



The Yukos Affair

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Yukos Affair - Outline

- Introduction
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Yukos - Introduction

- Yukos affair has received much criticism in the West
- In particular in the press and also by the US Government
- But also in Russia itself, in particular, Mr. Illarionov, former advisor to the President



Yukos – Introduction (II)

- The current presentation will focus on Yukos and Yukanskneftegaz (its main subsidiary)
- i.e., it will not deal with the criminal case against Messrs. Khodorkovskii and Lebedev
- This would lead us too much into criminal law issues



Yukos – Background (I)

- Weak institutions – strong officials (OECD Report)
- Byzantine culture – different groups of power
- In 19th century – Slavophiles v. *zapadniki* (Westernizers)



Yukos – Background (II)

- Under El'tsin and Putin - different groups (family, oligarchs, liberals, *siloviki*, etc.)
- Under El'tsin, the “family” got the upper hand
- Under Putin, the *siloviki* won the fight with occasional small victories for the Liberals (Gref)



Yukos – Facts (I)

- In 1989, Mr. Khodorkovskii founded Menatep Bank,
- allegedly with money earned from various schemes when he was a Komsomol leader
- In 1995, under the “loans for shares” scheme approved by El'tsin, Khodorkovskii acquired a controlling stake in Yukos for \$350M (far below its actual value)
- 1998: restructuring and modernization program for Yukos



Yukos – Facts (II)

- In 2000, the new elected President, Mr. Putin strikes a deal with the oligarchs (“stay out of politics and you may keep your businesses”)
- Yukos shares are listed in NY, London, Frankfurt
- 2 July 2003 – arrest of Mr Lebedev, major shareholder of Yukos on charges of illegal acquisition of shares in Apatit, a fertilizer company



Yukos – Facts (III)

- 16 July 2003 – raid on Yukos' offices
- 25 October 2003 – arrest of Mr. Khodorkovskii on charges of fraud and tax evasion
- 30 October 2003 – freeze of 44% stake in Yukos held by Menatep Bank
- 30 December 2003 – tax claim for \$3.5bn for unpaid taxes in 2000



Yukos – Facts (IV)

- July 2004, more time is granted to Yukos to pay its outstanding tax bill
- However, new tax claim for unpaid taxes in 2001 - \$3.4bn
- 20 July 2004 - Russian bailiffs say they will sell off Yuganskneftegaz
- August 2004 – tax inspectors start examining Yukos' 2002 accounts



Yukos – Facts (V)

- 1 November 2004 – a new tax claim of \$10bn for 2002
- 10 December 2004 – three bidders for 19 December auction of Yuganskneftegaz, incl. Gazprom
- 15 December 2004 – Yukos files for bankruptcy in Houston, USA



Yukos – Facts (VI)

- 19 December 2004 – auction of Yuganskneftegaz – sold to Baikal Finance Group for \$9.35bn
- 23 December 2004 – state-owned Rosneft buys Baikal Finance Group
- February 2005, Menatep announces plans to sue Russian Gov't for \$28bn



Yukos - Facts (VII)

- 14 Yukos sues Rosneft, Baikal, and Gazpromand (a unit of Gazprom) for damages of \$20bn
- 25 February 2005 – Houston court dismisses Yukos' bankruptcy petition on the grounds of no jurisdiction
- 15 March 2005 - Rosneft files claim against Yukos over \$11bn arrear tax bill allegedly owed by Yuganskneftegaz



Yukos – Facts (VIII)

- 19 April 2005 – Russian court freezes Yukos' assets for a claim by Yuganskneftegaz of having paid below-market prices for its oil
- Yuganskneftegaz demands \$6bn in compensation



Yukos – Criticism (I)

- The following criticism has been raised on handling the case
 - Arbitrariness
 - Intransparency of the procedure
 - Political bias
 - Actual renationalization
 - Disrespect of private ownership



Yukos – Criticism (II)

- The Gov't is using the Yukos affair to regain control over the energy sector, as profit margins in the Russian oil sector are up to 36% and 64% for gas (according to a World Bank Report)
- State control would be a blow to the industry's efficiency



Yukos – Criticism (III)

- Yukos should have been granted more time to pay its debts rather than forcing it into near bankruptcy
- State was pursuing Yukos out of political vendetta rather than enforcing fiscal rectitude



Yukos – Effects (I)

- Less aggressive tax planning by companies
- Cancellation of internal tax havens
- Increase of tax revenues
- Foreign investment has decreased, in particular, in the oil sector, where foreign investment is much needed



Yukos – Effects (II)

- Low profile of remaining oligarchs
- Lower economic growth
- Other companies have been submitted back tax claims, too (VimpelCom, BP-TNK, Volgotanker, Sibneft, and others)
- Impact on business in the regions, where the federal example is being followed by local administrators



Yukos – Effects (III)

- Increase of capital flight (positive in 2003; \$7.8bn in 2004)
- Increase of tax enforcement
- Improvement of corporate governance
- Listing of shares on int'l stock exchanges (currently, being countered)
- Higher dividends paid to shareholders



Yukos – Justification (I)

- Where other countries – f.i., the USA, have a long tradition of suing tax evaders, Russia has not
- As a result, Russia has no experience is dealing with such complex cases
- Aggressive tax evaders should face criminal liability
- There is large public discontent over the murky privatization deals in the 1990s



Yukos – Justification (II)

- Sending a clear message to oligarchs and to companies to observe the law
- Emphasis on strict enforcement
- Strengthening legalistic views rather than a liberal approach to law



Yukos - The Role of the Courts

- According to the Constitution, independent but in fact still subject and sensitive for political influence
- With the exception of the Constitutional Court, not very creative in finding reasonable and equitable solutions
- Strict legalistic approach



Yukos – The Courts (II)

- Several courts decisions in the Yukos case
- none of which led to satisfaction of Yukos' demands
- Decision of Moscow Arbitration Court of 26 May 2004 in re Ministry of Taxes and Duties v. Yukos



Yukos – The Courts (III)

- Court decision of 26 May 2006 regarding a arrear tax claim for 2000:
 - Yukos' argument that claim was time barred (statute of limitation of 3 years) under Art. 113 Tax Code was rejected
 - The three years period applies to *bona fide* taxpayers only, and not to *mala fide* taxpayers



Yukos – The Courts (IV)

- It appeared that Yukos was not *bona fide*
- Therefore, time bar did not apply
- Constitutional Court ruling of 18 January 2005 on Yukos' complaint of Arbitration Court's decision regarding constitutionality Article 113 Tax Code
 - Complaint cannot be heard, as it seeks to overrule the arbitration court's decision



Yukos – The Courts (V)

- In fact, Yukos requests confirmation of constitutionality of Article 113 Tax Code
- Nonetheless, Constitutional Court rejects arbitration court's conclusion that the Tax Code's guaranties apply to *bona fide* taxpayers only



Yukos – What Next?

- Yukos has initiated arbitration proceedings under the European Energy Charter Treaty
- All necessary appointments have been made
- Yukos has filed claims against Rosneft in Russia



Yukos – Recommendations to Foreign Investors

- Stick to the law
- Avoid aggressive tax planning
- Do not get involved with companies controlled by the oligarchs



New Yukos Cases? (I)

- Mr. Putin in his official message to the Federal Assembly (“State of the Union”) on 25 April 2005:
 - Stability of the right of ownership
 - Strict to those who break the law
 - Statute of limitation of three years will be included in the law



New Yukos Cases? (II)

- Mr Putin:
 - Tax authorities are not entitled to “terrorize” business by more than once returning to the same problems
 - Russia is most interested in attracting domestic and foreign investment
 - However, Russian strategic interests should be clearly defined as to avoid ambiguity



New Yukos Cases? (III)

- German Gref, Minister of Economic Development and Trade:
 - Reform agenda is still intact
 - New legislation on competition and state aid under way
 - Planned privatization of some 1,500 enterprises in 2005
 - Maximum economic freedom to citizens



Yukos - final observations (I)

- Russia is still in transition from an autocracy to a democracy based on the rule of law and market principles
- “democracy” and “market economy” got bad reputation before they could be fully introduced
- Reform will take at least one generation
- In fifteen years, a lot has been achieved
- Russia should be judged to what has been done rather than to Western standards



Yukos – final observations (II)

Умом Россию не понять,
Аршином общим не измерить:
У ней особенная статья –
В Россию можно только верить.

Fedor Tiutchev, 28 November 1866



Yukos– final observations (III)

With wit Russia cannot be understood,
It cannot be measured with a common
standard

She has a special character –
In Russia one can only believe.

Fedor Tiutchev, 28 November 1866