?

795. Respondent does not deny that the investigations, searches, seizures, arrests, interrogations and criminal trials took place. Respondent's main defence to the allegations is not that they are not true, but that the events complained of were legitimate and justified for purposes of law enforcement, that they were in line with practice in Russia and other countries, and that in any event they were not expropriatory and did not impair Claimants' investment.[893]

796. There are, however, some portions of the witness testimony with which Respondent takes issue. Respondent contends that Claimants' "conspiracy theory relies heavily on circumstantial evidence and sheer innuendo, attributable to the Oligarchs' public relations and lobbying campaign."[894] Respondent argues that:

> if the assessments and the subsequent enforcement measures were the product of a massive political conspiracy spanning several years and implemented by hundreds if not thousands of officials, including no fewer than 60 judges at four different levels of courts, along with a large cast of third parties worldwide, then surely, after nearly a decade of vigorous challenges, at least one document referring to this purported conspiracy would have surfaced, or one disgruntled conspirator would have reported having participated in it. Conspicuously, Claimants have offered no such evidence at all. To the contrary, they rely on double and triple hearsay renditions of purported conversations, provided by vocal opponents of the Russian Government, inaccurate and uninformed reports by political commentators, and mere speculation.[895]

797. Respondent also argues that "Claimants' hearing testimony on this issue is not credible, in light of its reliance on those who stand to gain billions of dollars if Claimants prevail."[896]

798. For example, Respondent decries Dr. Illarionov's testimony about a special unit established to come up with a theory to put Mr. Khodorkovsky away as "rank hearsay of the most grotesque

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893 Transcript, Day 3 at 184–85.

894 Counter-Memorial ¶¶ 777–823; Respondent's Post-Hearing Brief ¶ 56.

895 Respondent's Post-Hearing Brief ¶ 57, citing Transcript, Day 2 at 104–7 (Respondent's opening); Respondent's Closing Slides, pp. 282–92, 723–24.

896 Respondent's Post-Hearing Brief n.163, citing Respondent's Closing Slides, pp. 282–92.

sort, because Dr. Illarionov declined to identify the person who supposedly told him that."[897] Respondent described Dr. Illarionov's report as "manifestly not credible" because he had said nothing about it for seven years, and because he continued to serve President Putin for more than two years after hearing that report."[898]

799. The Tribunal found Dr. Illarionov to be a credible and convincing witness. He offered a satisfactory explanation for protecting the source of his information about the special unit. The Tribunal does not consider his evidence impeached merely because he had not come forward earlier with his evidence about the special unit nor that he stayed for a certain period in his position working for the President.

800. Similarly, Respondent attacks the credibility of Mr. Nevzlin's testimony on the basis that he had waited until 2010 to disclose certain facts, such as what Mr. Abramovich had told him about Mr. Khodorkovsky being targeted for political reasons.[899] When pressed as to why he had not disclosed the information in the earlier Russian criminal proceedings or the ECtHR proceedings, Mr. Nevzlin gave the following explanations:[900]

> [I]f I had spread the information about Abramovich and Putin fairly broadly, and if it had become available to the public, then from the perspective of Khodorkovsky, who is in Russian prison, I would have damaged him. . . . I would have caused him tremendous amounts of harm. . . . in the other corner facing him were Putin, Sechin and others; but I also would have turned Abramovich into an enemy of Khodorkovsky by disclosing this information.
>
> . . .
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> [After] things moved to a second absurd set of charges and a second trial, Khodorkovsky's position changed radically. He was no longer wary of a political . . . confrontation with Putin's regime because he realised that he was not going to be able to find truth in a Russian court if he tried to defend himself based on the laws . . .
>
> . . .
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> Russian courts have no interest in my position: it would be either ignored or rejected by them. Because it's not a judge who makes decision on Khodorkovsky and Lebedev; the judge just rubber-stamps decisions that are made by investigative committee and Prosecutor's Office. . . . The fact that I trust this court and tell this court a lot more than I've ever said on the matter, this is a typical position for me, because . . . if we're able to defend our interests, that would be either in courts in free countries or international courts.

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897 Transcript, Day 18 at 114.

898 Transcript, Day 18 at 114–15 (Respondent's closing). For the explanation from Dr. Illarionov about safety concerns for his source, see Transcript, Day 7 at 156.

899 Nevzlin WS ¶ 35; Transcript, Day 8 at 4–5. The Tribunal notes that in the judgment issued by the High Court in London, Mrs. Justice Gloster DBE was "not impressed" by Mr. Nevzlin as a witness (*Berezovsky v Abramovich, Berezovsky v Hine & Others* [2012] EWHC 2463 (Comm) ¶¶ 485–90, Exh. R-4654; *see also* Transcript, Day 8 at 39–40).

900 Transcript, Day 8 at 17–25.

801. The Tribunal accepts Mr. Nevzlin's explanations. The Tribunal notes again that the Russian Federation called no fact witnesses of their own to contradict or weaken the testimony of Claimants' fact witnesses. Respondent chose not to cross-examine Mr. Schmidt, simply noting instead that as he was Mr. Khodorkovsky's criminal lawyer his statement is "special pleading."[901] Respondent also chose not to cross-examine Dr. Kovalev, whose evidence, accordingly, also stands unchallenged.

802. During the Hearing on the Merits, the Chairman of the Tribunal invited Respondent's counsel:[902]

> to address the allegations of harassment: Rieger being presented by the Prosecutor's Office with a statement, "Just sign here on the bottom line"; the number of Yukos employees who were detained; Misamore, who was told "You shouldn't go back to Russia"; the campaign to make life impossible for Yukos-related officials, officers? That stands uncontradicted on the record right now. And it bothers us, my colleagues and me, and we would like to hear from the Respondent in respect of these matters.

803. With respect to Mr. Rieger, Respondent's counsel pointed out that the incident had occurred in 2006, several years after the arrest of Mr. Khodorkovsky and that "it's not atypical that an investigatory agency would have an idea of what they think a witness does or doesn't know, and might suggest to that [witness] what that evidence is and then find out from the witness whether they agree with it or disagree with it. Mr. Rieger said he didn't agree, and he didn't sign it." The Chairman recalled: "He was threatened, he was detained at the airport. This is background that speaks about the atmosphere. The Russian authorities are seen as being out to get Yukos." Respondent's counsel explained that: "I think that what you are seeing is the authorities having established that there was quite substantial fraud at many, many different levels of activity within a large company."[903]

804. The Tribunal accepts the evidence of Claimants' witnesses who testified with respect to the campaign of harassment and intimidation conducted by Respondent against Yukos. The Tribunal will now turn to the nature and consequences of the events described above.

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901 Counter-Memorial ¶ 696.

902 Transcript, Day 19 at 46 (Respondent's closing).

903 *Ibid*. at 47.

(b) Were the Actions of the Russian Federation Justified as Legitimate Law Enforcement Measures?

805. Respondent explains that its actions were consistent with a legitimate wide-scale investigation as part of "an attempt to enforce and try to understand what turned out to be one of the largest frauds in the experience of the modern Russian State."[904] Thus, in response to Mr. Kosciusko-Morizet's evidence recounting Mr. Khodorkovsky's *kompromat*, Respondent observes that this "is absolutely consistent with the fact that the authorities had valid grounds to bring criminal charges against Mr. Khodorkovsky."[905] Likewise, Respondent describes as "no surprise" that Mr. Dubov would have been advised to leave the country and warned that every shareholder of Yukos would face criminal charges. Respondent states that this is "not inconsistent with the unbroken thread of tax evasion in which Yukos engaged and for which it was held to account."[906]

806. In a similar vein, while acknowledging the unfortunate circumstances surrounding Mr. Aleksanyan's illness, Respondent remarked that "it is not shocking" that the Russian authorities were interested in Mr. Aleksanyan, given his role since 2001 in suppressing information about vulnerabilities of Yukos in the low-tax regions.[907]

807. Respondent argues that the "searches of Yukos offices and the seizures of its records as part of Russian law enforcement authorities' investigations have parallels in other countries as proper instruments of law enforcement, especially when those authorities are faced with the types of egregious violations in which Yukos engaged." Respondent cites the EU and the U.S. as jurisdictions that authorize expansive and aggressive, even armed, searches and seizures to combat financial crimes.[908]

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904 *Ibid*. at 49–52.

905 Transcript, Day 18 at 118–19 (Respondent's closing); Respondent's Post-Hearing Brief ¶ 205(iv).

906 Transcript, Day 18 at 116–17 (Respondent's closing); Respondent's Post-Hearing Brief ¶ 205(ii).

907 Transcript, Day 19 at 50 (Respondent's closing).

908 Respondent's Post-Hearing Brief ¶ 209–10. For example, in the European Union, companies are often subjected to "dawn raids", in which EU officials, without prior judicial authorization, conduct searches and seizures. *See* Transcript, Day 19 at 49–50 (Respondent's closing) ("[I]n the United States a search warrant is never executed unarmed; it's always executed by armed officers, sometimes wearing other gear that suggests something more than a simple commercial exercise. That's the way it happens. In Russia, that's the way it's always done. It's just their practice. It doesn't reflect or project anything unique to Yukos."). Claimants however point to the "very exacting standard of proof" at the ECtHR requiring "incontrovertible and direct" evidence, but that the ECtHR nevertheless accepted that "the circumstances surrounding the applicants' criminal case may be interpreted as supporting the applicants' claim of improper motives" and that "it is clear that the authorities were trying to reduce political influence

808. As for the convictions of Messrs. Khodorkovsky and Lebedev in 2005, Respondent asserts that Claimants have not criticized the conduct of the Russian appellate judges who upheld the convictions.[909] Respondent points to the ECtHR as having "rejected the central premise of Claimants' argument that Mr. Khodorkovsky was prosecuted in 2005 for political or other improper reasons."[910]

809. With respect to the second criminal trial of Messrs. Khodorkovsky and Lebedev, Respondent notes that it "had no effect on the investments at issue in these arbitrations and that, regardless, Claimants have not contested the factual bases of the charges in that trial. Their attempt to portray the charges as concerning the physical theft of oil, rather than complicated schemes of corporate abuse and sham auctions to secure underpayments of oil purchased from Yukos' subsidiaries for the Oligarchs' benefit, is manifestly baseless."[911] Respondent contends that the IBA Report was prepared without access to the full court file and without any knowledge of Russian criminal law, and that other criticisms reported by Claimants were biased and ill-informed.

810. Respondent also contends that its actions were necessary due to Yukos' attempts to obstruct Russia's investigative efforts.[912] Claimants deny that Yukos was obstructing the investigation, and note that most of the evidence relied upon by Respondent was based on interrogation records of individuals that Respondent has failed to put forward as witnesses. Claimants urge the Tribunal to treat the interrogation records with skepticism, "[g]iven the campaign of terror being waged against persons associated with Yukos and the relentless pressure deployed by the prosecutors to get Yukos' former employees or other Yukos-related persons to give false incriminating evidence against Yukos and Yukos' management."[913]

811. The Tribunal accepts that the Russian Federation had the power to conduct searches and seizures in Yukos' premises during the ongoing criminal investigations. Nevertheless, having reviewed the record, the Tribunal finds that the investigation of Yukos was carried out by the

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of 'oligarchs' and that the State was one of the main beneficiaries of the dismantlement of Yukos." *See Khodorkovsky v. Russia 2* ¶¶ 634–48, 931–32; and Claimants' submissions dated 30 August 2013 ¶ 47 concerning that judgment.

909 Respondent's Post-Hearing Brief ¶¶ 204, 206.

910 *Khodorkovsky v. Russia 1*; Rejoinder ¶ 1334.

911 Respondent's Post-Hearing Brief n.484. *See also* Rejoinder ¶¶ 1371–86.

912 Counter-Memorial ¶¶ 674–79.

913 Reply ¶¶ 77.

Russian Federation with excessive harshness. Respondent's counsel acknowledged that in the context of the large-scale fraud investigation "not everything is pretty in those circumstances, and we may each of us have circumstances that we would regret or have done differently."[914] The Tribunal considers "not pretty" to be an understatement in this case. The treatment of Yukos senior executives, mid-level employees, in-house counsel, external lawyers and related entities as described in this chapter support Claimants' central submission that the Russian authorities were conducting a "ruthless campaign to destroy Yukos, appropriate its assets and eliminate Mr. Khodorkovsky as a political opponent."[915] The legal consequences of Claimants' submission will be analyzed later in Part X of this Award when the Tribunal considers the alleged violations of Chapter III of the ECT.

812. The Tribunal will now examine the effect on Yukos, as a matter of fact, of the campaign of harassment and intimidation waged against it by Respondent.

(c) Did the Events Complained of Impact Claimants' Investments or was Yukos Able to Carry on Unaffected?

813. Having noted that the record is replete with evidence of intimidation and harassment of Yukos personnel by the Russian authorities, the key question for the Tribunal is whether such intimidation and harassment actually disrupted Yukos' operations and thus adversely affected Claimants' investment.

814. Claimants maintain that the harassment and intimidation campaign "crippled" Yukos by prosecuting its management and paralyzing its operations through massive raids and seizures with a view to undermining the viability of Yukos.

815. Claimants' witnesses spoke of the impact that the searches, seizures and, generally, the campaign of intimidation had on the company. As noted earlier, Mr. Misamore testified that the loss of key documents created difficulties in running the company and preparing the annual financial statements.[916] Mr. Rieger stated that 60 to 70 percent of the accounting department's documents were confiscated. He explained in his witness statement: "[w]hen you take into account the fact that all the day to day business operations of the company were reflected in

914 Transcript, Day 19 at 51 (Respondent's closing).

915 Claimants' Post-Hearing Brief, ¶ 165.

916 Misamore WS ¶ 32.

paperwork, such as invoices, bills, *etc.*, we soon reached a stage where Yukos employees didn't have access to the basic data they needed to perform their functions." He recalled that "[t]he constant threats and harassment caused many of my former colleagues to leave the company and, in the worst case, the country; a fate that I would soon share."[917]

816. Mr. Misamore described how staff retention became extremely difficult for Yukos. For example, he said that in the GAAP section of the accounting department "they all left the company because they didn't want to be harassed."[918] Similarly, in defending the company's decision to pay bonuses in 2004, Mr. Theede testified that:

> [I]t was a Stalinesque-type of environment there. It was a fearful kind of a place to have to work. We never knew when we were going to have another raid, and people would come in and, as I said yesterday, knock computers off the desks, tip desks over, and just roughneck through the place; or when someone would be called in for questioning to the Prosecutor's Office with totally unknown and illogical results. And in that kind of an environment, Yukos was not a particularly friendly place to work. We had huge concerns about retaining our employees. And if we didn't meet contractual obligations to them to pay the bonuses, it was our view that they would begin to leave. And so it was in that light that we felt it was really very important that we lived up to the obligations we had to these people, just so we could retain them and so that we could continue to operate the company. Because if we lost those people, hiring others was going to be almost impossible, because people just—it was a scary place to be, and to bring new people in—in fact, I don't really recall us being able to hire any new employees after the attack started . . .[919]

817. Respondent denies that Claimants have proven, as a matter of fact, that the harassment campaign impaired their investment.[920] As mentioned earlier, Respondent notes for example that Mr. Khodorkovsky resigned voluntarily, that Yukos' revenues in 2003 and 2004 were higher than before the arrests of Mr. Khodorkovsky and Mr. Lebedev, and that Yukos issued public statements following the arrest of Mr. Khodorkovsky to the effect that Yukos' operations were proceeding normally.

818. Respondent argues that Mr. Misamore's claims in his witness statement, seven years after the fact, about the disruptive effect of the raids, are not credible as they are contradicted by his contemporaneous statements to his colleagues, the audit committee and the board of directors in

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917 Rieger WS ¶¶ 28–29.

918 Transcript, Day 9 at 244–45.

919 Transcript, Day 11 at 15–16.

920 Rejoinder ¶¶ 1338–45, ¶¶ 1387–99; ¶¶ 1400–34. Respondent's Post-Hearing Brief ¶¶ 200–206. *See also* Respondent's submissions of 30 August 2013 ¶ 7, concerning *Khodorkovsky v. Russia 2*.

2003.[921] Respondent points to the following evidence in the record:

- The working group set up to deal study the effect of the government's actions confirmed that as at August 2003, despite the searches and seizures, "[o]perational activities [were] proceeding normally" and as at September 2003 "there had been no new adverse developments" and it was "business as usual"[922]
- Yukos stated on a conference call with financial analysts in November 2003 that Mr. Khodorkovsky's arrest and subsequent resignation had "no impact whatsoever on [its] operations"[923]
- Some 16 months later, Yukos stated to investors and the press that it "was extremely healthy."[924]
- The January–March 2004 internal Yukos newsletter publishing 2003 operational results of Yukos shows that the Company was not disrupted.[925]

819. The Tribunal views these statements of Yukos officers pertaining to the well-being of the company as an attempt by Yukos to project to its investors an image of stability and thus maintain their confidence. It is obvious to the Tribunal that a company which was targeted in the way Yukos was during those many years had to be severely affected and that its operations could not be managed by its officers and other employees in the normal and usual manner. In short, the Tribunal agrees with Claimants that, as a matter of fact, Respondent's aggressive campaign against Yukos impacted significantly the management of the company.

820. Having reviewed the abundant evidence in the record of the intimidation and harassment of Yukos' senior executives, mid-level employees, in-house counsel and external lawyers by the Russian authorities, the Tribunal is convinced that such intimidation and harassment not only disrupted the operations of Yukos but also contributed to its demise and thereby damaged Claimants' investment.

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921 Transcript, Day 19 at 87–88,

922 Rejoinder ¶ 1422, Respondent's Post-Hearing Brief ¶ 207, Report of Working Group, 25 September 2003, Exh. R-4102.

923 *Yukos Conference Call on Recent Developments – Final*, Financial Disclosure Wire, 5 November 2003, Exh. R-3991.

924 *Russia's Yukos says interim oil output up 5.3% on year in 2004*, Prime-TASS Energy Service, 21 March 2005, Exh. R-509.

925 Yukos Review, January–February–March 2004, Exh. C-23.

821. The Tribunal will now turn its attention to another chapter in Claimants' litany of conduct by the Russian Federation alleged to have negatively impacted their investment.

D. THE UNWINDING OF THE YUKOS–SIBNEFT MERGER

1. Introduction

822. In April 2003, Yukos, which was then Russia's largest oil company, announced plans to merge with Sibneft, then Russia's fourth largest oil company, into a new entity that would be called YukosSibneft Oil Company and constitute the world's fourth largest private oil producer.

823. Steps were taken to effectuate the merger between April and October 2003. By 3 October 2003, the main components of the transaction (a share purchase and a share exchange between Yukos' and Sibneft's principal shareholders) had been completed. An Extraordinary General Meeting ("**EGM**") of Yukos' shareholders was scheduled for 28 November 2003 for the approval of the merger's final details.[926] However, shortly before the scheduled meeting, the Sibneft shareholders announced their intention to halt the merger process.[927]

824. Ultimately, the share exchange component of the merger was invalidated through a series of court cases in Moscow and the Russian Far Eastern province of Chukotka,[928] and Sibneft was acquired by the Russian Federation through the State-owned company Gazprom.[929]

825. Claimants submit that Respondent was responsible for the unwinding of the merger, making it "one of the first casualties" of the Russian Federation's assault on Yukos.[930] According to Claimants, Sibneft's decision to halt the merger process was the direct result of Mr. Khodorkovsky's arrest. The arrest led Sibneft to insist on a change of the senior executives of the merged entity. This request was not acceptable to Yukos and the deal was aborted. Claimants also argue that the Russian courts were then "only too happy to lend their assistance" by invalidating parts of the merger on spurious grounds, paving the way for the Russian

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926 Minutes No. 120/1-21 of the Board of Directors of Yukos, 25 September 2003, pp. 8–9, Item 11, Exh. C-1103.

927 Misamore WS ¶ 37; Memorial ¶ 208; Counter-Memorial ¶ 326.

928 Appeal Resolution of the Moscow Arbitrazh Court of 31 May 2004, Exh. C-72; Resolution of the Federal Arbitrazh Court for the Moscow District of 26 August 2004, Exh. C-73; Resolution of the Federal Arbitrazh Court for the Far-East District, 25 April 2006, Exh. C-78.

929 Memorial ¶¶ 231−37.

930 *Ibid*. ¶ 199; Reply ¶ 95.

Federation's acquisition of Sibneft.[931] Claimants' primary damages claim of USD 114.174 billion reflects the value of YukosSibneft as a successfully merged entity. Alternatively, Claimants submit that if the Tribunal does not hold Respondent responsible for the unwinding of the merger, the damages claim should be reduced by approximately USD 6 billion.[932]

826. Respondent denies any responsibility for the unwinding of the merger. Sibneft, Respondent argues, was neither exercising governmental authority nor acting under the instructions of Russian state organs. The Russian Government in fact supported the merger. Moreover, Sibneft's leaders had every right to insist on changes to the management of the merged entity due to concerns about Mr. Khodorkovsky's arrest and charges of criminal activities against him; in so doing, they were acting "in the pursuit of their own legitimate commercial interests."[933] As for the Moscow and Chukotka courts, Respondent submits that they acted in accordance with Russian company law. Respondent also suggests that Yukos acquiesced in the court proceedings as they allowed Yukos to cancel the merger without obtaining the approval of minority shareholders and thus risking further claims being brought against it.[934]

827. In this chapter, the Tribunal will consider the circumstances of the Yukos−Sibneft merger and seek to determine whether the Russian Federation is responsible for the unwinding of the merger. The Tribunal's view on this issue may have an impact on the quantum of damages the Tribunal may ultimately award Claimants. The Tribunal will also consider in this chapter whether the merger was an important factor, as Claimants submit, in Yukos' decision not to pursue its ADR listing on the NYSE. The Tribunal recalls that Respondent argues that Yukos' decision was taken because the company had concerns about elements of its tax optimization scheme. The Tribunal will also consider Yukos' declaration of a USD 2 billion interim dividend in November 2003 ("**2003 Interim Dividend**"), which Respondent argues was intended to shield this sum from the reach of the Russian tax authorities.[935]

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931 Reply ¶¶ 135−37.

932 *Ibid*. ¶¶ 859, 861; Second Expert Report of Brent Kaczmarek, 15 March 2012 ¶¶ 65; 75−76.

933 Counter-Memorial ¶¶ 322–30; Rejoinder ¶¶ 776–79.

934 Rejoinder ¶¶ 805−06.

935 *Ibid*. ¶¶ 809−23.

2. Chronology

828. In the context of arguments about the Yukos−Sibneft merger, Respondent has accused Claimants of fighting a "losing battle with the calendar,"[936] while Claimants have accused Respondent of attempting "to rewrite history".[937] The Tribunal therefore considers it useful to lay out a short chronology of key events.

(a) Merger is Announced; NYSE Listing is Put on Hold; Steps are Taken to Complete Merger

829. On 22 April 2003, Yukos and Sibneft announced their merger in a press release describing the principal features of the transaction.[938] The merger would be achieved in two parts. Firstly, Yukos would acquire 20 percent (minus one share) of Sibneft shares from Sibneft's principal shareholders for a cash consideration of USD 3 billion pursuant to a Share Purchase Agreement ("**Share Purchase Agreement**"). Secondly, Yukos would acquire 72 percent (plus one share) of Sibneft shares from Sibneft's principal shareholders in exchange for 26.01 percent of the fully diluted share capital of Yukos pursuant to a Share Exchange Agreement (the "**Share Exchange Agreement**").[939]

830. A few days after the merger was announced, President Putin stated that he had approved the transaction in a meeting with Mr. Khodorkovsky, Mr. Roman Abramovich (a Board member and significant shareholder of Sibneft) and Mr. Evgeny Shvidler (Sibneft's CEO).[940]

831. Concurrently with this announcement, the proposed listing of Yukos on the NYSE, which Yukos and a team of external advisers had been preparing for over a year, was put on hold. By then, Yukos and its advisers had conducted an extensive review of the company's operations

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936 Transcript, Day 3 at 18 (Respondent's opening).

937 Transcript, Day 17 at 11 (Claimants' closing).

938 *Yukos and Sibneft Agree in Principle to Merger*, Yukos Press Release and Sibneft Press Release, 22 April 2003, Exh. C-629.

939 Memorial ¶ 47 & n.61.

940 Nevzlin WS ¶ 26; Dubov WS ¶ 69; *Sibneft President Eugene Shvidler comments on upcoming merger with Yukos to create YukosSibneft, a new international energy super major*, BusinessWeek Online, 21 May 2003, Exh. C-634.

for purposes of drafting the required SEC form.[941] A first draft had been circulated in June 2002 and a near final draft had been circulated on 19 March 2003.[942]

832. From April to October 2003, steps were taken to complete the merger. On 30 April 2003, Yukos and Sibneft's principal shareholders signed the Share Purchase Agreement[943] and the Share Exchange Agreement.[944] The share exchange component of the merger was broken down into two tranches: the exchange of 57.5 percent of Sibneft shares for newly issued shares in Yukos representing 17.2 percent of Yukos' fully diluted share capital and the exchange of 14.5 percent of Sibneft shares for 8.8 percent of Yukos shares (consisting of a mixture of newly issued shares, treasury shares and shares acquired through a share buy-back).[945]

833. On 1 May 2003, Yukos' and Sibneft's principal shareholders signed a Shareholders' Agreement, which specified, *inter alia*, that the Yukos shareholder group would nominate the "Senior Management Positions."[946] On 27 May 2003, Yukos' shareholders approved the merger.[947]

834. On 30 May 2003, Yukos made a first cash payment of USD 1.25 billion pursuant to the Share Purchase Agreement.[948] On 30 June 2003, the Yukos Board of Directors adopted resolutions

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941 *See* Memorandum from Mr. Maly to Mr. Sheyko, 22 April 2002, Exh. R-184.

942 Reply ¶¶ 101–02; Draft Yukos F-1 Form and Registration Statement Under the Securities Act of 1933, 19 March 2003, Exh. C-1067.

943 Deed of Share Purchase between Kravin Investments Limited, White Pearl Investments Limited, Marthacello Co Limited, N.P. Gemini Holdings Limited, Heflinham Holdings Limited and Kindselia Holdings Limited, and Yukos Oil Company, 30 April 2003, Exh. C-1101 (hereinafter the "Share Purchase Agreement"). In another arbitration, Yukos' lawyers described the Sibneft shareholders party to the Share Purchase Agreement as "companies incorporated under the laws of Cyprus . . . [and] ultimately controlled by Roman Abramovich, the owner of Chelsea Football Club and Governor of Chukotka." S*ee Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, ¶¶ 10−12, Exh. R-3601.

944 Deed of Share Exchange between Kravin Investments Limited, White Pearl Investments Limited, Marthacello Co Limited, N.P. Gemini Holdings Limited, Heflinham Holdings Limited and Kindselia Holdings Limited, and Yukos Oil Company, 30 April 2003, Exh. C-1100 (hereinafter the "Share Exchange Agreement").

945 *Ibid*; *see* Memorial ¶ 47.

946 Shareholders' Agreement in respect of Yukos Oil Company among Yukos Universal Limited (hereinafter "YUL"), Hulley Enterprises Limited (hereainfter "Hulley"), White Pearl Investments Limited, N.P. Gemini Holdings Limited, Marthacello Co. Limited, Kindselia Holdings Limited, Heflinham Holdings Limited and Kravin Investments Limited, 1 May 2003, Article 6.1, Exh. C-1102.

947 Minutes No. 2 of the Extraordinary General Meeting of Yukos Shareholders, 27 May 2003, Exh. C-50; *Extraordinary meeting of YUKOS shareholders adopts decision associated with realization of transaction with Sibneft*, Yukos Press Release, 28 May 2003, Exh. C-635.

948 Receipt from Kravin Investments Limited, 30 May 2003, Exh. C-54; *see* Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements, 30 June 2003, p. 9, Exh. C-30.

with respect to the merger.[949] In July and August 2003, regulatory approvals were obtained for the merger.[950] On 28 August 2003, Yukos made a further cash payment of USD 500 million pursuant to the Share Purchase Agreement.[951]

835. On 25 September 2003, the Yukos Board of Directors set 28 November 2003 as the date for the EGM at which final details for the merger would be submitted to shareholders.[952]

836. On 2 October 2003, Yukos made a final cash payment of USD 1.25 billion pursuant to the Share Purchase Agreement.[953]

837. On 3 October 2003, Yukos acquired 72 percent plus one share of Sibneft shares, in exchange for 26.01 percent of Yukos shares, pursuant to the Share Exchange Agreement.[954]

838. Thus, by 3 October 2003, with both the share purchase and share exchange components of the transaction complete, Yukos had acquired 92 percent of Sibneft. The remaining steps for implementing the merger included the "full operational integration" of the two companies, changing the name of Yukos to YukosSibneft and electing a new board of directors.[955]

(b) Mr. Khodorkovsky is Arrested; Yukos Continues with Merger; Sibneft has Second Thoughts

839. The Tribunal recalls that Mr. Khodorkovsky was arrested on 25 October 2003.

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949 *Board of Directors of YUKOS Oil Company approves issuance of up to 1 billion shares*, Yukos Press Release, 7 July 2003, Exh. C-639.

950 Notification of the State registration of the additional share issue by the Federal Commission for the Securities Market, 23 July 2003, Exh. C-51; Opinion and Directive issued by the Ministry for Antimonopoly Policies and Support to Entrepreneurship, 14 August 2003, Exh. C-52.

951 Receipt from Kravin Investments Limited, 28 August 2003, Exh. C-55; *see* Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements, 30 June 2003, p. 9, Exh. C-30.

952 Minutes No. 120/1-21 of the Board of Directors of Yukos, 25 September 2003, pp. 8–9, Item 11, Exh. C-1103.

953 Receipt from Kravin Investments Limited, 2 October 2003, and account statement evidencing payment of USD 1.25 billion under the Share Purchase Agreement, Exh. C-57; *see* Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements, 30 June 2003, p. 9, Exh. C-30.

954 Account statements evidencing transfer of 57.5 percent of Sibneft (2,724,362,618 shares) to Yukos under the Share Exchange Agreement, 3 October 2003, Exh. C-58; Notices of transaction and account statements evidencing transfer of 17.2 percent of Yukos (463,517,826 shares) to Sibneft's principal shareholders under the Share Exchange Agreement, 3 October 2003, Exh. C-59; Account statements evidencing transfer of 14.5 percent of Sibneft (689,373,122 shares) to Carenet under the Share Exchange Agreement, 10 October 2003, Exh. C-60; Account statements evidencing transfer of 8.8 percent of Yukos (238,879,333 shares) to Sibneft's principal shareholders under the Share Exchange Agreement, 10 October 2003, Exh. C-61; Yukos Oil Company U.S. GAAP Interim Condensed Consolidated Financial Statements, 30 June 2003, p. 9, Exh. C-30.

955 Memorial ¶¶ 54, 208; *Sibneft Principal Shareholders and Yukos Oil Company Finalize Merger Transaction*, Yukos Press Release and Sibneft Press Release, 3 October 2003, Exh. C-648.

840. On 28 October 2003, the Yukos Board of Directors recommended, in view of the capital restructuring of the company in anticipation of the merger, that shareholders approve the 2003 Interim Dividend of USD 2 billion to all shareholders of record as at 25 September 2003.[956] Mr. Khodorkovsky resigned as CEO of Yukos on 3 November 2003. Yukos then issued a press release which named the persons it would nominate to the new management board of the merged YukosSibneft entity.[957] Mr Khodorkovsky was not on that list. On 21 and 22 November 2003, Yukos and Sibneft senior executives met to discuss the logistics of the merger.[958]

841. In late November, the media reported that Mr. Abramovich had met with President Putin to discuss the Yukos–Sibneft merger. Reference was made to the fact that "Abramovich is understood to have raised the prospect of changing the management team of the combined company with Putin, who welcomed the idea."[959]

842. In his witness statement, Mr. Nevzlin narrates that he had met with Mr. Abramovich in "late 2003" in Tel Aviv and that he had been told that

> YukosSibneft could be saved if the management of the merged company was transferred to his team . . . President Putin had told Roman Abramovich that Mikhail Khodorkovsky had been targeted because of his involvement in politics and . . . was too angry with Mikhail Khodorkovsky to even discuss his release.[960]

843. Shortly before the Yukos EGM scheduled for 28 November 2003, representatives of Sibneft's principal shareholders summoned representatives of Yukos' principal shareholders and advised them that they no longer wished to proceed with the merger. They asked that steps be taken to unwind the merger.[961] However, the EGM was held as scheduled. The agenda included: (a) early termination of the powers of board members and election of a new board; (b) approval of new articles of association (including a name change to YukosSibneft); and (c) payment of

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956 Abstract from Minutes No. 120/1-24 of the Meeting of the Board of Directors of Yukos, 28 October 2003, Exh. R-3605.

957 *YukosSibneft Proposed Management Board*, Yukos Press Release, 4 November 2003, Exh. C-666.

958 Agenda, material and list of attendees for 21−22 November 2003 meeting, Exh. C-62.

959 *Abramovich met Putin before vetoing Yukos−Sibneft merger*, The Sunday Telegraph, 30 November 2003, Exh. C-669.

960 Nevzlin WS ¶¶ 27, 35.

961 Memorial ¶ 208; Counter-Memorial ¶ 326; *see Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, Exh. R-3601. Around the same time as Sibneft advised Yukos it was pulling out of the merger, the media reported that an economic and tax crimes unit of Russia's interior ministry had announced it had no questions for Mr. Abramovich. *Kremlin seen as a deep well of influence*, The Financial Times, 29−30 November 2003, Exh. C-668.

the 2003 Interim Dividend. Claimants voted against the election of Sibneft's nominees to the Yukos Board of Directors, abstained on the vote to change the company's name to YukosSibneft and voted to approve the dividend.[962]

844. After the EGM, Yukos' principal shareholders proceeded as if the merger was still going forward. For example, on 2 December 2003, GML issued a press release stating that the merger agreements remained in full effect.[963] On 8 December 2003, Claimant Hulley received payment for the 2003 Interim Dividend.[964] At the same time, Yukos and its principal shareholders were exploring options to negotiate the unwinding of the merger with Sibneft.[965] Yukos continued to resist Sibneft's proposal to appoint Sibneft nominees as members of the merged entity.[966]

(c) Russian Courts Invalidate the Share Exchange Agreement

845. On 19 January 2004, a few weeks after Yukos received the 2000 Tax Audit Report, NP Gemini Holdings Limited and Nimegan Trading Limited, two former Sibneft shareholders,[967] applied to a Moscow court to have the issue of Yukos shares carried out in the context of the first tranche of the share exchange declared invalid.[968] On 1 March 2004, the Moscow Arbitrazh Court annulled the share issue.[969] The decision was upheld on appeal on 31 May 2004 and confirmed

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962 Agenda for the Extraordinary General Shareholders' Meeting of Yukos Oil Company, 28 November 2003, Exh. R-3606; *Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, Exh. R-3601; Misamore WS ¶¶ 22, 37; *Completion of Yukos−Sibneft Merger Suspended*, Interfax, 28 November 2003, Exh. R-3609 (quoting Mr. Nevzlin as saying: "The Sibneft shareholders came to us this week and told us some technical difficulties had emerged. They asked for Yukos charter amendments to be taken off the agenda at today's meeting and to leave the board of directors intact. We coordinated our voting with [the Sibneft shareholders]. As for the Yukos dividends, we voted for Yukos"); *see Yukos Oil Company Shareholders' Meeting approves dividend of about $2 billion*, Yukos Press Release, 28 November 2003, Exh. C-666.

963 *Yukos Sibneft Merger*, Company News, Group Menatep Website, 2 December 2003, Exh. C-670.

964 Transcript, Day 9 at 22−24 (cross-examination of Mr. Misamore).

965 *Statement on the Status of Negotiations with Representatives of Former Principal Shareholders of Sibneft*, Yukos Press Release, 17 December 2003, Exh. C-672.

966 *Yukos Oil Company retains consultants for negotiations with former Sibneft core shareholders*, Yukos Press Release, 2 February 2004, Exh. C-680; Misamore WS ¶ 37.

967 At the time of the application, the two petitioners were Yukos shareholders. NP Gemini Holding Limited was a former principal shareholder of Sibneft and had participated in all the steps of the merger. Nimegan Trading Limited was already a shareholder of Yukos when the Share Exchange Agreement was signed, with less than 0.001 percent of Yukos shares. According to Claimants, both companies were linked to Mr. Abramovich through Millhouse Capital, an investment company that manages Mr. Abramovich's assets. Memorial ¶¶ 216–19.

968 Petition to declare the FCSM (Federal Commission for the Securities Market) decision to register the issuance of securities unlawful, and to declare as null and void the issuance of the securities, 19 January 2004, Exh. C-71.

969 Decision of the Moscow Arbitrazh Court, Case No. A40–2353/04–92–35, 1 March 2004, Exh. R-549.

by the Federal Arbitrazh Court on 26 August 2004.[970] Accordingly, in September 2004, Yukos returned to Sibneft's shareholders the 57.5 percent shareholding in Sibneft it had received in exchange for its newly issued shares. Yukos' shareholding in Sibneft was then reduced to 34.5 percent.[971]

846. On 6 July 2004, Nimegan Trading Limited commenced legal proceedings against Yukos and others before the Arbitrazh Court of Chukotka, the Russian Far Eastern province where Mr. Abramovich was governor, seeking to have the second tranche of the share exchange (concerning a 14.5 percent stake in Sibneft) declared invalid. In order to confer jurisdiction to the Chukotka Court, a defendant related to Mr. Abramovich had opened a bank account in the Chukotka province on the day that Nimegan paid the filing fee. The other nominal defendants all supported the court action.[972] The Chukotka Arbitrazh Court invalidated the second tranche of the share exchange on 14 September 2004. After a series of appeals, this decision was ultimately confirmed by the Federal Arbitrazh Court for the Far-East District in April 2006,[973] following which Yukos returned the 14.5 percent shareholding in Sibneft obtained through the second tranche of the share exchange to Sibneft's shareholders. Yukos' shareholding in Sibneft was then reduced to the 20 percent minus one share acquired pursuant to the Share Purchase Agreement.

847. On 30 September 2004, Yukos commenced an LCIA arbitration against the former principal shareholders of Sibneft, seeking an injunction prohibiting the respondents from initiating, continuing or encouraging any proceedings in the Russian courts to invalidate the share exchange.[974] Ultimately, the arbitration would be discontinued by Yukos' Russian bankruptcy receiver, Mr. Eduard Rebgun.[975]

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970 Appeal Resolution of the Moscow Arbitrazh Court, 31 May 2004, Exh. C-72; Resolution of the Federal Arbitrazh Court for the Moscow District, 26 August 2004, Exh. C-73.

971 Yukos' withdrawal instructions to Custody Department of Deutsch Bank, 24 September 2004, Exh. C-74.

972 Payment Order for filing fee for the Chukotka proceedings, 27 May 2004, Exh. C-75; Petition to Declare Invalid an Interested Party Transaction and to Apply the Consequences of the Invalidity of the Transaction, 6 July 2004, Exh. C-76; Documents relating to the opening of Marthacello's bank accounts in Chukotka, 8 July 2004, Exh. C-77.

973 Resolution of the Federal Arbitrazh Court for the Far-East District, 25 April 2006, Exh. C-78.

974 *Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Request for Arbitration, 30 September 2004, Exh. R-3600; *Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, Exh. R-3601.

975 Misamore WS ¶ 37.

(d) Russian Federation Ultimately Acquires Sibneft via Gazprom

848. In 2005, the Russian State-owned company Gazprom acquired 75.68 percent of Sibneft shares from Sibneft's principal shareholders for around USD 15 billion.[976] In May 2006, Sibneft changed its name to OAO GazpromNeft.[977]

849. The Tribunal notes that the 20 percent minus one shareholding in Sibneft that Yukos had acquired under the Share Purchase Agreement was sold in Yukos' bankruptcy auctions in April 2007 to EniNeftegaz, an Italian company,[978] and that in 2009, Gazprom exercised a call option (which had been in place since April 2007) to purchase the Sibneft shares from EniNeftegaz for the sum of USD 4.1 billion.[979]

3. Parties' Arguments and Tribunal's Observations

(a) Was Yukos' NYSE Listing Put on Hold Because of the Yukos−Sibneft Merger or Fears of Exposing Yukos' Tax Optimization Scheme?

850. Claimants maintain that Yukos' proposed NYSE listing was put on hold in April 2003 as a result of the proposed Yukos−Sibneft merger and the need to conduct further due diligence.[980]

851. In his witness statement, Mr. Misamore stated that

> Yukos' plan to obtain a Level 2 or 3 ADR listing on the NYSE was put on hold because of the decision in the beginning of 2003 to merge with Sibneft . . . and the need for further due diligence with respect to Sibneft to ensure complete transparency and financial statement accuracy before proceeding with any kind of listing of the merged company.[981]

852. Mr. Misamore confirmed this statement in his re-direct examination before the Tribunal:

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976 Gazprom 2005 Annual Report (excerpts), Exh. C-370; *Shares and Registrar*, Gazprom Neft Website, Exh. C-389; *Gazprom and Millhouse Capital Sign Legally Binding Documents for Purchase/Sale of 72.663 percent Stake in Sibneft*, Gazprom Press Release, 28 September 2005, Exh. C-771; *Management Committee Approves Gazprom's Buying into Sibneft*, Gazprom Press Release, 28 September 2005, Exh. C-772; *Gazprom agrees $13bn deal with Abramovich*, The Financial Times, 29 September 2005, Exh. C-773.

977 *Sibneft Changes Name to Gazprom Neft*, The Moscow Times, 16 May 2006, Exh. C-803.

978 *Gazprom, indirectly, wins assets of Yukos*, NY Times, 4 April 2007, Exh. C-847; *Eni announces $5.83 bn acquisition of Yukos assets. Major first step into Russian upstream market*, Eni Press Release, 4 April 2007, Exh. C-849; *A Yukos Auction With a 2nd Act*, The Washington Post, 5 April 2007, Exh. C-851; *On Working Meeting Between Alexey Miller and Paolo Scaroni*, Gazprom Press Release, 17 September 2007, Exh. C-877; *Eni to keep Gazprom Neft stake until 2009*, Reuters, 9 November 2007, Exh. C-878.

979 *How Putin Put Kremlin Back on Top*, The Moscow Times, 1 February 2008, Exh. C-879.

980 *See* Reply ¶ 104.

981 Misamore WS ¶ 20.

> Mr. Khodorkovsky informed me early in 2003 that he was working on a significant transaction—that turned out to be Sibneft—and he asked me to put the F-1 registration process on hold. Certainly I could not have gone ahead with an F-1 in a significant transaction mode anyway. So we put it on hold solely as a result of what subsequently became the Sibneft transaction.[982]

853. Mr. Kosciusko-Morizet also confirmed this explanation when he testified. After referring to the considerable work done in preparation for the NYSE listing and the extensive disclosure involved, he said:

> So work was pursued during and until the end of the year and the beginning of 2003, and then in April it was interrupted by the prospect of the Sibneft-Yukos merger, which obviously was material to any filing. So negotiations were going on, and that prevented the filing of an ADR 3.[983]

854. The Tribunal notes that, in the April−June 2003 edition of the *Yukos Review*, it was reported that the merger plans were "likely to push back Yukos' listing on the New York stock exchange from later this year into 2004."[984]

855. Claimants also refer to an e-mail of 29 April 2003 from a lawyer at Akin Gump—the firm advising Yukos on its proposed NYSE listing—to Mr. Misamore reporting that the lawyer had spoken to an SEC official "to let him know about the proposed merger . . . and to tell him that although the timetable for the listing has been extended due to the merger, the company still intends to pursue a listing after the merger . . . ."[985]

856. Respondent, however, maintains that the NYSE listing project was "abandoned" not because of the merger but because of "fears that, as a result of the extensive disclosures required by the [SEC], the process would publicly reveal Yukos' 'tax optimization' program, and this in turn would lead to major tax reassessments."[986] According to Respondent:

> Whatever excuse Yukos may have provided to the SEC in March 2003 for halting its proposed NYSE listing, the possibility of a 2003 listing was in fact called off in February of that year as the result of Mr. Khodorkovsky's refusal to sign the company's registration statement out of an understandable concern for his own personal liability.[987]

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982 Transcript, Day 9 at 240.

983 Transcript, Day 4 at 72–73.

984 Yukos Review, Issue 13, April−June 2003, p. 79, Exh. C-19.

985 E-mail from Mr. Robert Langer to Mr. Bruce Misamore, 29 April 2003, Exh. C-1384.

986 Counter-Memorial ¶ 1019.

987 Respondent's Post-Hearing Brief ¶ 77.

857. In support of its submission, Respondent refers to an exchange of e-mails of 19 and 20 February 2004 between Mr. Oleg Sheiko, Yukos' Director of Corporate Finance, and Mr. Khodorkovsky, in which Mr. Sheiko notes that Mr. Misamore had been asked by Mr. Khodorkovsky to delay the NYSE, and Mr. Khodorkovsky replies:

> If the lawyers do not confirm to me that my personal risks are limited by a reasonable period of time, I will not sign the form, because if my political career develops in 5 years, the American hook will become dangerous. I warned about this.[988]

858. Claimants did not comment on this e-mail. In the Tribunal's view, this e-mail is consistent with Mr. Misamore's testimony that, in "early 2003", Mr. Khodorkovsky had asked him to put the listing on hold due to a substantial transaction, which turned out to be the merger with Sibneft.

859. Respondent also relies on a "blackline" version of Yukos' draft filing for the SEC sent by PwC to Yukos on 23 July 2002.[989] As telling as that document may be with respect to Yukos' awareness of its tax risks,[990] the Tribunal notes that this document pre-dates by more than 9 months Yukos' decision to suspend the NYSE listing.

860. In conclusion, the Tribunal finds that Yukos' decision to put the NYSE listing project on hold in the spring of 2003 appears to have been motivated by the anticipated Yukos–Sibneft merger.

(b) Was the 2003 Interim Dividend a Component of the Yukos−Sibneft Merger or a Means to Siphon Funds out of Russia?

861. Claimants submit that the timing and amount of the 2003 Interim Dividend were solely related to and dictated by the Yukos−Sibneft merger. They write:

> Yukos and Sibneft had agreed to target specific levels of net debt intended to reflect the relative values of the individual companies prior to the completion of the merger. At that time, Yukos was substantially underleveraged as compared to Sibneft, with significant cash reserves. It was therefore agreed that in order to leverage up and meet its target net debt level, Yukos would undertake the payment of dividends, a share buy-back and/or the taking out of a loan. The 2003 interim dividend was therefore part of the Company's efforts to match the capital structure of Yukos and Sibneft, and return value to its shareholders prior to the completion of the merger, as is confirmed by the contemporaneous documentation.[991]

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988 E-mail from Mr. Oleg Sheiko to Mr. Mikhail Khodorkovsky, 19 February 2003 and reply e-mail from Mr. Mikhail Khodorkovsky to Mr. Oleg Sheiko, 20 February 2003, Exh. R-3611.

989 Extract from Yukos' Draft F-1 Form, 23 July 2002, Exh. R-1477.

990 As to which, see paragraph 491 above.

991 Reply ¶ 115 (footnote omitted); *see* Transcript, Day 17 at 7–11 (Claimants' closing).

862. With respect to the "contemporaneous documentation", Claimants refer to Yukos' press release of 22 April 2003 announcing the merger, which stated that

> [p]rior to completing the transaction, YUKOS intends to increase its leverage and is considering, among other things, cash distributions to its shareholders in the form of dividends and share buybacks. It is expected that after such capital restructuring and the completion of the transaction, YukosSibneft will have a moderate level of leverage and a strong working capital position.[992]

863. Claimants also refer to analysts' reports from the same period, which are all consistent with their submission. For example, a Brunswick UBS Report dated 23 April 2003 stated that "Yukos has every reason to leverage up further—if its leverage reached levels similar to Sibneft . . ., implying $3.75 bn of new debt, Yukos could return $5.15 bn to shareholders . . . *before* the deal."[993] An internal Yukos PowerPoint presentation about the merger also referred to the plan to declare a dividend in order to achieve the targeted net debt level.[994] Mr. Misamore testified that the 2003 Interim Dividend was "an integral part" of the merger transaction:

> [The approval and payment of the dividend] was entirely related to the Sibneft transaction . . . [A]s part of the Sibneft transaction it was a desire of both of the shareholder groups to have a capital structure in YukosSibneft which did not disadvantage either of the two shareholder groups. And therefore there were a series of transactions in association with the Sibneft merger/acquisition that were undertaken, including share repurchases, the bank debt, the payment of the dividend . . . and that was the reason for the dividend[, it] was the very last step in the consummation of the Sibneft transaction.[995]

864. Claimants explain that the decision to pay the 2003 Interim Dividend was taken in three steps.[996] Firstly, on 25 September 2003, when the Yukos Board of Directors scheduled for 28 November 2003 an EGM of Yukos' shareholders for purposes of approving the merger, the agenda included as an item "payment of dividend for 9 months of 2003."[997] Secondly, on 28 October 2003, the Yukos Board of Directors set the amount of and process for approving and

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992 *Yukos and Sibneft Agree in Principle to Merger*, Yukos Press Release and Sibneft Press Release, 22 April 2003, Exh. C-629.

993 Brunswick UBS Report "YukosSibneft", 23 April 2003, p. 9, Exh. C-1370 (emphasis in the original). *See also* a Credit Suisse First Boston Report which predicted a dividend distribution in excess of USD 1.7 billion to shareholders as a means for Yukos to increase its net debt in the context of the merger. Credit Suisse First Boston Report "Yukos and Sibneft merge to form a GEM supermajor," 24 April 2003, p. 4, Exh. C-1371.

994 "YukosSibneft, Detailed transaction plan and Major Issues," Yukos PowerPoint Presentation, 18 June 2003, Exh. C-1068.

995 Transcript, Day 9 at 21, 236.

996 For a description of these steps, see Joint Stock Companies Law of the Russian Federation, Arts. 42–43, Exh. R-3604.

997 Minutes No. 120/1-21 of the Board of Directors of Yukos, 25 September 2003, p. 8, Item 11, Exh. C-1103.

paying the dividend.[998] Thirdly, Yukos shareholders approved the 2003 Interim Dividend at the EGM on 28 November 2003. According to Claimants, this sequence of events undermines Respondent's argument that the 2003 Interim Dividend was declared with unprecedented haste as a "clever", "eleventh hour" ploy to siphon funds out of Russia.[999]

865. In its Counter-Memorial, Respondent argues that the 2003 Interim Dividend "betrays an unusual sense of urgency on the part of those who proposed it . . . who evidently sensed the gathering storm, wanted to get as much money as possible, as quickly as possible, out of the company, and out of Russia, and into their pockets."[1000] In its Rejoinder, Respondent argues that, while the dividend might have had its origins in the Yukos−Sibneft merger, "by the time the dividend was actually declared, on November 28, 2003, the Sibneft merger had been halted and there was no longer any merger-related reason for the dividend."[1001] Respondent recalls that Sibneft's principal shareholders informed Claimants before the EGM that they no longer wished to proceed with the merger, and points out that Claimants agreed with the Sibneft shareholders not to vote for items 1 and 2 of the EGM's agenda (changes to the board and the company's articles of association), but proceeded to vote in favour of the dividend. Thus, Respondent argues, "the giga-dividend can only be explained by Claimants' desire to transfer outside the reach of the Russian authorities US$ 2 billion that could otherwise have been used to pay Yukos' taxes and other liabilities."[1002]

866. During the hearing, in response to a question from the Tribunal regarding the fact that the 2003 Interim Dividend had been planned since the spring of 2003, counsel for Respondent explained that, between this planning stage and the declaration of the dividend, "the world had changed," Mr. Khodorkovsky had been arrested and Sibneft had called off the merger, so that the "link between the declaration of the dividend and the Sibneft merger had been severed, and any prudent company, frankly, would have marshaled its resources rather than declared and paid a dividend that was unprecedented in size, at a time when it was under considerable financial pressure."[1003]

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998 Agenda for the Extraordinary General Shareholders' Meeting of Yukos Oil Company, 28 November 2003, Exh. R-3606.

999 Counter-Memorial ¶ 351.

1000 Counter-Memorial ¶ 350.

1001 Rejoinder ¶ 821.

1002 *Ibid*.

1003 Transcript, Day 18 at 162 (Respondent's closing).

867. It is not entirely clear to the Tribunal when Yukos' shareholders found out about the decision of Sibneft's shareholders to withdraw from the merger.[1004] However, the exact timing does not matter. The Tribunal accepts that Sibneft's decision was communicated to Yukos shortly before the EGM, but in time for Yukos' shareholders to agree with Sibneft's principal shareholders not to vote on the first two items of the agenda.

868. Mr. Misamore testified that the Sibneft shareholders, Hulley and YUL "agreed between themselves to agree to vote for the dividend" because it was "an integral part of that [merger] transaction," although one of the parties had, at that point, changed its mind.[1005] Claimants submit that, after the Sibneft announcement, as at 28 November 2003, the completed merger transaction was still in place and the 2003 Interim Dividend was a final step in consummating the merger. The status of the transaction was not affected and there were ongoing negotiations to resolve outstanding issues with Sibneft.[1006] In fact, in an announcement by GML in December 2003, it was stated that the merger agreement remained in full effect.[1007]

869. In conclusion, the Tribunal finds that the decision to approve the 2003 Interim Dividend at the EGM on 28 November 2003 was an integral part of the merger process, which was still legally alive at the date of the EGM. Whether it was practically still alive is questionable. On balance, the evidence does not support Respondent's contention that the dividend was simply an "eleventh hour" device to siphon funds out of Russia for improper purposes. Nevertheless the Tribunal sees some force in Respondent's contention that Yukos' stockholders might have more prudently acted to conserve Yukos' resources rather than to proceed with a massive dividend whose essential rationale was evaporating.

(c) Was the Unwinding of the Merger Caused by the Russian Federation?

870. As noted earlier, the Russian Federation initially supported the Yukos−Sibneft merger. President Putin expressed his approval of the transaction in a meeting with Mr. Khodorkovsky

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1004 Some sources suggest that the announcement was made on the day of the EGM (*e.g.*, Misamore WS ¶ 37), while others state it took place on the eve of the meeting (*e.g.*, *Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, Exh. R-3601).

1005 Transcript, Day 9 at 20 (cross-examination of Mr. Misamore). However, as Respondent pointed out in its closing statement, Sibneft shareholders were not yet Yukos shareholders of record and could therefore not have voted for the dividend. S*ee* Transcript, Day 18 at 147–48.

1006 *See e.g.*, Yukos Review, Issue 16, January–February–March 2004, p. 58, Exh. C-23.

1007 *Yukos Sibneft Merger*, Company News, Group Menatep Website, 2 December 2003, Exh. C-670.

and Messrs. Abramovich and Shvidler in April 2003.[1008] In May 2003, Mr. Shvidler stated in an interview that President Putin and Prime Minister Kasyanov had encouraged him to promote the merged YukosSibneft entity as a "national-champion".[1009] On 22 July 2003, the Russian Federal Commission for the Securities Market approved the registration of new Yukos shares to be issued in connection with the merger.[1010] On 14 August 2003, the Russian Ministry for Antimonopoly Policies and Support to Entrepreneurship approved Yukos' acquisition of the Sibneft shares.[1011]

871. Following the arrest of Mr. Khodorkovsky in October 2003, Sibneft declared that it would halt the merger process unless the management team was changed.

872. Claimants argue that the Russian Federation is responsible for the unwinding of the Yukos–Sibneft merger, despite its initial support for the transaction. Claimants frame the question as one of causation. As Claimants' counsel put it: "[B]ut for the Russian Federation's attack on Yukos, the Yukos–Sibneft merger would never have been unwound. And that point is not seriously challenged by the Respondent."[1012] Claimants describe the arrest of Mr. Khodorkovsky as having "marked a radical escalation in the Russian Federation's attack on Yukos and . . . also marked the beginning of the end for the YukosSibneft merger."[1013] According to Mr. Theede:

> [A]fter [Sibneft] saw what the Russian Federation was doing to Yukos, . . . saw it being destroyed . . . and in my opinion it was a direct result of that that caused Sibneft to want to detach itself from Yukos . . . . I knew Sibneft was doing everything they could to get out of this, and they were fairly panicked because they wanted to get out before the Government destroyed our company . . . [A]s soon as Sibneft saw and learned what was happening to Yukos, they wanted out of the deal . . . . [W]e had completed the merger, we were moving ahead with it; everything was really going along quite smoothly, and I think we were all excited about it. But Mr. Khodorkovsky's arrest and the political fallout from that, and then the subsequent attack on the company that was related to

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1008 Nevzlin WS ¶ 26; Dubov WS ¶ 69; President of Russia, Official Web Portal, 24 April 2003, Exh. C-1053.

1009 *Sibneft President Eugene Shvidler comments on upcoming merger with Yukos to create YukosSibneft, a new international energy super major*, BusinessWeek Online, 21 May 2003, Exh. C-634.

1010 Notification of the State registration of the additional share issue by the Federal Commission for the Securities Market, 23 July 2003, Exh. C-51.

1011 Opinion and Directive issued by the Ministry for Antimonopoly Policies and Support to Entrepreneurship, 14 August 2003, Exh. C-52. Respondent points out that some of these approvals were given *after* the arrest of Mr. Lebedev and Mr. Nevzlin's flight to Israel. Rejoinder ¶ 792.

1012 Transcript, Day 17 at 16 (Claimants' closing).

1013 Reply ¶ 127.

> Mr. Khodorkovsky's arrest, scared Sibneft off. And there's no question in my mind that they were afraid that the attack on Yukos was going to carry over to them . . . .[1014]

873. Mr. Nevzlin also testified that "[a]fter it became apparent that Mikhail Khodorkovsky was being targeted by the Kremlin, Roman Abramovich abruptly changed his mind and sought to unwind the merger."[1015]

874. In support of their submission, Claimants mention that Mr. Abramovich met with President Putin only a few days before Sibneft's announcement of its decision to cancel the merger.[1016]

875. Respondent does not dispute that concerns over Mr. Khodorkovsky's arrest led Sibneft to change its mind about the merger. Respondent says that Sibneft's decision

> was not at all surprising, as Messrs. Khodorkovsky and Lebedev, Yukos' two leading Directors, had recently been arrested and charged with various criminal acts . . . . [Their] future leadership of the company was thus in serious doubt, and any proposed partner would have understandably been concerned . . . .[1017]

876. One London newspaper speculated that "[a]nalysts believe Mr. Abramovich's decision to cut ties with Yukos is an attempt to insulate himself from an apparently politically motivated campaign by the Kremlin against Mr. Khodorkovsky and Yukos."[1018]

877. However, Respondent forcefully denies that Mr. Abramovich's decision was made "at the behest" of President Putin. It writes in its Counter-Memorial that

> Mr. Abramovich did not need the President of the Russian Federation to tell him that Sibneft's proposed merger partner was the subject of a contentious tax dispute . . . . In the circumstances, any reasonable company would have sought to extricate itself from the planned merger, or at least to ensure that the new company was not led by two executives recently indicted for tax evasion.[1019]

1014 Transcript, Day 10 at 39–41, 46.

1015 Nevzlin WS ¶ 27.

1016 Memorial ¶ 211 (citing *Abramovich met Putin before vetoing Yukos−Sibneft merger*, The Sunday Telegraph, 30 November 2003, Exh. C-669).

1017 Counter-Memorial ¶ 326.

1018 *Abramovich pulls out of $11bn merger with Yukos*, The Independent, 29 November 2003, Exh. C-667.

1019 Counter-Memorial ¶ 767(iv); *see* Rejoinder ¶ 786.

878. According to Respondent, the meeting between Mr. Abramovich and President Putin, if at all relevant, only demonstrates that the Russian President welcomed Sibneft's proposal of a change in the management of the merged entity.[1020]

879. The Tribunal notes that the Parties agree that Sibneft was firmly of the view that the only way for the merger to be saved would be if there was a change in the senior management of the merged company, *i.e.*, if Mr Shvidler was appointed as President. Yukos was equally "adamant" that management issues were "not negotiable."[1021] As the BBC reported on 28 November 2003, the "breaking point [of the merger] came when Yukos was not ready to hand over management of the company."[1022]

880. Claimants characterize Mr. Abramovich's insistence on a change of management as "a manifestly unreasonable proposal which sought to turn the agreed terms of the merger upside-down."[1023] They refer to the terms of the initial merger agreement which provided that Yukos would nominate the "Senior Management Positions" including the President,[1024] and to the 22 April 2003 press release which announced that Mr. Khodorkovsky would be CEO.[1025] Claimants contend that Yukos' refusal to change the agreed terms of the merger was "hardly surprising" and that Respondent's "attempt to rely on such refusal to exonerate itself from responsibility for the consequences of its own actions should be rejected."[1026]

881. Respondent replies that Yukos "could and should have accommodated" the entirely reasonable concerns of Sibneft.[1027] Respondent points out that Yukos would still have nominated the other senior managers and that the CEO Yukos suggested in replacement of Mr. Khodorkovsky (Mr. Simon Kukes), was a relatively unknown figure. With respect to causation, Respondent argues that it was "Yukos' stubborn refusal to consider Sibneft's change-in-management proposal—

1020 Counter-Memorial ¶ 328.

1021 *Abramovich met Putin before vetoing Yukos–Sibneft merger*, The Sunday Telegraph, 30 November 2003, Exh. C-669.

1022 *Yukos–Sibneft Merger Called Off*, BBC News, 28 November 2003, Exh. R-397 (quoting Mr. Boris Berezovsky).

1023 Reply ¶ 134.

1024 Shareholders' Agreement in respect of Yukos Oil Company among YUL, Hulley, White Pearl Investments Limited, N.P. Gemini Holdings Limited, Marthacello Co. Limited, Kindselia Holdings Limited, Heflinham Holdings Limited and Kravin Investments Limited, 1 May 2003, Article 6.1, Exh. C-1102.

1025 *Yukos and Sibneft Agree in Principle to Merger*, Yukos Press Release and Sibneft Press Release, 22 April 2003, Exh. C-629.

1026 Reply ¶ 134.

1027 Rejoinder ¶ 786.

and not any action on the part of the Russian Federation—that ultimately doomed the Yukos–Sibneft merger."[1028]

882. Respondent also argues that it cannot bear any responsibility for the unwinding of the merger because Claimants and/or Yukos voluntarily agreed to it. It is a matter of public record that, in early 2004, Yukos retained external advisers for negotiations with Sibneft.[1029] Respondent also alleges that Claimants signed two protocols dated December 2003 and February 2004 to unwind the merger.[1030] The Tribunal notes that these protocols are not in the record of this arbitration. Under cross-examination, Mr. Misamore stated that he did not recall ever seeing the protocols.[1031]

883. Claimants acknowledge that, "[a]lthough under no obligation to do so, Yukos and its majority shareholders agreed to enter into formal discussions with the former principal shareholders of Sibneft to consider a possible unwind of the transaction."[1032] Claimants add however that Yukos and its majority shareholders made it clear that unless an acceptable agreement was reached and approved by the Yukos Board of Directors and its shareholders, Yukos would maintain the existing agreements and proceed with its merger with Sibneft.[1033]

884. The Tribunal observes that, in the end, the decisions of the Moscow and Chukotka Arbitrazh Courts, although criticized by Claimants, effectively put an end to the merger. There never was a consensual negotiated solution.[1034]

885. Respondent speculates that it could have been Yukos that instigated the two court cases in order to achieve the demerger without having to seek the approval of minority shareholders.[1035] Respondent refers to an e-mail of 13 February 2004 where Yukos' counsel Mr. Gololobov

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1028 Counter-Memorial ¶ 330.

1029 *Yukos Oil Company retains consultants for negotiations with former Sibneft core shareholders*, Yukos Press Release, 2 February 2004, Exh. C-680.

1030 Respondent's Post-Hearing Brief ¶ 75 n.193 (citing *Yukos Oil Company v. Kravin Investments and others*, LCIA Arbitration No. 4589, Statement of Case, 2 May 2005, Exh. R-3601 ¶¶ 41, 44, 50).

1031 Transcript, Day 9 at 11–12.

1032 Memorial ¶ 212.

1033 *Yukos Sibneft Merger*, Company News, Group Menatep Website, 2 December 2003, Exh. C-670; *Statement on the Status of Negotiations with Representatives of Former Principal Shareholders of Sibneft*, Yukos Press Release, 17 December 2003, Exh. C-672.

1034 *See* Transcript, Day 17 at 25.

1035 Rejoinder ¶¶ 797–806.

proposed a five-part "Scheme of Actions for Unwinding Transaction."[1036] The first step was a "[s]uit to have issuance of shares declared invalid,"[1037] which, Respondent argues, bears a striking resemblance to the lawsuit brought in January 2004 by NP Gemini Holdings Limited and Nimegan Trading Limited before the Moscow Arbitrazh Court.

886. The Tribunal notes that this e-mail was sent after the commencement of the Moscow lawsuit. Respondent's theory is also inconsistent with the fact that Yukos applied to an LCIA tribunal to prevent the former Sibneft shareholders from pursuing actions for the invalidation of the share issuance before the Moscow and Chukotka courts. The Tribunal finds this argument of Respondent unpersuasive.

887. The central question remains. Did the Russian Federation cause the demerger? In the view of the Tribunal, it did not. It is abundantly clear that Sibneft wanted out of the merger after the arrest of Mr. Khodorkovsky. It was perfectly understandable for Sibneft to have second thoughts about the merger under the leadership of a CEO who was under arrest and embroiled in controversy.[1038] The Tribunal does not see the fingerprints of Respondent in Sibneft's decision to insist upon a change in management after the arrest of Mr. Khodorkovsky or in Sibneft's subsequent announcement that it would not proceed with the merger.

888. The Tribunal therefore concludes that Claimants have not established any basis which would allow them to claim damages based on the assumption that the merged YukosSibneft company would have been successful.[1039]

889. However, the circumstances of the Yukos−Sibneft merger are instructive in evaluating Yukos' attempts to settle its tax debts with the Russian authorities, which will be discussed in the next chapter.

890. The Tribunal will now review the attempts by Yukos to settle its tax debts and the reaction of the Russian authorities to Yukos' offers.

1036 E-mail from Mr. Dmitry Gololobov to Mr. Yuriy Beilin attaching "Scheme of Actions for the Unwinding Transaction," 13 February 2004, Exh. R-3602.

1037 *Ibid.*, Flowchart.

1038 The Tribunal notes that Sibneft's position was not inconsistent with the spirit of the Shareholders' Agreement, which contained a provision allowing the Sibneft shareholder group to remove any Yukos-appointed senior managers if they committed fraud or embezzlement. Shareholders' Agreement in respect of Yukos Oil Company among YUL, Hulley, White Pearl Investments Limited, N.P. Gemini Holdings Limited, Marthacello Co. Limited, Kindselia Holdings Limited, Heflinham Holdings Limited and Kravin Investments Limited, 1 May 2003, Article 6.1, Exh. C-1102.

1039 *See* Part XII on Quantification of Damages at paragraph 1779.