TAXATION AND EXPROPRIATION—THE DESTRUCTION OF THE YUKOS OIL EMPIRE

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I. INTRODUCTION

The rise, fall, and death agony of the Yukos conglomerate have all the elements of great literature. The tale features strong personalities, sudden twists of fate, and profound clashes of principle. The arc of the plot tracks Russia's deepest struggles in the two decades since the demise of the Soviet Union and Soviet Communism. Real individuals have suffered, one dying horribly in prison. The events have inspired books and movies, and the story is not close to ending.[1]

This article does not have literary aspirations, but it does press the importance of the Yukos affair as a window into contemporary Russia and, more generally, modern efforts to impose order on the world economy. It focuses not on the human drama of the story, great though it is, but rather on the episode's significance in the ongoing struggle over economic freedom and

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1. *Khodorkovsky*, a documentary by German film maker Cyril Tuschi released in 2011, has received favorable reviews. Books about the affair include MARSHALL I. GOLDMAN, PETROSTATE: PUTIN, POWER, AND THE NEW RUSSIA (2008); RICHARD SAKWA, THE QUALITY OF FREEDOM: KHODORKOVSKY, PUTIN, AND THE YUKOS AFFAIR (2009); MARTIN SIXSMITH, PUTIN'S OIL: THE YUKOS AFFAIR AND THE STRUGGLE FOR RUSSIA (2010). The law review literature includes Paul M. Blyschak, *Yukos Universal v. Russia: Shell Companies and Treaty Shopping in International Energy Disputes,* 10 RICH. J. GLOBAL L. & BUS. 179 (2011); Sara C. Carey, *What Do the Recent Events Involving Yukos Oil Company Tell Us About Legal Institutions for Transition Economies?*, 18 TRANSNAT'L L. 5 (2004); Dmitry Gololobov, *The Yukos Tax Case or Ramsay Adventures in Russia*, 7 FLA ST. U. BUS. REV. 165 (2008); 'Dmitry Gololobov, *The Yukos Money Laundering Case: A Never-Ending Story*, 28 MICH. J. INT'L L. 711 (2007); Matteo M. Winkler, *Arbitration Without Privity and Russian Oil: The Yukos Case Before the Houston Court*, 27 U. PA. J. INT'L ECON. L. 115 (2006); Brenden Marino Carbonell, *Comment, Cornering the Kremlin: Defending Yukos and TNK-BP from Strategic Expropriation by the Russian State*, 12 U. PA. J. BUS. L. 257 (2009); Peter C. Laidlaw, *Comment, Provisional Application of the Energy Charter as Seen in the Yukos Dispute,* 52 SANTA CLARA L. REV. 655 (2012); Alex M. Niebruegge, *Comment, Provisional Application of the Energy Charter Treaty: The Yukos Arbitration and the Future Place of Provisional Application in International Law*, 8 CHI. J. INT'L L. 355 (2007). .

state sovereignty. Most importantly, the Yukos story indicates the limits to the international rule of law.

In a nutshell, the rise and fall of Yukos illuminates four narratives about the modern world economy. First, it exposes the challenges—some might say insuperable barriers—to creation of a liberal society on Russian soil. Second, it shows the deep problems with top-down law reform in societies undergoing rapid and wrenching political, economic and social change. Third, it demonstrates how renationalization works in a particularly high-stakes context. Finally, it reveals the capabilities and limits of international dispute settlement through courts, arbitration, and diplomacy when confronting profound conflicts between private rights and fiercely guarded national interests.

As for the first point, one must carefully distinguish liberalism from democracy. A democratic society gives the population power and influence through effective mechanisms that translate the popular will into government policy. Liberalism entails the maintenance of institutions, both public and private, that check government power and open up a space for private transactions and expression. Russia since the fall of Communism has enjoyed a robust if imperfect democracy. By every conceivable indicator, President Putin enjoys widespread popular support, with his actions against Yukos in particular bolstering his approval. But democracy does not necessarily lead to constraining the state, as the Yukos affair demonstrates. The voice of the polis can call out for and cheer on the destruction of over-mighty private actors: In Russia, it did.[2]

Law reform was a worldwide growth industry in the 1990s, the era that spawned the Yukos empire. The transition from totalitarian and authoritarian states with government monopolies over economic activity to something that might resemble liberal democracy inspired many to look to law as the midwife of a new order. Foreign specialists, myself included, flocked into the former Warsaw Pact countries in hopes of

2. On the distinction between democracy and liberalism in Russia, see Allen C. Lynch, *What Russia Can Be: Paradoxes of Liberalism and Democracy*, THE AM. INTEREST, Nov.–Dec. 2006, at 58.

building new institutions, with law as the bricks and mortar. But for many of the reasons that liberalism did not take to Russian soil, legal reform all too often became a tool for expanding, rather than constraining, state power. The Yukos story is an exemplary tale of the perversion of legal instruments to empower arbitrary and exploitative bureaucrats to destroy private wealth. It also suggests something more general about the limits of law in shaping social change.

On a technical level, Yukos provides a textbook example of how formal legal requirements, in particular tax law, can lend themselves to a program of renationalization of the commanding heights of the economy. Each element of the case that the Russian authorities brought against the company, in isolation, had an air of plausibility if not inevitability. Yet, once assembled as a whole, the case seemed preposterous. The government pursued two profoundly differently goals simultaneously, maintaining a veneer of legality while communicating clearly to the private sector that the state could act ruthlessly whenever it wished. At the end of the day, Yukos ceased to exist as a legal entity, a great energy empire ended up in government hands, and the Yukos shareholders (many of whom were foreign portfolio investors, not oligarchs and their minions) received nothing in return. In style if not in substance, these events resemble Falangist Spain's destruction of Barcelona Traction, a chestnut of international investment law.[3]

Finally, the death throes of Yukos have spawned an extraordinary array of litigation in many national and international forums. More than a billion dollars in liquid assets resided outside Russia at the time of government's attack on the firm. Much of this became a war chest to fund lawsuits and arbitrations. Although the company has enjoyed considerable success in these ventures, the main purpose of the litigation seems to have been to clarify the extent of the Russian

3. Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belg. v. Spain), 1970 I.C.J. 3 (Feb. 5). In both cases the state orchestrated a bankruptcy proceeding to seize ownership of a valuable firm. In the case of Franco's Spain, the transaction dispossessed foreign investors in favor of private actors favored by the regime; in Putin's Russia, the state grabbed the asset, only partly owned by foreign investors, for itself.

government's audacity and impropriety, with the possibility of a global settlement in the background. To date, however, the government has defended itself fiercely, if not always successfully.

I employ all these narratives in the course of telling the Yukos story. This article begins with a brief account of the origins of Yukos and its rise to become the largest Russian energy company. The beginnings were sordid, and along the way abuses of corporate governance undoubtedly occurred, but the entity that entered the twenty-first century aspired to provide a new model of transparency and corporate probity for Russian businesses. The article puts the early years of Yukos in the context of the wild and contradictory period of Yeltsin's presidency, a time viewed as inspiring by many in the West and as disastrous by most Russians. It pays especially close attention to the role of U.S. technical advisers, in particular those who contributed to the design of the tax system that became the instrument of Yukos's destruction.

The next section of this article describes Yukos's destruction in some detail, concentrating on the role of Russian courts in ratifying and enforcing the government's program of seizing the company's most productive assets. It follows with an account of the multijurisdictional and multinational litigation that ensued. It concludes with a review of the lessons learned from the affair, focusing on the potential of international law to mediate between private economic power and state interests. At the end of the day, the episode teaches us that the rule of law, both domestic and international, is a more fragile and uncertain enterprise than the optimistic architects of the Washington consensus may have believed two decades ago.

II. THE RISE—YUKOS IN THE ERA OF COWBOY CAPITALISM

Any historical narrative of Russian events must frame them with presidential terms. This is not because Russian Presidents necessarily have any greater discretion or influence than political leaders in other countries, but rather because Presidents serve as the nexus of debate and administrative decisionmaking. It helps that the turnover of leaders was abrupt and specific, with Putin following Yeltsin just as the 1990s came to an end. The arc of Yukos's ascent cuts across both regimes, but took different shape in each. The legal background, especially the law reform project, also differed significantly during the two periods.

A. *The Yeltsin Period—1990 to 1999*

The first part of the story involves the 1990s, a time when Russia discarded the Soviet Union and embarked by fits and starts on the path of reform. Hordes of international advisors descended on Moscow and received an intermittently attentive audience. Many in the West, first and foremost the leaders of the United States, purported to be impressed with these changes and gave them their blessings as well as significant material support. Ordinary Russians, however, became increasingly disillusioned with a transformation that seemed to produce economic chaos, immiserization and injustice, rather than a better life. The tension between the hopes for reform and the actual practice of powerful actors frames the events around the rise of Yukos.

To understand the pathway of reform in Russia, one must remember the challenges presented by the Soviet legacy. The Soviet economy relied on state ownership and management of nearly all productive activity, using quantitative targets rather than prices to determine outcomes. This system suppressed important information about performance and encouraged widespread corruption and rent-seeking. Not only did Soviet management ensure that the country could not compete internationally (which in turn required autarchy to protect the economy from the outside world), but it facilitated the accumulation of wealth and power among middle-managers that subverted the supposed hierarchy of central command and control.[4]

In theory, reform would entail overturning these structural features. Assets would move from state to private ownership,

4. For further evidence and discussion, see Paul B. Stephan III, *Privatization After* Perestroyka*: The Impact of State Structure*, 14 WHITTIER L. REV. 403 (1993); Paul B. Stephan III, Perestroyka *and Property: The Law of Ownership in the Post-Socialist Soviet Union*, 39 AM. J. COMP. L. 1101 (1991).

markets would emerge, and competition and price transparency would direct economic activity towards its most productive possibilities. Lost in the confusion was two profound constraints on the project: Many powerful actors benefitted more from opacity rather than transparency, because they could do better by stealing existing assets than by producing new ones, and the institutions necessary to support transparent market transactions, especially strong and independent courts and a civil society that could investigate and publicize abuses, did not exist. The international advisers, drawn from the international financial institutions (the International Monetary Fund, the World Bank, and the Organization for Economic Cooperation and Development) and the ministries of finance of the great Western powers, initially wielded considerable influence because of the international debt burden that Russia had inherited from the Soviet Union. But they mostly were deaf to these institutional factors. As a result, privatization in Russia became synonymous with kleptocracy.[5]

During the summer and fall of 1995, Boris Yeltsin, a hero abroad but a dismaying and damaged figure in his homeland, faced the consequences of this feckless reform. Most Russians viewed his administration as disastrous, attributing the country's sharp drop in economic output and widespread economic insecurity to the reforms and perceiving its gains as concentrated largely in the hands of a small number of opportunists and insiders. Polls suggested that Yeltsin had lost almost all popular support and had essentially no chance of winning re-election in 1996.[6] Dramatic steps were necessary if

5. Paul B. Stephan III, *Toward a Positive Theory of Privatization—Lessons from Soviet-Type Economies*, 16 INT'L REV. L. & ECON. 173 (1996). During this time I undertook various compensated projects for each of the aforementioned international financial institutions as well as for the U.S. Department Treasury, but none of these activities directly involved Russia's privatization program.

6. For a discussion of these events, see ALLEN C. LYNCH, HOW RUSSIA IS NOT RULED: REFLECTIONS ON RUSSIAN POLITICAL DEVELOPMENT 151–54 (2005); RICHARD SAKWA, RUSSIAN POLITICS AND SOCIETY 82–93 (3d ed. 2002). Yeltsin originally had been elected to the post of President in the summer of 1991, at a time when the Russian Soviet Federative Socialist Republic had been a component of the U.S.S.R. The 1993 Constitution transformed the R.S.F.S.R. into the Russian Federation, and 1996 was the first chance that Yeltsin had to confront the polls under the new post-U.S.S.R. regime.

he was to retain power.

The precise details of the arrangement that resulted remain obscure, but the broad outlines are evident. The so-called oligarchs, who had amassed wealth and power during the privatization process, largely through banking and media companies, would throw their weight behind Yeltsin. What this weight entailed, and whether the resulting election was merely bent or an outright fraud, will always be a matter of debate. What they received in return was access at a deep discount to the most valuable assets remaining in state hands. They would obtain these properties through the so-called loan for shares scheme, under which the Russian state would borrow money from the oligarchs and provide security worth many times the amount of the loans. Upon the anticipated default on the loans, the lenders would take over state-owned firms controlling vast natural resources.[7]

These events led to the creation of Yukos as a private company. The transaction by which the government transferred this entity to a consortium led by the Menatep Bank was one of the more prominent, indeed notorious, of the loans-for-shares program. For starters, Menatep also acted as the representative of the State Committee of Privatization, the borrower/seller, and enjoyed an intimate relationship with the Russian Ministry of Finance, which had significant minority interest in the bank. Because of this clear conflict of interest, the possibility that Russia would receive anything like a fair return seemed vanishingly remote.

Other banks challenged Menatep's bid for Yukos, not

7. For an account of these events by World Bank staff members, see Ira W. Lieberman & Rogi Veimetra, *The Rush for State Shares in the "Klondyke" of Wild East Capitalism: Loans-for-Shares Transactions in Russia*, 29 GEO. WASH. J. INT'L L. & ECON. 737 (1996). For a defense of these transactions by a U.S. adviser, see Daniel Treisman, *"Loans for Shares" Revisited,* 26 POST-SOVIET AFFAIRS 207 (2010). Treisman in particular notes Khodorkovsky's assertion that Yukos came burdened with more than $3 billion in debt at the time that Menatep acquired its stock. Steven Theede, who became CEO of Yukos after the Russian government's attack, gave further details of Yukos's debt burden at the time of the privatization in testimony before the U.S. Senate. *Democracy in Retreat in Russia: Hearing Before the U.S. S. Comm. on Foreign Relations*, 109th Cong. 8 (2005) (statement of Steven M. Theede, Chief Executive Officer of Yukos Oil Co.).

because these conflicts were illegal (other banks were doing similar things), but because Menatep's creditworthiness was suspect. The transaction nonetheless closed in December 1995 with the consortium acquiring 78 percent of Yukos's shares either directly or as collateral.[8] The price paid indicated that Yukos's equity had a value of roughly $450 million, while a public offering of the stock less than two years later valued the firm at $9 billion. At this point Mikhail Khodorkovsky, the oligarch who had put together and led Menatep, shifted the focus of his activities to the energy company.[9]

Menatep borrowed much of the money needed to consummate this transaction, pledging its shares in Yukos as collateral. Russia's financial crisis in 1998 triggered a rearrangement of Yukos and its assets, largely to defraud Menatep's creditors but also to squeeze out minority investors in Yukos's most valuable holdings. First, Menatep transferred its principal assets to a new company and then destroyed the paper trail that documented the transfer.[10] Second, to erase the value of the security for some of Menatep's debts to foreign banks, Yukos's management hollowed out the company to render its stock worthless. Yukos then consisted principally of its majority stakes in three production companies, Yuganskneftegaz (YNG), Tomskneft (TK), and Samaraneftegaz (SNG). The management orchestrated a massive dilution of the ownership of these entities, resulting in transfer of control to offshore shells, presumably beneficially owned by them, at less than ten percent of actual value.[11] Foreign investors with minority stakes in the production companies sued, but recovered very little.[12] Once the holders of the security interests in Yukos stock settled their claims for a small fraction of their value and the minority investors in the production companies sold out, Yukos retransferred control over YNG, TK and SNG back to itself.[13] By

8. Lieberman & Veimetra, *supra* note 7, at 750–53.

9. SAKWA, *supra* note 1, at 42–43.

10. Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?* 52 STAN. L. REV. 1731, 1754–55 (2000).

11. *Id.* at 1770–71.

12. SAKWA, *supra* note 1, at 61–62.

13. *Id.* at 59–60.

the end of the 1990's, Yukos had become a holding company free from much outside debt with full control over subsidiaries that held enormously valuable oil and gas rights. Menatep correspondingly became a passive shareholder rather than the nexus of Yukos's control and management.

Parallel to the freebooting grabs of state assets, of which the Yukos episode was prominent but hardly unique, there proceeded efforts to build legal institutions that would put business transactions on a more stable basis and, it was hoped, preclude the kinds of larceny that the existing Russian regime seemed to encourage. Western, and particular U.S., advisers, mostly academics, played a role in drafting many of these laws, although the extent of their influence is debatable.[14] Two of the law reform projects had a direct bearing on the Yukos affair, namely the Joint Stock Company Law and the Tax Code.

The principal drafters of the Joint Stock Company Law were Professor Bernard Black of Columbia and Stanford Law Schools and Professor Renier Kraakman of Harvard Law School. These distinguished academics sought to put corporate governance in Russia on a sounder legal basis. They identified as the principal problems with current law a history of insider self-dealing with respect to company assets and weak legal institutions, courts in particular. Their solution was to endow shareholders with strong rights to challenge transactions that satisfied a broad, and perhaps elastic, definition of self-dealing. They believed that clarity in the legal entitlement would overcome the problem of weak courts.[15] The Russia legislature, or Duma, adopted the statute in 1995.[16]

The path to comprehensive reform of the Russian tax system was not as direct and the role of U.S. law professors not as high-profile as with corporate governance.[17] Russia had adopted

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14. For criticism of the advisers, see JANINE R. WEDEL, COLLISION AND COLLUSION: THE STRANGE CASE OF WESTERN AID TO EASTERN EUROPE (Rev. ed. 2001).

15. Bernard Black & Renier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911 (1996).

16. Federal Law of the Russian Federation on Joint Stock Companies, Federal Statute No. 208 of Dec. 29, 1995.

17. Among professors at U.S. law schools, I may have been as involved as anyone in the Russian project, entirely as a contract employee of the U.S. Treasury Department.

a variety of tax laws during the early months of the Republic, some while it still was part of the U.S.S.R. In the following years taxes proliferated, as well as loopholes and exemptions. Discussions of folding this welter of legislation into a unified tax code began as early as 1993. On the Russian side, the most important figure pushing for adoption of a code was Sergey D. Shatalov, a physicist who had been elected to the Russian Supreme Soviet (the predecessor of the Duma) during the first wave of reforms in 1990.[18] He was the principal architect of tax legislation up to Yeltsin's dissolution of the Supreme Soviet in 1993. He then served President Yeltsin as Deputy Minister of Finance, concentrating on tax policy, from 1995 to 1998. Shortly after President Putin took office in 2000, Shatalov rejoined the government as First Deputy Minister of Finance, and has held the post of Deputy Minister since 2004. He will feature in the next part of this article, dealing with Yukos's fall.

In general terms, the foreign advisers advocated that Russia simplify and rationalize its tax laws. They proposed consolidating taxes into a valued added tax (VAT), a tax on business profits (profits tax), a tax on individual income limited to a small fraction of the population (income tax), and various excise taxes designed to discourage certain behavior. More fundamentally, the advisers recommended that the Code regulate the authority of sub-national units to levy taxes, cut back on the draconian penalties for tax offenders, and formalize the lines of administrative authority over, and judicial oversight of, the assessment and collection process.

One thread of the discussions between the advisers and Russian authorities was the role of formalism in the interpretation and application in Russian tax law. The 1990s saw an explosion of contractual and organizational forms in the

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The following account of the project rests mostly on my recollections. Others who played a role, working under contract with either the Treasury or the Harvard Institute for International Development (HIID), included Professors Louis Kaplow of Harvard, Richard Schmalbeck of Duke, and Eric Zolt of U.C.L.A. Many practitioners and current and retired IRS lawyers also took part.

18. Shatalov's official biography is available at http://www1.minfin.ru/en/orgstr/management/?id4=54 (last visited Nov. 17, 2012). He was the main point of contact for the U.S. advisers associated with Treasury and HIID both when he was in the private sector and when he held government office.

private sector. This arose partly in response to the lifting of the heavy hand of state management of the economy, but mostly to conceal the nature of transactions and to defeat the state requirements, taxation in particular, that survived. The tax authorities had little experience with these new forms and had a tendency to respond woodenly rather than creatively. The advisers wished to supply the authorities with conceptual tools that would allow them to react appropriately to these transactions while honoring the rule of law. Shatalov in particular seemed to appreciate these suggestions.

An example may illustrate the problem. When a merchant sells a product to a consumer, a VAT should impose a charge based on the price paid by the buyer. A VAT normally does not apply, however, to payments representing loan disbursements or repayments, because in either case the change in cash on hand is exactly offset by a change in the payer and payee's net debt owed. Russian VAT taxpayers sought to manipulate these rules by accepting loans from consumers in an amount equal to the sale price of a good, and then having the consumer cancel the loan in return for receipt of the good. Initially, Russian authorities responded to the challenge by arguing that the VAT should apply to all transfers of loan proceeds as well to sales. When confronted with the bizarre consequences of such a stance, in particular the assessment of a significant surcharge on inflows of debt investments from foreign sources, the authorities reconsidered, but had difficulty coming up with a clear conceptual basis for levying a VAT on these transactions.

From a U.S. perspective, at least two techniques exist to solve this problem. First, because the loan and the transfer of the goods were legally interdependent, in the sense that the parties agreed to one transaction only because they agreed to the other, one could collapse them into a single sale of goods for cash.[19] Alternatively, one could treat the discharge of the debt as a payment for purposes of the VAT.[20] Either move rests on a power of the tax authorities, supervised by the courts, to

19. The canonical case is Comm'r v. Court Holding Co., 324 U.S. 331 (1945).

20. *Cf.* United States v. Kirby Lumber Co., 284 U.S. 1 (1931) (holding that discharge of indebtedness constitutes income for income tax purposes).

recharacterize the transaction to align the private law aspects with its tax incidents.

When the Russian tax authorities attacked these transactions, they took the first route. The High Arbitrazh Court, the highest court with jurisdiction over questions of tax law, agreed that the intent of the parties, rather than the labels invoked in the documentation, would determine the outcome.[21] Because the parties intended a sale of goods for cash, the taxes applicable to such sales would apply.[22]

U.S. experts encouraged the drafters of the Tax Code to include provisions that would provide a statutory basis for a limited power to recharacterize transactions to achieve the intended results. While Shatalov embraced this proposal, the Duma did not. Ultimately it adopted language that became Article 11(1). This provision states: "Institutions, concepts and terms of civil law, family law and other branches of law used in this Code shall apply in the meaning in which they are used in these branches of law unless otherwise provided by this Code."[23] This meant that the tax authorities could not invoke tax concepts or policy to determine the tax incidents of transactions, but rather had to accept transactions as the civil (private) law determined them.[24] The Duma simply did not trust the tax

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21. Three different court systems operate in Russia. The general courts handle criminal cases (such as those brought against Khodorkovsky and the other Yukos officials) as well as private suits among individuals. Russian law, like most continental jurisdictions, does not recognize criminal liability for legal, as opposed to physical, persons. The arbitrazh courts (which, in spite of their name, constitute a regular court system and have nothing to do with arbitration) handle suits among firms as well as suits involving the government and firms, including tax disputes. Some translations refer to them as commercial courts, which is functionally accurate even if linguistically false. The Constitutional Court addresses only constitutional questions.

22. Presidium of the High Arbitrazh Court of the Russian Federation, Resolution No. 367/96 of September 17, 1996. Part II of the Tax Code, adopted in 2000, employs the second strategy, treating the discharge of a debt in compensation for the transfer of property or a service as a sale. Tax Code of the Russian Federation, Part II, Federal Statute No. 117 of Aug. 5, 2000, Art. 146(1)1.

23. Tax Code of the Russian Federation, Part I, Federal Statute No. 146 of July 31, 1998 [hereinafter Tax Code Part I], art. 11(1).

24. For fuller explanation by the principal U.S. adviser on the Tax Code, see Joel M. McDonald, *The Rise and Fall of the Russian Government's Draft Tax Code*, 16 TAX NOTES INT'L 121, 127 (1998).

authorities to wield discretion, and was willing to sacrifice tax enforcement to prevent bureaucratic abuse.[25]

One particular area where private law and tax policy conflict is transfer pricing. When separate legal entities with a common economic interest, such as sibling companies controlled by a common parent, transact, price is a matter of bookkeeping rather than a motivation for the deal. Absent some kind of regulation, taxpayers will choose prices that minimize taxes. Recognizing this problem, most tax regimes have rules that explicitly authorize the tax authorities to restate prices where transactions are not arms-length. The U.S. advisers urged Russia also to incorporate transfer pricing authority into the Tax Code.

The provision that resulted, Article 40 of the Tax Code, broadly conformed to what the foreign advisers recommended.[26] It allows the authorities to challenge the prices of transactions between related parties in cases where the contract price deviates by more than twenty percent from market prices. The provision contains two interpretive ambiguities that might have limited its usefulness: It does not make absolutely clear how its recalculation rules operate when there exist no comparable arms-length market transactions, and it does not expressly provide for price adjustments that benefit a taxpayer, as in the case where increasing one party's profit lowers the counterparty's gains.[27] The provision does indicate, however, that the Duma anticipated transfer pricing issues and sought to provide the tax authorities with the tools needed to deal with them.

After extensive debates and many revisions of the government's proposal, the Duma enacted Part I of the Tax Code in July 1998.[28] This law did not deal with particular taxes, but

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25. On the pressure in the Duma to protect taxpayer rights, see Joel M. McDonald, *Russian State Duma Considers Key Tax Measures*. 17 TAX NOTES INT'L 137 (1998).

26. Tax Code Part I, *supra* note 23, at art. 40.

27. The language of the provision can be read as allowing an adjustment only to increase liability, but not to decrease it. The Russian courts, however, have cast severe doubt on such a bizarre and unintended construction. Resolution of the High Arbitrazh Court of the Russian Federation of July 6, 2010, No. 17152/09.

28. Some disruption in the role of U.S. tax assistance occurred in the summer of

rather enacts general and transubstantive rules of procedure, interpretation, and delegation of authority. Thus it provides rules of administration, assessment and enforcement for all taxes.

Part II of the Tax Code, which provides a comprehensive set of rules for substantive Russian taxes, proceeded apace. At the time of President's Yeltsin's resignation at the end of 1999, much progress had been made. Final enactment, however, did not come until after Vladimir Putin had assumed power.

Outside of the Tax Code, another tax-related issue relevant to Yukos was the creation of so-called domestic tax havens. These came in two flavors. First, a 1992 law allowed "closed administrative-territorial entities" (ZATO is the Russian acronym) to control fully all taxes collected within their territory, including the authority to rebate the taxes to firms that made contributions to the ZATO's budget. ZATOs were former closed cities engaged primarily in secret national security work, all of which had experienced economic collapse with the end of the Soviet Union.[29] Second, Moscow responded to the problem of ethnically distinct regions, mostly in the middle of the country and the Caucasus, that threatened to break away from the center by granting similar local control over their fiscal powers.[30] All the private energy companies, including Yukos, took advantage of the domestic tax shelters by sourcing profits to thinly capitalized entities located in domestic tax havens.[31]

By 1999, it had become apparent that these tax privileges

1997, when two of the leaders of HIID were accused of violating the conflict-of-interest rules imposed by the U.S. government on these activities. *See* WEDEL, *supra* note 14, at 132–33, 151. Assistance by the U.S. Treasury continued after that date, but at a lower level of staffing and intensity. The United States brought criminal charges against the HIID leaders and then substituted a civil claim, which produced a substantial settlement in favor of the United States. *Harvard Defendants Pay Over $31 Million to Settle False Claims Act Allegations, Reports U.S. Attorney*, PRNEWSWIRE, http://www.prnewswire.com/news-releases/harvard-defendants-pay-over-31-million-to-settle-false-claims-act-allegations-reports-us-attorney-54649792.html (last visited Nov. 18, 2012).

29. Vladimir Samoylenko, *Government Policies for Internal Tax Havens in Russia*, 34 TAX NOTES INT'L 77, 79 (2004).

30. *See Id.*; ANDREI SHLEIFER & DANIEL TREISMAN, WITHOUT A MAP: POLITICAL TACTICS AND ECONOMIC REFORM IN RUSSIA 114–36 (2000).

31. *See* Samoylenko, *supra* note 29, at 80–82.

were a highly wasteful means of encouraging economic development in the targeted areas. Competition among tax havens meant that outside firms were able to obtain significant tax benefits at the cost of only modest contributions to the local budget. The Duma at first sought to rein in the ZATOs, adopting a law in 1999 that limited benefits to firms that had a substantial portion of its capital and work force on the territory of the ZATO in question. Energy companies managed to comply with the new requirements by setting up trading companies that did not need significant amounts of capital or employees to operate. Finally the Duma abolished ZATO tax exemptions altogether, commencing in 2000. Reform of the regional tax shelters, however, awaited later legislation.[32]

B. The Putin Period—2000 to 2008

Although in evident declining health, Yeltsin still shocked the world when he announced that he would step down as President at the end of 1999 in favor of Putin, his recently designated successor.[33] Putin immediately began to establish a new direction in Russian domestic policy, based on the concepts of stability and consolidation of the achievements of the previous decade. He made it clear that he would take no action against those in Yeltsin's entourage who had become rich by feasting on the Russian state, but also indicated that henceforth the new class of Russian super-rich would be expected to give back to the society that had fed their wealth. In the most general terms, he held out the prospect of greater order without Soviet-style repression.[34]

At first Yukos responded to the new regime positively. Having rather outrageously shed claims by others on its assets, either through loans or by minority membership in the production companies, it sought to repackage itself as a new, westernized firm that aspired to be a paragon of transparency and good corporate governance. It tried to draw a line through

32. *Id.*

33. On the succession, see ALLEN C. LYNCH, VLADIMIR PUTIN AND RUSSIAN STATECRAFT 58–61 (2011).

34. *Id.* at 70–71.

its past, and to enter the new decade as a model for a new, more civilized form of Russian capitalism.[35] At least superficially, this married nicely with the Putin administration's message of promoting capitalism, but without the robber barons.

During the first few years of the Putin period, Yukos continued to grow and thrive. In 2002 it acquired Rospan, a natural gas company, with Kremlin backing greasing the way.[36] Then, in the spring of 2003, came the firm's apotheosis. It contracted to acquire Sibneft, another energy giant that also arose out of the loans-for-shares episode. The merger was intended to create the dominant energy company in Russia as well as one of the largest in the world. It closed in October, 2003, just as the storm was about to break.

During the fall of 2003, as Yukos danced ever closer to the precipice, it entered into talks with several western oil majors about a possible combination. By integrating Yukos within a western company, not only would its owners have created what effectively would have been the world's largest energy company, but the marriage of private ownership and Russian energy would have become unbreakable. The market seemed to like all this, as shortly before Khodorkovsky's arrest the implied market valuation of the firm was in the neighborhood of $43 billion.[37]

During this first phase of the Putin period, law reform proceeded apace. For purposes of the Yukos story, the most significant event was the enactment of Part II of the Tax Code. This legislation contains detailed rules defining the tax base and taxpayers. In large part it rationalized and clarified the preexisting substantive law of taxation.

Another significant development in tax legislation was first the policing, and then the elimination, of so called domestic tax shelters. As noted above, the privileges accorded ZATOs were wound down at the end of the 1990s. The Duma turned to the designated regions during the Putin years, and ultimately

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35. *See* LEON ARON, *The Yukos Affair 2003*, *in* RUSSIA'S REVOLUTION: ESSAYS 1989–2006, 219, 222 (2007); SAKWA, *supra* note 1, at 62–63.

36. *See* LYNCH, *supra* note 6, at 97; SAKWA, *supra* note 1, at 66.

37. *See* ARON, *supra* note 35, at 223; SAKWA, *supra* note 1, at 70.

eliminated these privileges entirely as of 2004.[38] With these changes, the incentive to use transfer prices so as to locate all profits inside sales companies would disappear, because domestic firms would face essentially the same tax rules regardless of their location.

As of mid-2003, then, Russia seemed reconciled to the excesses of the 1990s, although also determined not to permit their repetition. Optimists hoped that the Putin regime would accept the new economic order, characterized by significant concentration of ownership balanced by fair contributions to state and society, mediated largely by the tax system. Perhaps nothing gave advocates of the rule of law in Russia greater hope than the restoration of Valery Zorkin as chairman of the Constitutional Court in February 2003. Zorkin, the first head of what in some sense is Russia's highest legal body, had lost that position (but not his place on the Court itself) following Yeltsin's overthrow of the Court and the then Duma in 1993. His restoration as chair seemed to capture a mood of stability based on a shaky, but growing, legal order.

III. THE FALL—EXPROPRIATION BY LITIGATION

Russian history can be told largely as a series of false dawns followed by crushed hopes. 2003 was no exception. Whatever the odds were at the beginning of the year that Russia under Putin might nurture an emerging liberal order based on property rights, social solidarity, and a government committed to the maintenance of ordered freedom, within twelve months these prospects seemed to be receding rapidly into the distance. The Yukos affair crystallized the turnaround in hopes for liberalism.

Much of what captured the popular imagination in this story concerns the fate of Mikhail Khodorkovsky, the company's head, and Platon Lebedev, a leading figure in Menatep, who were arrested in October and July 2003, respectively.[39] Without

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38. Vladimir Samoylenko, *Punished for Yesterday's Loopholes,* MOSCOW TIMES, Dec. 20, 2004, *available at* http://www.themoscowtimes.com/opinion/article/punished-for-yesterdays-loopholes/226257.html.

39. In a meeting with President Putin in the Kremlin in February 2004, Khodorkovsky had made an outspoken speech about corruption in the highest levels of the presidential administration. Putin responded by asking Khodorkovsky if his taxes

belittling the personal fate of these figures, along with that of other Yukos officials arrested and imprisoned by Russia, the heart of the story involves what happened to the company itself. The cases against Khodorkovsky and Lebedev doubtlessly involved abuses, as even the remarkably gun-shy European Court of Human Rights has acknowledged.[40] But, from an international perspective, as least as important as the mistreatment of Russian nationals through the criminal law is the destruction of property, much of it foreign investment, through a spectacular perversion of the tax system. The attack on Yukos itself not only affected foreigners, many of whom enjoy traditional protection under international law, but indicated a profound unreliability about the core governmental institutions on which private economic activity rests.

In theory, the Russian government might have sought simply to undo the privatization of Yukos. As noted above, the transaction involved deep conflicts of interest, resulting in robbing the state of a valuable asset. But to take on the loans-for-shares affair directly would implicate Yeltsin, which in turn would cast a shadow over Putin, Yeltsin's creature. An alternative theory was necessary to justify destroying Yukos without undoing the parallel privatizations of that period.

The government found its answer in tax enforcement. The criminal charges against Khodorkovsky included participation in corporate tax evasion. In December 2003 the tax authorities announced that it would re-audit Yukos for the tax year 2000, and three weeks later announced that they had uncovered underpayment of $2.27 billion in taxes. The following April the authorities imposed a total assessment of $3.4 billion and simultaneously went to court to obtain enforcement. The next day the court issued a freeze order forbidding the company from alienating or encumbering its property.[41]

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were in order. Many see this encounter as the precipitating event for Khodorkovsky' and Yukos's downfall. *See* SAKWA, *supra* note 1, at 142–44.

40. *See* Khodorkovsky v. Russia, 53 Eur. H.R. Rep. 32 (2011); *see generally Aleksanyan v. Russia*, 52 Eur. H.R. Rep. 18 (2008); Lebedev v. Russia, 47 Eur. H.R. Rep. 34 (2007).

41. Decision of the Moscow District Arbitrazh Court in Case No. A40-17669/04-1-09-241, Apr. 15, 2004.

The legal theory behind the new assessment comprised elements that, standing alone, had some plausibility, but, once assembled, defied credibility.[42] In essence, the company followed industry practice in limiting the profits-tax exposure of its production companies by running sales through trading companies located in domestic tax havens.[43] The trading companies typically were not owned directly by Yukos, although Yukos managed most of their activities through a series of agency relationships. The production companies sold their output to the trading companies, which in turn either traded among themselves or sold to an independent broker, in most cases a foreign one. The production companies sought to avoid any profits tax by selling the product at cost, while the trading companies took advantage of the profits-tax exemption provided by the current domestic tax haven legislation. Yukos, as a holding company, owed nothing, because it was not a party to any of these transactions. Significantly, none of this affected the net VAT liability for these sales. The tax haven exemptions did not apply to the VAT, and Russia's law, like that of every VAT in the world, used a zero rate for exports.[44]

A numerical example can illustrate the stakes. Suppose YNG spent 100 to produce oil that had an objective market price (putting aside how one might arrive at this figure) of 200. Further assume that half of this cost involved the purchase of inputs subject to a twenty percent VAT, and that the profits tax

42. In the discussion that follows, I draw heavily on the testimony I gave as an expert on Russian tax law in various forums, in each case acting on behalf of Yukos shareholders. Representatives of the Russian government have contested this account, as discussed in Part III of this article.

43. Yukos did not go as far as some competitors, such as Lukoil, which tried to source their production income to domestic tax havens. Lukoil would set up a company in a haven jurisdiction, and then have that company lease refining capacity and hire the refinery owner to conduct refining operations. The Russian courts had no trouble determining that the haven companies had not actually carried out any refining. Resolution of August 23, 2002, Matter No. KG-A41/5478-02, Federal Abitrazh Court for the Moscow Circuit.

44. A VAT is ultimately a flat-rate tax on domestic consumption. Imports generate a VAT equal to the normal rate multiplied by the declared value of the product. Exporting a product means there will be no domestic consumption, so the tax is zero and the exporter is entitled to a credit for any VAT paid on inputs.

applicable to YNG was forty percent of its net income. If YNG were to sell the oil to a trading company for 100, and the trading company in turn were to sell the oil to a foreign customer for 250, YNG and the trading company would both pay a profits tax of zero. YNG would have no profit, and the trading company would have enjoyed an exemption for its nominal gain of 150. YNG initially would have paid a VAT of 10 on its inputs through surcharges imposed by its suppliers, and then would have collected a surcharge of 20 on the sale to the trading company, with a net payment to the government of 10 after taking advantage of the credit due for its input VAT. Upon export, the trading company would have gotten a refund for its input VAT of 20. Overall, the government would have collected no profits tax and no net VAT.

A plausible line of attack by the tax authorities would have been to insist, pursuant to transfer pricing rules, that YNG and the trading company be taxed as if YNG received 200 for the oil. As a result, at a hypothetical profits tax rate of forty percent, YNG would face a liability of 40 on its gain of 100. This adjustment would not change the amount of VAT collected, however, as any upward increase on the VAT imposed on the sale by YNG to the trading company would be exactly offset by a credit received by the trading company on the export sale.

In the Yukos assessment, the Tax Ministry did not invoke this logical and obvious strategy. Instead, it constructed an unprecedented and one-off theory that doubled the imputed liability and assigned it to Yukos rather than YNG. The Tax Ministry asserted that, for every tax purpose but one, all of the trading company transactions should be attributed to Yukos. Yukos, not located in a domestic tax haven, thus would pay a profits tax on the difference between the low price paid the production companies and the arm's-length price paid by foreign brokers. But, because the production companies were the owners of record, Yukos never had filed on its own behalf for application of the zero VAT rate to the export sales. This failure to file barred Yukos from claiming the zero rate, thus obligating it to treat all the sales as if they were to domestic customers and thus subject to a full VAT.[45]

In effect, the Ministry simultaneously (1) insisted on a strong substance-over-form story to attribute profits, formally earned by the production companies and the trading companies, and the resulting profits tax, to Yukos, and (2) insisted on an extremely formalistic argument as to why Yukos had to pay a full VAT on goods that indisputably had been exported and thus qualified for the zero rate. The double punch had an enormous impact on the total owed: The VAT assessment, as well as interest and penalties associated with the nonpayment, was a large portion of the total liability for 2000. Taking into account the additional assessments for 2001 through 2003, all levied in the run up to the December auction of the company's most valuable asset, the VAT bill substantially exceeded that related to the profits tax.[46]

Because Article 11(1) of the Tax Code required the tax authorities to tax transactions in accordance with their civil law characteristics, the tax authorities needed a civil law argument to justify attributing all of the trading company activities (other than the filing of documents for the zero VAT rate) to Yukos. The one chosen was so weak that the Russian government abandoned it when later confronted with international arbitration, but it did the trick at the time. The Tax Ministry noted that Article 209 of the Civil Code describes what powers the owner of property exercises.[47] It argued, and the courts agreed, that this provision implied that anyone who possesses these powers must be an owner. Yukos, through consignment contracts and other agency agreements, could carry out sales on behalf of the trading companies, and thus possessed these powers. Ergo, it must have been the owner.

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45. *See* To Hold the Taxpayer Fiscally Responsible for a Tax Offense, Decision No. 14-3-05/1609-1 of the Ministry of Taxation of the Russian Federation, Apr. 14, 2004, at 2–3.

46. In 2000, the VAT assessment constituted 31% of the total, and the profits tax 39%. For 2000 through 2003 combined, the percentages are 49% and 45%. Reply to the Further Observations of the Respondent Gov't at 2, Yukos Oil Co. v. Russia, Application No. 14902/04 (Jan. 22, 2007) (submission by Yukos to European Court of Human Rights).

47. Article 209 provides: "An owner shall be entitled to the rights of possession, use and disposal of his property." Civil Code of the Russian Federation Part I, Federal Law 51 of Nov. 30, 1994 [hereinafter Civil Code] (author's translation).

If all the actions of the trading companies were attributable to Yukos, what about the documentation presented by those companies to justify a zero VAT rate for export sales? The documents, it turned out, had a fatal deficiency: They claimed that the trading companies, and not Yukos, did the exporting. Because the documents did not name Yukos as the owner, they failed to meet the statutory requirements for receiving a zero rate.[48]

Even a modest knowledge of how civil law works would suffice to expose the absurdity of the tax authorities' argument. Russia's Civil Code, like that of any country with a comparable body of private law, recognizes an array of agency relationships, pursuant to which a non-owner can exercise powers on behalf of an owner. The delegation or assignment of these powers does not change the fact of ownership. Article 209 does not identify who should be considered an owner. Rather, it specifies, once it is determined who is an owner, what that owner can do.

The Civil Code does deal with phony transactions, where the asserted form does not reflect reality. Article 170 treats as void transactions "made only for appearances without the intent to bring about the corresponding legal consequences" or "made for the purpose of hiding another transaction."[49] The authorities might have tried to argue that the transactions between the production companies and the sales companies lacked substance, because the parties never intended the trading companies to act as buyers or sellers of oil. Yukos doubtlessly would have responded that the companies did intend to carry out these transactions, and that trading for one's account does not require either significant hardware or numerous personnel (unlike, say, refining crude oil). Perhaps because this response seems compelling, the authorities never invoked Article 170.[50]

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48. The Tax Ministry rejected a later effort by Yukos to file documents on its own behalf to obtain a zero VAT rate.

49. Civil Code, *supra* note 47, at pt. I.

50. Article 169 of the Civil Code also treats as void transactions undertaken with the purpose of knowingly violating the fundamentals of the legal order or morality. Unlike Article 170, this provision allows the government to confiscate the proceeds of such transactions. At the time of the Yukos assessment, a few lower courts had allowed the tax authorities to argue that a purpose of reducing tax liability constituted a

The proceedings against Yukos arose while Shatalov was the leading tax official in the Russian government. Some persons associated with Yukos accused him of orchestrating the case, although direct evidence of this does not exist.[51] Given his earlier interest in substance-over-form doctrines developed in the United States, and his dissatisfaction with the legislative politics that led to the incorporation of Article 11(1) in the Tax Code, it would not be surprising if he seized on the opportunity presented by a political mandate from above to destroy Khodorkovsky to move tax law in what he perceived as a sound direction. It also would not be inconsistent with his background, which included great experience with tax policy and enormous conceptual intelligence but also no formal training in civil law, for him to approve a superficially plausible legal theory that lacked any substantial basis in the Civil Code. At the end of the day, however, one can only speculate about these matters.[52]

Not satisfied with a dubious legal theory, the tax authorities employed ferocious tactics to undermine any judicial resistance to enforcement of their assessment. One judge who tried to overturn the asset freeze was removed from the case, and then fired; another judge who fully backed the government's case won an award, and then promotion. The company's legal department, in turmoil due to the arrests of Yukos personnel, was given exceptionally short deadlines to respond to the government's case and no effective opportunity to review the government's

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violation of the fundamentals of the legal order sufficient to trigger Article 169, although no case actually had applied this provision. Later the High Arbitrazh Court categorically repudiated this argument, recognizing that its acceptance would effectively overturn Article 11 of the Tax Code. Resolution of the Plenum of the High Arbitrazh Court No. 22, of April 10, 2008, On Certain Questions in the Practice of Handling Disputes in Connection with the Application of Article 169 of the Civil Code of the Russian Federation. In the Yukos case itself, the tax authorities never made any reference to Article 169.

51. *Cf.* Vitaly Yaroshevsky, *Victor Gerashchenko, "I encountered total disregard for the law"*, NOVAYA GAZETA, Jul. 10, 2008, *available at* http://www.old.khodorkovsky.info/media/136489.html (asserting that the tax demands were something that Shatalov had "dreamed up").

52. Shatalov's public statements make clear that he found the use of domestic tax shelters by energy companies to be offensive, whether legal or not. To my knowledge, he has never addressed the question of why Yukos, rather than any of the other private energy company that engaged in similar or worse behavior, was singled out.

evidence. Most extraordinarily, the government relied on the asset freeze to bar any payment of the assessment. Between its Sibneft stock and Menatep's holdings of Yukos stock, there existed more than enough liquid assets to satisfy the government's claim. But the government insisted on payment only in cash, not in property, and used the freeze to bar Yukos from converting its liquid assets into cash.

Throughout the summer of 2004, the government rang up victory after victory in the Russian courts. In July it identified its real objective by announcing its intention to sell off Yukos's YNG stock. YNG owned the majority of the production under Yukos's control, so severing it from Yukos would effectively cripple the company.

During the fall of 2004, as the deadline for the YNG auction approached, the government upped the ante by bringing new assessments for the 2001 through 2003 tax years.[53] Ultimately the total amount claimed came to more than $24 billion, a figure that exceeded what even a fair sale of YNG could bring in. The auction of YNG in December 2004, however, failed to satisfy even minimal standards of fairness. Based on proven reserves and its recent history of production, YNG probably was worth somewhere between $15 and $20 billion. Baikal Finance Group (BFG), a shell company created two weeks before the auction, put in the only bid above the reservation price and acquired YNG for $9.35 billion. Rosneft, a state-owned energy company, then acquired YNG from BFG with financing provided by the China National Petroleum Corporation.[54]

Stripped of its most valuable asset and crippled by the remaining tax assessment, Yukos limped along a little longer.

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53. *See* To Hold the Taxpayer Fiscally Responsible for a Tax Offense, Decision No. 30-3-15/3 of the Ministry of Taxation of the Russian Federation, Sept. 2, 2004 (covering 2001 tax year); To Hold the Taxpayer Fiscally Responsible for a Tax Offense, Decision No. 52/896 of the Ministry of Taxation of the Russian Federation, Nov. 16, 2004 (covering 2002 tax year); To Hold the Taxpayer Fiscally Responsible for a Tax Offense, Decision No. 52/985 of the Ministry of Taxation of the Russian Federation, Dec. 6, 2004 (covering 2003 tax year). Yukos was unable to obtain judicial review of these assessments before the auction of YNG.

54. SAKWA, *supra* note 1, at 184–66. A last-minute injunction issued by a U.S. bankruptcy court apparently prompted the use of the shell as a cut-out for Rosneft. *See infra*, notes 63–65, and accompanying text.

Beginning in 2005, Rosneft filed several suits against Yukos for nonpayment for oil purchases as well as for YNG's tax liabilities. Bankruptcy proceedings began in March 2006. Rosneft and the Tax Ministry rejected a proposed restructuring in July, and final liquidation of the company occurred in the fall of 2007, with Rosneft receiving most of the remaining assets and Promnefstroy, a former Rosneft subsidiary, obtaining a claim to Yukos's Dutch subsidiary Yukos Finance B.V. Remarkably, once the liquidation got under way, YNG's tax liabilities somehow disappeared. At the end of the day, all of the assets of Russia's largest energy company had passed into the hands of a state-owned holding company, without any compensation to its owners or any outlay by the Russian state.[55]

Throughout the debacle, the lower courts in Russia played a crucial role in confirming the government's theories and mechanisms, most importantly including the outrageous tax assessment for 2000, the asset freeze, and the auction of YNG. Interestingly, however, the highest courts in the system, while not risking any intervention, mostly kept their distance from the mess. The High Arbitrazh Court limited its involvement to a determination, made long after the YNG auction, that the three-year statute of limitations applicable to the collection of penalties (but not the underlying assessment) did not apply to Yukos's 2000 tax year because of its supposed noncooperation with the audit.[56] The Constitutional Court first ducked this question on a procedural ground, and then, over the dissent of three members of the Court, reached the same conclusion as did the High Arbitrazh Court.[57] Then in 2006 the Plenum of the

55. SAKWA, *supra* note 1, at 240–43.

56. Russian Federation High Arbitrazh Court, Judgment of the Presidium No. 8665/04 of Oct. 4, 2005.

57. Judgment of the Constitutional Court of the Russian Federation in Case No. 36-O of Jan. 18, 2005 (case does not raise a constitutional question because there exists no established judicial practice regarding the statute of limitations); Resolution of the Constitutional Court of the Russian Federation in Case No. 9-P of Jul. 14, 2005. The European Court of Human Rights, while refusing to review the government's overall behavior in the tax assessment of Yukos, did determine that this decision, along with that of the High Arbitrazh Court discussed above, produced such a breach of settled Russian law as to constitute a violation of the European Charter of Human Rights. OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04 Eur. Ct. H.R., at ¶ 591

High Arbitrazh Court issued general guidelines to the lower courts on the interpretation of tax law that, in general, disapproved the kinds of arguments that had worked in Yukos.[58] Overall, the leading courts, while recognizing their powerlessness to stop a politically determined outcome, sought to erect barriers against infection of the legal system with essentially unreviewable government discretion to reassess taxes and seize taxpayer assets.

Whatever the diffidence expressed by some figures in the legal system, however, the brute facts of the case remain. What in 2003 was a political and personal dispute with the leading figures of Yukos became, in 2004, an all-out assault on the company itself. The Russian government, using a groundbreaking legal theory and intimidation of the reviewing courts, invented an enormous tax liability and then barred the company from paying it. This allowed the government to take over one of the largest production companies in Russia at virtually no cost, meaning without any compensation to Yukos or its shareholders. It was not enough for the Kremlin to destroy Khodorkovsky and his wealth: It also wiped out all outside investment in Khodorkovsky's enterprises.

IV. THE AFTERMATH—LITIGATION EVERYWHERE

After 2004, all of Yukos within Russia was either seized or crippled. But because the company had an international dimension, the government and its cat's-paw courts could not control everything involving Yukos. Foreign affiliates and assets survived the attack and had to be disposed of. Foreign shareholders remained free to demand compensation for the destruction of their property. In particular, foreign managers affiliated with the company as well as the shareholders had the

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(2011), *available at* http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-106308.

58. Resolution No. 53 of the Plenum of the High Arbitrazh Court of the Russian Federation, Oct. 12, 2006. The Resolution counsels that "the opportunity to achieve the same economic result with less tax benefit for the taxpayer by concluding other transactions permitted or not prohibited by law does not constitute a ground for considering a tax benefit unjustified" (point 4) and remarked that many of the factors at issue in the Yukos case "may not by themselves constitute a ground for considering a tax benefit unjustified" (point 6).

capacity and inclination to fight back against the Russian government. As a result, offshore litigation exploded.

The foreign legal proceedings triggered by the destruction of Yukos fall into three categories. First, the Russian government invoked the jurisdiction of foreign courts either to extradite people associated with Yukos, to lend assistance in the collection of evidence to be used in criminal prosecutions, or to claw back the overseas assets of Yukos. Yukos interests responded, for the most part successfully. Second, Yukos stakeholders, either creditors or shareholders, brought actions against Rosneft and other Russian entities and person in foreign courts. The plaintiffs so far have had only limited success. Finally, several groups of Yukos shareholders and the company itself invoked treaty rights to international adjudication against the Russian government. Investment tribunals have upheld these rights, but the European Court on Human Rights (Strasbourg Court) reached a mixed result. The most important proceeding, in terms of the size of the claim, remains pending. I describe each litigation in turn.

A. *Russian Claims on Foreign People and Property*

Having consummated the destruction of Yukos and incarcerated its leadership in Russia, the government sought others who had fled abroad. In the United Kingdom, Cyprus and Lithuania, it tried to extradite persons associated with the company. In each case, the local courts rejected the request because of what they regarded as deficiencies in the criminal and tax proceedings in Russia.[59] In Liechtenstein and Switzerland, Russia requested that the local authorities seize the records of certain companies that had transacted with Yukos so as to bolster its prosecution of Khodorkovsky and others. In both instances, the courts refused legal assistance because of

59. Government of the Russian Federation v. Maruev and Chernysheva, Bow Street Magistrates Court, Mar. 18 2005; Government of the Russian Federation v. Temerko, Bow Street Magistrates Court, Dec. 23, 2005; Regarding Law on Extraction of Fugitives 95/70, Application No. 2/07, District Court of Nicosia, Apr. 10, 2008; Lithuanian court rules Russian Manager of Yukos bank has right to asylum, Oct. 16, 2006, published at http://www.forbes.com/feeds/afx/2006/10/16/afx3094141.html.

what of they held to be abuses in the Russian proceedings.[60]

As of 2004, Yukos held several offshore financial subsidiaries, including Yukos Finance B.V. in the Netherlands and Yukos CIS in Armenia. Once Yukos went into bankruptcy, the Russian administrator purported to sell these companies to Rosneft and Promneftstroy, a former Rosneft subsidiary, as part of the settlement of Yukos's debts. In the Netherlands, a Dutch court refused to recognize the Russian bankruptcy proceeding because of what it regarded as manifest shortcomings. It instead upheld the decision of the local managers of Yukos Finance to transfer its most significant assets to a Dutch stichting, a protective trust under local control. Included in the trust assets was Yukos Capital S.a.r.L., a Luxembourgish entity that figures in the Dutch and British litigation discussed below.[61]

The one foreign jurisdiction that did recognize the Russian bankruptcy was Armenia. The local administrator of Yukos CIS initially obtained an injunction against its transfer to Rosneft, but the Armenian courts reconsidered and allowed Rosneft to register itself as the company's owner. Legal challenges to this decision continue, but given the high degree of dependency of the Armenian government on Russia and the poor reputation of the local courts for independence and integrity, the prospects of success seem slight.[62]

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60. Khodorkovsky v. Office of the Attorney General, Federal Supreme Court, Case 1A29/2007, Aug. 23, 2007; Decision of Feb. 6, 2006, Princely Court of Justice of Principality of Liechtenstein.

61. Judgment of the District Court of Amsterdam in Case No. 355622/HA ZA 06-3612 of Oct. 31, 2007. On appeal, the Amsterdam Gerechtshof (Court of Appeals) confirmed that Dutch law would not recognize any interest in Yukos Finance that Promneftstroy had purported to acquire through the Russian bankruptcy. Judgment in Cases No. 200.002.097/01 and 200.002.104/01 of 19 October, 2010. Most recently, the Supreme Court ruled that Eduard Rebgun, the former receiver of Yukos in the Moscow bankruptcy proceedings, lost his standing to participate in the case when the bankruptcy terminated. Rebgun v. Godfrey, Case No. 11/00860 of 29 June 2012. Other dimensions of the case remain under appellate review.

62. *See Armenia*, THE YUKOS LIBRARY, http://www.theyukoslibrary.com/en/jurisdictions/armenia (last visited Jun. 29, 2012). This web site is run by supporters of Yukos and should be evaluated accordingly. For official criticism of the poor record of Armenian courts, particularly their lack of independence, see *U.S. Department of State Bureau of Democracy, Human Rights and Labor, Country Reports on Human Rights Practices in 2011—Armenia*, *available at* http://www.state.gov/j/drl/rls/hrrpt/

On balance then, Russia's efforts to obtain external legitimacy from foreign courts for its attack on Yukos have all failed, excepting only those in its Armenian satellite. In each case, the foreign court made its own assessment of the criminal prosecutions and the tax and bankruptcy proceedings and found them fundamentally flawed. In particular, no country has cooperated with any Russian criminal prosecution.

B. Attacking the Yukos Transactions in National Courts

Yukos shareholders and overseas managers were not content to play defense in non-Russian national courts. Once it became clear that the Russian government intended to destroy the company, they sued in foreign courts to block, delay, or at least call attention to the attack on the company. Results have been mixed. While no other court has attempted to undo the company's expropriation, one offshore entity has managed to obtain substantial compensation from Rosneft. I discuss each wave of lawsuits in turn.

1. United States

Even before the consummation of the government's expropriation of Yukos, the company's external representatives sought to enlist a U.S. bankruptcy court to forestall the sale of YNG. Yukos filed for voluntary bankruptcy in Houston in December 2004, seeking to block the pending YNG auction and to effect a reorganization. The court issued a temporary restraining order forbidding Gazprom and Deutsche Bank, two entities that had appeared as potential bidders, from participating in the auction, finding that "the series of events within Russia which has led to the notice of an auction of the principal producing assets of Yukos Oil Company . . . is inconsistent with the regular application of Russian law within Russia."[63] As noted above, Rosneft circumvented this order by using BFG as the auction purchaser.[64] A few months later, the

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humanrightsreport/index.htm#wrapper (last visited Jun. 29, 2012).

63. In re Yukos Oil Co., 320 B. R. 130, 132 (Bankr. S.D. Tex. 2004).

64. Rosneft was not named in the TRO, but presumably could have been added quickly if it had emerged as a potential bidder. The U.S. court then would have had to

Houston court determined that, based on the totality of the circumstances, the possibility of U.S. proceeding achieving a reorganization of Yukos was too remote and ordered dismissal of the case.[65]

Yukos shareholders next brought a civil suit in Washington against Russia, Rosneft, and a number of Russian officials. They alleged numerous violations of federal, state, and Russian law for what they characterized as effectively the theft of the company's assets. The court observed that the allegations in the complaint "tell a troubling story if proven true," but ruled that it lacked jurisdiction to hear the case.[66] According to the court, all of the defendants either enjoyed foreign sovereign immunity or lacked sufficient contacts with the United States to permit the assertion of judicial power. With this decision, U.S. litigation came to an end, excepting only requests for evidentiary assistance with respect to the European civil suits discussed below.[67]

2. Netherlands

The creation of the Dutch stichting allowed overseas Yukos managers to assert claims against the Russian entities created by the bankruptcy. Yukos Capital S.a.r.L. (Yukos Capital), a wholly owned subsidiary of Yukos Finance B.V., asserted that YNG had defaulted on a loan and, pursuant to the loan agreement, obtained arbitration of the claim in the Russian Chamber of Commerce. In 2006 the Chamber's International Commercial Court (ICC) awarded Yukos Capital $425 million, at about the time when Rosneft became the legal successor to YNG.

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consider whether it could exercise in personam jurisdiction over Rosneft. The use of BFG in the auction made these issues moot.

65. In re Yukos Oil Co., 321 B. R. 396 (Bankr. S.D. Tex. 2005).

66. Allen v. Russian Fed'n, 522 F. Supp. 2d 167, 171 (D.C. Cir. 2007).

67. In re Application of Yukos Hydrocarbons Inv. Ltd., 2009 WL 5216951 (N.D.N.Y. Dec. 30, 2009) (application brought by Rosneft subsidiary for evidence in connection with Dutch proceedings denied because of procedural irregularities); In re Application of OOO Promneftstroy, 2009 WL 3335608 (S.D.N.Y. Aug. 17, 2011) (application denied because intended to circumvent Dutch restrictions on discovery). A securities fraud class action brought by shareholders against Yukos was dismissed based on a failure sufficiently to allege material misstatements that could be actionable under U.S. law. In re Yukos Oil Co. Sec. Litigation, Fed. Sec. L. Rep. ¶ 94,115 (S.D.N.Y. 2006).

Rosneft in turn sought Russian judicial review of the ICC's decision, while Yukos Capital sought to enforce the arbitral award against Rosneft in the Netherlands.

In 2007 the Russian arbitrazh courts annulled the ICC award. Yukos Capital sought leave to enforce the award in the Netherlands, notwithstanding the Russian annulment. A first-instance Dutch court ruled that the determination of the Russian courts was binding, but the Amsterdam Court of Appeal reversed. It held that Yukos Capital had overcome the presumption of regularity normally accorded to a foreign judicial decision by proving that the Russian courts were not impartial and independent. As a result, the rules of private international law and the Dutch public order required the Dutch courts to ignore the Russian annulment decree and to treat the arbitration award as enforceable.[68] Rosneft then paid the award while reserving its right to seek to claw back the payment in other proceedings.

The Dutch litigation is significant. It represents the first time when a non-Russian court concluded that the performance of the Russian judiciary in the enforcement of the tax award against Yukos and the subsequent sale of YNG represented a lawless surrender of authority to the government.[69] Moreover,

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68. Yukos Capital S.A.R.L. v. OAO Rosneft, Case No. 200.005.269/01, Decision (28 April 2009) (Amsterdam Gerechtshof), *discussed in* Vera van Houtte, Stephan Wilske & Michael Young, *What's New in European Arbitration?* 64-JUL DISP. RESOL. J. 12 (2009). The Supreme Court of the Netherlands turned down Rosneft's request for an appeal. Vera van Houtte, Stephan Wilske & Michael Young, *What's New in European Arbitration?* 65 DISP. RESOL. J. 16 (2011).

69. The Dutch court, in the course of discussing the failings of the Russian judiciary in the Yukos affair, referred in passing to my expert testimony, given in a British case involving other parties and matters. Yukos Capital S.A.R.L. v. OAO Rosneft, note 68 *supra*, at 1093–95 (quoting Cherney v. Deripaska, [2008] E.W.H.C. 1530 (Comm.)).

In a French proceeding with respect to a different arbitral proceeding, the French Cour d'appel de Paris declined to recognize an award against Tomskneft, a Rosneft subsidiary, in favor of Yukos Capital. It ruled that a lack of notice to Tomskneft of the arbitration rendered the award ineffective. Société O.A.O. "Tomskneft" Vostochnoi Neftyanoi Kompanii v. Société Yukos Capital, No. 11/03911 (Jan. 13, 2013), *available at* http://www.transnational-dispute-management.com/search/get_page.asp?v2=legal&v1=03%5FRU%5FTomskneft%5Fv%5FSociete%5FYukos%5FCapital%5F%2D%5FCour%5FD%2DAppel%5FDe%5FParis%5F%2D%5FArret%5Fdu%5F15%5FJanvier%5F2013%2Ep

the outcome involved a significant amount of money, even if it was only a small fraction of the value of the assets seized by the Russian government and transferred to Rosneft.

3. *United Kingdom*

Attacks on Rosneft in the British courts proceeded in two waves. First, the Russian government in 2006 sought to capitalize on the recent engorging of Rosneft at Yukos's expense by listing Rosneft's shares on the London Stock Exchange and offering a minority interest for sale to the public (IPO). The Financial Services Authority (FSA), the U.K. regulator, along with the Stock Exchange, approved the proposed listing and IPO. Yukos entities then sought to set that decision aside. They maintained that the offering would violate a provision of British law forbidding a listing intended to launder the proceeds of a crime.

The High Court rejected Yukos's argument. It understood the relevant legislation as allowing the FSA to apply the act of state doctrine so as to bar any challenge to the validity of the Russian government's actions under Russian law. Thus, as a matter of Russian law, no theft had occurred, meaning that the sale of Rosneft stock in London would not result in laundering of the proceeds of a crime.[70] The court was careful not to decide that the FSA had correctly interpreted the act of state doctrine, but rather determined only the FSA had the discretion to interpret the doctrine as it did. In particular, the court did not understand the statute as requiring the FSA to determine that Rosneft was innocent of participation in violations of international law, in particular of practices outlawed by the European Convention on Human Rights.

Later litigation revisited the issue of the power of a British court to review the legality of the acts of the Russian government with respect to Yukos. After collecting from Rosneft on the ICC award, Yukos Capital sued in London for $160

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70. R v. Fin. Servs. Auth., [2006] E.W.H.C. 2044 (Admin.) ¶¶ 80–90. The British doctrine parallels, but does not exactly match, the U.S. doctrine, which sets out the circumstances when a domestic court will give preclusive effect to the acts of a foreign sovereign within its own territory regardless of any claims of illegality.

million post-award interest due. In response, Rosneft invoked the Russian judicial annulment as well as arguing that the loan agreement that had generated the arbitral award reflected an illegal scheme to hide Yukos's supposed tax fraud. In the course of defending the annulment, Rosneft relied on the act of state doctrine mentioned in the FSA litigation. The High Court ruled that the act of state doctrine did not apply, and that the determination of the Dutch courts as to the invalidity of the Russian annulment decision estopped Rosneft from invoking the annulment in a British court.[71]

On appeal, the Court of Appeals upheld the High Court on the act of state question but not as to estoppel. Each state applies its own standard of public order, so the Dutch standard for rejecting the Russian court decisions did not necessarily match the British one. In impeaching the Russian decisions, however, the act of state doctrine posed no obstacle to Yukos Capital. The doctrine, the court ruled, applies only to governmental or parliamentary acts, and not to judicial ones. As a result, Yukos Capital could use generic as well as specific evidence in attacking the decisions, including evidence that Russian courts throughout the Yukos affair demonstrated an inability to exercise effective judicial review of apparently lawless acts of the executive.[72]

At the present time, then, Yukos interests have the opportunity to prove again in London the same charges against the independence of the Russian courts that prevailed in the Netherlands. As in the Dutch proceedings, substantial money is at stake, although nothing like the value of Yukos that the government seized for Rosneft. In light of the Court of Appeal's recent decision, it seems clear that the initial reluctance of the High Court to bar the listing of Rosneft stock on the London Stock Exchange reflected the limits of judicial authority to review administrative acts, and not an independent determination that the Russian government behaved appropriately with respect to the tax assessment and the disposition of Yukos's assets.

71. Yukos Capital S.a.r.L. v. OJSC Rosneft Oil Co., [2011] E.W.H.C. 1461 (Comm.).

72. Yukos Capital S.a.r.L. v. OJSC Rosneft Oil Co., [2012] E.W.C.A. Civ. 855.

C. International Adjudication

Taken together, the domestic lawsuits demonstrated that only collateral attacks on the Russian expropriation of Yukos were possible in national courts. Yukos could offer the events of 2004 as a ground for withholding assistance from Russian officials, protecting local assets from Russian claims, and, in the Dutch and British instances, stripping away a defense that might otherwise have existed against enforcement of an arbitral award. None of these cases, whatever their symbolic importance, opened up the possibility of compensation for the wrongs done the company by the Russian government. As the U.S. suit demonstrated, barriers such as sovereign immunity and the prerequisites for the exercise of adjudicative jurisdiction made redress through domestic litigation improbable.

The alternative was international adjudication.[73] There is, of course, no general international forum with the global authority to address injustices. As the International Court of Justice demonstrated in the *Barcelona Traction* case, those international courts that do exist usually take seriously the constraints on their jurisdiction.[74] But Russia was tied to

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73. In addition to its claims against Russia and Rosneft, Yukos also had a grievance with Sibneft, which successfully unwound the 2003 merger once the Russian government launched its campaign. For an example of the creative litigation strategy of Sibneft in the Russian courts to get back its stock, involving a remarkable application of the Joint Stock Company law to force Yukos to disgorge a portion of the Sibneft stock, see Chukotka Autonomous District Arbitrazh Court, Decision of July 13 2005, in Case No. A80-170/2005, *excerpted in* RICHARD N. DEAN & PAUL B. STEPHAN, DOING BUSINESS IN EMERGING MARKETS, 156–61 (2010). Yukos then invoked the arbitration clause in its merger agreement with Sibneft to challenge these actions. Sibneft in response asserted, among other grounds, Yukos's purported culpability for the steps taken by the Russian government. Yukos retained me to provide expert assistance regarding the issues of Russian tax law involved in the case, but the matter was settled before I was able to prepare any testimony or report. The terms of the settlement were confidential and were never disclosed to me.

74. Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain), 1970 I.C.J. 3 (Feb. 5). In that case, Spain expropriated through a phony bankruptcy of a Canadian company, most of whose shareholders were Belgium nationals. Belgium and Spain were party to a treaty that gave the International Court of Justice the authority to consider disputes involving expropriation, but Canada was not. The Court ruled that the absence of a Canadian treaty was fatal to its jurisdiction, notwithstanding that the Belgian shareholders were the real party in interest.

several treaties that seemed to offer some chance of compensation for individual victims of international law violations. First, several bilateral investment treaties (BITs) to which it was a party seemed to give some foreign nationals a right to arbitrate investment disputes.[75] Second, a multilateral treaty, the Energy Charter Treaty (ECT), opened up dispute resolution to a broader class of investors, including those with large stakes in Yukos.[76] Russia had signed this treaty but not ratified it. Third, the European Convention of Human Rights also bound Russia, although it offered only weak protection against government expropriation of property. Claims under that treaty could be brought to the Strasbourg Court.[77]

In each case, Yukos investors or, in the case of the European Convention, Yukos itself sought to compel proceedings against Russia. In every instance the tribunal has determined that it was competent to hear the case.[78] With respect to the ECT, this finding was bold, because Russia had not yet joined the treaty.[79]

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75. Agreement for the Promotion and Reciprocal Protection of Investments, U.K.-U.S.S.R., art. 8, ¶ 2, Apr. 6, 1989, 1670 U.N.T.S. 28; Agreement Concerning the Encouragement and Reciprocal Protection of Investments, art. 9, ¶ 2, art. 10, ¶ 2, Spain-U.S.S.R., Oct. 26, 1990, 1662 U.N.T.S. 216.

76. The Energy Charter Treaty, art. 27, Dec. 17, 1994, 208 U.N.T.S. 95 [hereinafter ECT].

77. Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, C.E.T.S. No. 5. The Convention itself does not protect property from arbitrary deprivation. Protocol 1, Article 1, while guaranteeing a right to peaceable enjoyment of possessions, also provides that this guarantee "shall not . . . in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties." On the limited applicability of Protocol 1, Article 1 to tax litigation, see Paul B. Stephan, *Tax Administration in Comparative Perspective*, in INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW 599, 618 n. 43 (Stephan W. Schill ed., 2010).

78. Renta 4 S.V.S.A v. Russian Fed'n, I.I.C. 369, at ¶ 67 (Arb. Inst. Stockholm Chamber of Commerce 2009); RosInvest Co. UK Ltd. v. Russian Fed'n, I.I.C. 315, at ¶ 139 (Arb. Inst. Stockholm Chamber of Commerce 2007). In *Renta 4*, I submitted expert testimony concerning Russian tax law at the requests of the claimants.

79. Hulley Enterprises Ltd. v. Russian Fed'n, 2009 I.I.C. 415, ¶ 393–94 (Per. Ct. Arb. 2009). The ECT does require that a state accept provisional application pending ratification "to the extent such provisional application is not inconsistent with its constitution, laws or regulations." States may opt out of provisional application with a declaration upon signing, something Russia did not do. ECT, *supra* note 76, at art. 45.

In the case of the European Convention, the Strasbourg Court had to decide that the liquidation of Yukos in bankruptcy and the termination of its corporate existence in Russia did not strip the company of its right to redress.[80] Both of these decisions, if nothing else, constitute important contributions to the jurisprudence of the jurisdiction of international tribunals.

Forced to defend its actions before international tribunals, Russia's lawyers distanced themselves from the arguments that the tax authorities had invoked and that the Russian courts had ratified. Before the BIT tribunals, they argued that the power to characterize Yukos as the actual taxpayer (the VAT filings aside) came not from the Civil Code, but rather from a constitutional doctrine that distinguished between good-faith and bad-faith taxpayers.[81] The Constitution, so the argument went, allowed the government to disregard transactional forms used by taxpayers who purposively sought excessive tax benefits.

The doctrinal support for Russia's constitutional argument was thin at best, and the principle so stated had no logical limits. The argument rested on two Constitutional Court decisions in cases that arose out of the 1998 banking crisis. Russian legislation expressly authorized payment of taxes by internal bank transfers into special government accounts established in private banks. When many of these banks became insolvent, and thus unable to pay out any money nominally in the government accounts, the tax authorities argued that taxpayers who had complied with the statutory payment procedure nonetheless should be treated as delinquent. The Constitutional Court responded that the government's position represented an unconstitutional rewriting of the statute.[82]

80. OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04 Eur. Ct. H.R., at ¶ 591 (2011).

81. Before the Strasbourg Court, Russia did rely on the Article 209 argument. The Court did not explicitly reject it, but its remarkably brief analysis seemed to focus on the good-faith/bad-faith distinction. OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04 Eur. Ct. H.R., at ¶ 597 (2011).

82. Resolution of the Constitutional Court of the Russian Federation of October 12, 1998, No. 12-P, in the Case of the Verification of the Constitutionality of Article 11, Clause 3 of the Russian Federation Statute of December 27, 1991, "On the Fundamentals of the Tax System of the Russian Federation."

Opportunistic taxpayers then sought to exploit the ruling. They typically would buy notes issued by the banks at a deep discount, remit the notes to the banks at face value to establish accounts in the insolvent banks, and then order a transfer from these phony accounts to the government to satisfy outstanding tax obligations. In a second decision, the Constitutional Court clarified that its prior ruling applied only to good faith taxpayers. A person who had no intention of creating a bank account with real value had not really complied with the statutory procedures.[83]

Out of this casual reference to good-faith taxpayers, Russia sought to construct a powerful weapon that would allow it to disregard any transaction, no matter how valid under the Civil Code, that produced disproportionate tax benefits. It did so without specifying the criteria for disproportionality, thus claiming unreviewable discretion on the part of the tax authorities to punish or pardon taxpayers. Several years after the Yukos litigation had ended, the High Arbitrazh Court expressly rejected the argument.[84] Before the BIT tribunals and the Strasbourg Court, however, Russia's lawyers argued that, whatever the ultimate fate of this legal theory, it was well enough established in 2004 to insulate the tax authorities from the charge that their conduct was so arbitrary and lawless as to constitute an expropriation under international law.[85]

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83. Determination of the Constitutional Court of the Russian Federation of July 25, 2001, No. 138-O, upon a Petition of the Russian Ministry for Taxation and Charges for Clarification of the Resolution of the Constitutional Court of the Russian Federation of October 12, 1998, in the Case of the Verification of the Constitutionality of Article 11, Clause 3 of the Russian Federation Statute of December 27, 1991, "On the Fundamentals of the Tax System of the Russian Federation."

84. *See supra* note 58 (discussing Resolution No. 53 of the Plenum of the High Arbitrazh Court of the Russian Federation, Oct. 12, 2006).

85. The virtually identical provision of the Spanish and U.K. BITs, adopted during the Soviet period, provided more limited protection to investors than the BITs used by the United States. They allowed a claim only in the case of an expropriation, narrowly defined. For discussion of these provisions, see Renta 4 S.V.S.A. v. Russian Fed'n, *supra* note 78, at ¶ 20; RosInvest Co. UK Ltd. v. Russian Fed'n, *supra* note 78, at ¶¶ 127–33. The Swedish Supreme Court ruled that Swedish courts have jurisdiction to review these awards, and appeals are pending. Rosinvest Co. UK Ltd. v. Russian Fed'n, Case No. Ö 2301-09, Swedish Supreme Court, decision of Nov. 12, 2010. Moreover, after the Supreme Court decision, Russia filed an independent action in the Swedish courts

To date, three international tribunals have reached judgments on the merits. The first, addressing the claim brought by British shareholders under the Russia-United Kingdom BIT, resulted in a victory for the shareholders and a repudiation of Russia's conduct. The tribunal found that, during the enforcement proceedings against Yukos, the Russian courts had applied new interpretations of Russian law that were inconsistent with established Russian tax law and previous practice.[86] Taking into account how the changes in the tax authority's position and their exercise of discretion affected this one taxpayer, compared to the treatment of others, the tribunal could not accept the "objectivity and fairness of the process."[87] Russia's behavior, when considered against "the cumulative effect of the totality of [the Russian government's] conduct," constituted a breach of the treaty.[88]

The Strasbourg Court, applying the significantly different legal standard found in Protocol 1 to the European Convention, reached the opposite result. It stated that:

> Overall, *having regard to the margin of appreciation enjoyed by the State in this sphere* and the fact that the applicant company was a large business holding which at the relevant time could have been expected to have recourse to professional auditors and consultants . . ., the Court finds that there existed a sufficiently clear legal basis for finding the applicant company liable in the Tax Assessments.[89]

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seeking a declaratory judgment as to the invalidity of the final award. RosinvestCo did not make an appearance and a default judgment in Russia's favor was issued.

86. Rosinvest Co. UK Ltd. v. Russian Fed'n, 2010 I.I.C. 471, at "Holdings" ¶ 2 (Arb. Inst. Stockholm Chamber of Commerce 2010).

87. *Id.* at ¶ 496.

88. *Id.* at ¶ 498.

89. OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04 Eur. Ct. H.R., at ¶ 599 (2011) (provisional judgment on the merits) (italics added). It may or may not be relevant that the decision to bring a case in the Strasbourg Court fell to Yukos's former managers, especially to those associated with the Dutch stichting. The company itself had no rights under any of the investment protection treaties. To some extent, then, the managers and the shareholders had a conflict of interest: The shareholders could derive only an uncertain benefit from a Strasbourg proceeding (depending on a how the stitching might later dispose of the proceedings from an award) and could suffer collateral damage from an unfavorable precedent, while the managers had to choose

While the Court believed that some of the procedures used by the Russian courts to apply fines and to enforce the tax assessment breached the European Convention, it did not otherwise question Russia's approach to determining Yukos's tax liability.[90] It did not endorse the claim that Article 209 of the Civil Code justified treating Yukos as the owner of the energy products sold by YNG and purchased by foreign customers, but it did accept the proposition that Russian tax law allowed the authorities to disregard the tax consequences of transactions constructed by bad-faith taxpayers.[91]

One point in particular illustrates the casualness, one might say credulousness, of this portion of the Strasbourg Court's opinion. Russia argued, and the Court accepted, that Article 45(2)3 of the Tax Code allowed the government generally to recharacterize transactions as it chose.[92] This provision,

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between getting some compensation in Strasbourg, however limited, or getting nothing at all.

90. The Strasbourg Court ruled, *inter alia*, that a change in interpretation of the applicable statute of limitations, which both the Constitutional Court and the SAC had endorsed, represented an unforeseeable change in the law that departed from established practice and thus violated Article 1 of Protocol 1. *Id.* ¶¶ 563–65, 572–74.

91. After describing the tax scheme, including the use of what Russia called "letter-box companies," (*i.e.*, the trading companies), the Court ruled:

> The domestic courts found that such an arrangement was at face value clearly unlawful domestically, as it involved the fraudulent registration of trading entities by the applicant company in the name of third persons and its corresponding failure to declare to the tax authorities its true relation to these companies . . . This being so, the Court cannot accept the applicant company's argument that the letter-box entities had been entitled to the tax exemptions in questions. For the same reason, the Court dismisses the applicant company's argument that all the constituent members of the Yukos group had made regular tax declarations and had applied regularly for tax refunds and that the authorities were thus aware of the functioning of the arrangement. The tax authorities may have had access to scattered pieces of information about the functioning of separate parts of the arrangement, located across the country, but, given the scale and fraudulent character of the arrangement, they certainly could not have been aware of the arrangement in its entirety on the sole basis on the tax declarations and requests for tax refunds made by the trading companies, the applicant company and its subsidiaries.

Id. at ¶ 592.

92. *Id.* at ¶ 597.

however, does nothing of the sort.[93] Russia had not relied on it in any of the Russian court proceedings, because everyone in Russia understood that Article 45 does not grant the tax authorities a power to recharacterize, but rather specifies the consequences of those recharacterizations that the Tax Code otherwise allows.[94] Because of the Tax Code's general rule limiting the tax authorities to the rules of the Civil Code, a recharacterization based on Yukos's facts would have had to rest on a provision such as Article 170 of the Civil Code, discussed above.[95] And, as noted above, the tax authorities never had invoked that provision in the Russian litigation, probably because it would not have supported the result reached. The Strasbourg Court, in short, accepted at face value the government's *post hoc* rationalization of its conduct, without attempting an even minimally credible independent assessment of the plausibility of these assertions.

Finally, the Court's treatment of the VAT issue, which comprised the lion's share of the tax assessment at the time of the YNG auction, was remarkably credulous regarding the Russian government's account:

> 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

93. The provision states that a tax can be assessed against a person "if its obligation to pay the tax is based upon a change by the tax authority of the legal characteristic of a transactions made by the taxpayer or the status or nature of such taxpayer's activity." Tax Code Part I, *supra* note 23, at art. 45(2)3 (my translation).

94. In the April 2004 assessment, the Tax Ministry did refer to Article 45 of the Tax Code, but only as a ground for disregarding certain limited tax payments by the trading companies. The trading companies had sought to satisfy their liabilities with debt instruments rather than cash, a method expressly disallowed by the Tax Code. The government thus recognized that Article 45 on its own did not permit recharacterization of transactions, but rather worked in tandem with the provision specifying the method of payment. Decision No. 14-3-05/1609-1, *supra* note 45, at 70, 90.

95. *See supra* notes 49–50.

> 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 . . . The Court concludes that the applicant company did not receive any adverse treatment in this respect.[96]

Thus the Court accepted at face value Russia's claim that Yukos should have known that it, and not the trading companies, bore the responsibility of making the filings and that filings actually made by the trading companies had no legal effect. The opinion also ignored the evidence that the Russian government had indicated from the outset that it would refuse to accept any filings from Yukos.

In July 2012 yet another arbitral tribunal, constituted under the bilateral investment treaty with Spain, produced an award in favor of the investors.[97] It expressed substantial agreement with the findings and conclusions of the U.K. BIT tribunal and largely disagreed with those of the Strasbourg Court. The tribunal grounded its conclusions on the distinct and rather liberal legal standard that the Spanish BIT called on it to apply. It did not have to determine that Russia violated its own laws, much less any of the specific human rights obligations found in the European Convention. Rather, it had to determine whether Russia's actions, in their entirety, constituted a compensable expropriation. To do so, it only had to determine that the government's behavior was inconsistent with "routine regulatory powers," that is normal tax assessment and enforcement.[98]

Applying that standard, the Spanish BIT tribunal had little difficulty finding that the course of the Yukos proceeding in Russia in no way corresponded to normality. In particular, it forcefully rejected Russia's argument that the government could disregard so-called sham transactions by Yukos:

> The Tribunal is unwilling to find that Yukos engaged in

96. OAO Neftyanaya Kompaniya Yukos v. Russia, App. No. 14902/04 Eur. Ct. H.R., at ¶ 602 (2011).

97. Quasar de Valores S.I.C.A. v. Russian Fed'n, I.I.C. 557 at ¶ 227 (Arb. Inst. Stockholm Chamber of Commerce 2012). I testified in this case on behalf of the Spanish investors as an expert on Russian tax law.

98. *Id.* at ¶¶ 41–43.

> sham transactions with its affiliated trading entities. For one thing, the notion of a "sham" suggests something surreptitious, whereas the tax authorities obviously had access to the tax returns of both Yukos and the affiliated entities in question and would, or should, have had little difficulty in seeing that Yukos was assigning significant revenues to the latter by way of inter-company transfers. These transfers might be questioned on the basis of the arm's length standard discussed above, but not as shams. (Incidental internal communications advising staff members not to preserve documents relating to the arrangements are not, in the Tribunal's view, decisive proof of a guilty corporate conscience; they might just as well suggest a disinclination to call attention to the tax savings made, particularly if there were apprehensions of aggressive audits. At any rate, as said, Yukos' intragroup practices were known or could readily have been ascertained.) That leads to the more significant consideration, namely that a sham transaction above all involves an attempted masquerade, attempting to disguise the very nature of what is being done . . . .
>
> In the present case, there was nothing of the sort. The sales transactions were just that: the transfer of title to goods for a certain price. From the ultimate independent purchaser, a legal relationship was created between that purchaser and the intermediary Yukos affiliate. There was no "fake" transaction. The buyer had a right to certain deliveries, the duty to make certain payments, and a right to bring action against the intermediate entity, notably in the form of an international arbitration – but no privity to bring an action against Yukos, with which it had no contractual relations.[99]

The Tribunal was equally blunt on the question of whether Russia properly refused to recognize the export sales for VAT purposes:

> The unattractiveness of the Respondent's position in this connection is readily apparent. The amounts

99. *Id.* at ¶¶ 67–68.

> 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 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.[100]

Looking back at the Strasbourg Court's treatment of this issue, the Tribunal observed that:

> [T]he ECHR appears . . . 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.[101]

The improbability of Russia's argument undercut any attempt to characterize Yukos's tax bill as a legitimate assessment.

On each substantive point, then, the Spanish BIT Tribunal concluded that, whatever the government's motivation, its conduct constituted an expropriation for which its treaty obligation required compensation. Both the Russian government's theory of the tax assessment and the method of its enforcement, as well as the conduct of the YNK auction and the subsequent bankruptcy proceedings, departed so far from the normal standards of tax administration as to lose that label, and to become something else. Investment protection law could not interfere with normal tax mechanisms, but neither could it permit the label of taxation to immunize government conduct

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100. *Id.* at ¶ 80.
101. *Id.* at ¶ 82.

from legal review under the treaty standards.[102]

What do these decisions imply for the one outstanding case, namely the ECT proceeding? It is the nature of international adjudication that the decisions of one tribunal do not bind any other. Thus the ECT tribunal need not apply any decision as precedent. But, the absence of binding authority aside, one still might predict that the ECT tribunal will follow the BIT decisions and not that of the Strasbourg Court. The legal standards at issue ECT case are similar to those involved in the U.K. and Spanish BITs, and substantially different from that of the European Convention. Moreover, the Strasbourg Court operates in a significantly different context than does an investment tribunal. The Strasbourg Court has to worry about the impact of its jurisprudence on measures that European governments may soon have to take to manage their mounting financial crisis, some of which might produce significant and arbitrary wealth transfers. With such issues on the horizon, it understandably may wish to rein in the already diffident protection that the Convention accords property rights.[103] Investment tribunals do not have any comparable responsibility.

On balance, then, one might expect Russia to face more losses as the international challenges come to a head. Whether the outcome of the litigation will affect its behavior, however, is less clear. In the next section I will discuss the limits of international litigation as a means of achieving either corrective justice or as an incentive to affect state behavior.

V. IMPLICATIONS FOR THE GLOBAL ECONOMIC ORDER

The Yukos affair, standing alone, is a remarkable object lesson about abuse of government power, ingenuity in legal argumentation, and the perils facing investors in emerging markets. What makes this episode important, however, is its wider implications for legal regulation of the world economy. It

102. *Id.* at ¶ 48.

103. Another recent case that is consistent with this conjecture is Soros v. France, App. No. 50425/06 Eur. Ct. H.R. (2011). Again the Court refused to intervene when a rich investor challenged arbitrary regulatory punishment, in this case an insider-trading rule that even the French government conceded was opaque.

exposes the illusions that underlay simplistic versions of globalization theory that thrived during the 1990s as well as the shortcomings of an overly enthusiastic view of the power of international law. While only a single event, the case nonetheless demonstrates the limits of law as a check on state behavior.

First of all, Yukos demonstrates the fallacies of the so-called Washington consensus that many in the international financial community embraced in the wake of the Soviet Union's collapse. That consensus assumed that government blunders, as exemplified by the state-run economy of the Soviet Union itself, explained poor economic performance, and that the proper policy response was to move economic activity into the private sector.[104] But not all private sectors are alike, any more than all governments are alike. In the giddy triumphalism that accompanied the end of the Soviet system, if not history itself, experts avoided a more fine-grained approach to the reconstruction challenges that faced them.[105]

This naiveté was understandable but unnecessary. Already by that time, economists had developed the field of institutional economics, resulting in Nobel Prizes for Ronald Coase in 1991 and Robert Fogel and Douglass North in 1993. Coase, Fogel and North demonstrated in their work that social institutions, built up over time and resting on unstated assumptions as well as formal attributes, play a profound role in actual economic transactions.[106] They specify that one cannot usefully talk of markets and prices in the abstract, but rather must account for

104. For one critique of the consensus by a Nobel laureate who served the Clinton Administration and also worked inside the World Bank, see JOSEPH E. STIGLITZ, MAKING GLOBALIZATION WORK (2006).

105. A famous and influential example of this triumphalism, from which its author has since walked back, is FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN (1992).

106. *See*, *e.g.*, Ronald Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960); ROBERT FOGEL, RAILROADS AND AMERICAN ECONOMIC GROWTH: ESSAYS IN ECONOMETRIC HISTORY (1964); DOUGLASS NORTH, STRUCTURE AND CHANGE IN ECONOMIC HISTORY (1981). The work of Oliver Williamson in transaction-cost economics, which resulted in the 2009 Nobel Prize, also is relevant. *E.g.*, OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985).

the complex social understandings that underlie the processes of exchange and production. This work provides substantial evidence for the belief that one cannot will capitalism into existence, any more than it was possible for the Soviet leaders, were they so inclined, to will communism into existence. The Washington consensus, however, largely ignored these insights, as well as the particular (and peculiar) institutional context in which post-Soviet reforms unfolded.

One can see both the rise and fall of Yukos as a product of the gap between reform objectives and institutional context. The birth of Yukos in the loans-for-shares scheme resulted in a massive transfer of value from the state to well-positioned entrepreneurs. As both adviser to the government and purchaser, Menatep faced a manifest conflict of interest. Unfortunately, in Russia this is considered a synonym for an opportunity not to be missed. Not only did the transaction potentially strip the state of valuable assets at an insufficient price, but it sent an important and harmful message to the larger Russian public. The episode demonstrated that rent-seeking, rather than wealth creation, was the pathway to riches, and that the absence of any institutional checks on self-dealing would let rent-seeking work unfettered.

The death of Yukos illustrates the flip side of Russia's institutional context. On the one hand, the government did not simply seize the company for itself, but rather went through the charade of a tax assessment, followed by an asset seizure and an auction, followed by bankruptcy and a further auction.[107] Throughout the process it cited legal authority for its actions. Yet a wide chasm separated the asserted legal authority from the facts of the case, as the Russian audience and many foreign

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107. In its discussion of fixing the time of the expropriation for purposes of determining damages, the Spanish BIT tribunal commented in an aside that Russia could have solved the timing problem simply by acting transparently:

> This the Respondent could have done by a plain and simple decree to that effect, duly motivated by governmental policy. Instead, it engaged in a series of measures over many months, resulting in the consummation of Yukos' dismantlement and effective expropriation at a time when the value of the Claimants' shareholdings had plainly appreciated.

Quasar de Valores SICA V S.A. v. Russian Fed'n, *supra* note 97, at ¶ 214.

investors clearly understood. An independent judiciary would have rebuffed the government, forcing it to make more modest tax demands that Yukos actually could have paid. Yet the Russian courts consistently failed to undertake an even minimally adequate review of the government's claims. No other institutions spoke out strongly on behalf of the investors, partly because of disgust with the terms of Yukos's creation, partly because of a general populism that distrusted both the rich and foreigners, and partly because of an understandable unwillingness to challenge an increasingly ruthless government.

The broader message of Yukos's death was that, in Russia, wealth based on legal ownership of property meant little unless accompanied by governmental favor. Any challenge to political authority, whether real or perceived, could result in the destruction of property rights. In particular, tax assessments, unchecked by judicial oversight or any other form of legality, could be deployed to punish critics.[108]

But what should one then make of the multitude of litigation that proceeded outside of Russia? The fundamental premise of the two principal European legal structures—the European Union and the European Convention on Human Rights—is that external constraints can deter a state from slipping backwards into totalitarianism.[109] The second of these apparatuses comprises Russia. Moreover, national courts increasingly internalize international standards of fundamental fairness.[110] One can see the post-seizure litigation as a test of the efficacy of these overlapping constraints on national governments.

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108. Yukos's message to the broader Russian public is ongoing. For example, Russian tax authorities recently announced that they had opened an investigation of Gennady Gudkov for tax evasion. Gudkov, who spent most of his career in the Federal Security Service and who entered the Duma as a strong supporter of President Putin, in the past year became an outspoken critic of his practices. The tax investigation appears to be his reward. *See* Tom Balmforth, *Gennady Gudkov: From Kremlin-Loyal KGB Veteran to Opposition Leader, Radio Free Europe-Radio Liberty*, RADIO FREE EUROPE RADIO LIBERTY (Jun. 27, 2012), http://www.rferl.org/content/gennady-gudkov-from-loyal-kgb-veteran-to-opposition-leader/24628093.html (last visited Jul. 11, 2012).

109. *See* Andrew Moravcsik, *The Origins of International Human Rights Regimes: Democratic Delegation in Postwar Europe*, 54 INT'L ORG. 217 (2000).

110. On the use of international law by domestic courts, see ANDRÉ NOLLKAEMPER, NATIONAL COURTS AND THE INTERNATIONAL RULE OF LAW (2011).

On balance, the national and international judicial constraints have achieved mixed results. On the one hand, national courts (Armenia excepted) have protected people and assets outside of Russia from claims by the Russian government derived from Yukos's destruction. On the other hand, they have done very little to compensate the victims. In particular, when British authorities faced a choice between hosting the Rosneft IPO (financial services being England's lifeblood) and making Russia pay, national interest came ahead of distributive justice.

As for the international tribunals, much remains to be seen. The U.K. BIT tribunal awarded only a few million dollars to the investors, as they purchased their Yukos stock after the 2004 attack on the company. The status of the award in light of Swedish litigation remains uncertain.[111] The Strasbourg Court has not yet fixed damages but is unlikely to award any significant relief. The Spanish BIT tribunal also rendered a modest award, mostly because the small size of the investors' stake. The investment at issue in the ECT claim, by contrast, is considerable. A recovery of billions of dollars is possible. But Russia is not more likely to cooperate in enforcement of any ECT award than it has in other instances.

Moreover, both the existing awards and any future ones face substantial barriers to enforcement. Normally the assets of state-owned companies, such as Rosneft, cannot be used to satisfy a judgment against the parent state, and most of the property that a foreign state typically owns outright in other countries, such as embassies, consulates, and central bank deposits, enjoy immunity from all forms of legal process. Over the past decade Russia has been notorious for evading enforcement of arbitral awards.[112] In light of this history,

111. *See supra* note 85.

112. One of the longest outstanding disputes involves an award of several hundred million dollars owed Compagnie Noga d'Importation et d'Exportation based on contracts undertaken by the Yeltsin administration while the U.S.S.R. still existed. *E.g.*, Compagnie Noga d'Importation et d'Exportation v. Russian Fed'n, 361 F.3d 676 (2d Cir. 2004). I was engaged by that company to assist in an ultimately unsuccessful effort to enforce its award against assets located in the United Kingdom. Another longstanding dispute involves Franz Sedelmayer, who obtained an award under the German-Soviet BIT in 1998. After Russian courts refused to enforce the award, Sedelmayer managed to obtain partial enforcement in Germany in 2008 after attaching a building in Cologne

further resistance by Russia seems likely.

A conventional explanation for the willingness of foreign states to pay their legal obligations, in spite of the opportunities presented by sovereign immunity, is that flouting unambiguous legal obligations raises the state's cost of capital.[113] But due to the increase in energy prices over the last decade, Russia has enjoyed a buffer from foreign economic pressure. Its export revenues have allowed it to postpone any confrontation with international capital markets.

Diplomatic pressure also remains a possibility. U.S. investors in particular represent a far larger share of the Yukos ownership than do British or Spanish ones, but there exists no BIT between the two countries.[114] Vindication of these investors' rights thus will depend on espousal of their claim by their government, perhaps as part of a broader effort to promote the rule of law in Russia.[115] Whether the U.S. government will treat the vindication of investors' rights as a critical national interest, however, cannot be taken for granted.[116]

This situation probably is unstable. There is no reason to expect energy prices always to increase, any more than investors

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owned by the Russian government but not used for any governmental functions. He overcame a sovereign immunity defense to attach a Swedish building in 2011. The sum involved was in the low seven figures, minute compared to the potential liability entailed in the various Yukos claims. *See* Yaraslau Kryvoi, *Chasing the Russian Federation*, CIS ARBITRATION FORUM (July 9, 2012), http://cisarbitration.com/2011/07/13/chasing-the-russian-federation/ (last viewed July 9, 2012).

113. *See*, *e.g.*, Douglass C. North & Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England*, 49 J. ECON. HIST. 803 (1989).

114. Russia and the United States signed a BIT in 1992, and the Senate consented to ratification the following year, but the Russian parliament has refused to approve this instrument. U.S.-Russia Economic Relationship: Implications of the Yukos Affair: Hearing before the Subcomm. on Domestic and Int'l Monetary Policy, Trade, and Tech. of the H. Committee on Fin. Serv., 110th Cong. 1, 2 (2007).

115. At the end of 2012, the United States enacted P.L. 112-208, Russia and Moldova Jackson-Vanik Repeal and Magnitsky Rule of Law Accountability Act of 2012, 126 Stat. 1496. Section 202(b)(2) of that legislation requires annual joint reports from the U.S. Trade Representative and the Secretary of State on the status of pending petitions for espousal filed by U.S. investors in Russia.

116. For past criticism of confusion on the part of the United States regarding the goals of its Russian diplomacy, see Hugh Ragsdale & Paul B. Stephan, *Don't Feed the Bear*, THE AM. INTEREST, 90 (Mar./Apr. 2007).

in the United States and other developed nations should have expected the value of real estate always to go up. If this buffer were to fray, or if U.S. diplomatic priorities were to change, Russia could begin to face the consequences of defying the Yukos awards. How long it will take for Russia to again become dependent on foreign capital markets and the good will of the United States, however, is unknowable. The standoff between the Yukos investors and the Russian government may continue indefinitely.

VI. CONCLUSION

When the Bolshevik revolution came to Russia, expropriation of private property soon followed. The mechanism was a decree, typically by an executive organ, and the justification was ideological rather than legal.[117] Foreign states resisted the extraterritorial application of those decrees in their own courts but otherwise did nothing to undo them.[118] By insulating its economy from the outside world, the Soviet state in turn minimized foreign pressure to provide compensation.

After the collapse of the Soviet Union and the seeming embrace of legality in Russia, law changed, but, as Yukos illustrates, social practice has not fully caught up. Rather than seizing the property of rich investors because they are class enemies, the contemporary Russian government invokes the rhetoric of law enforcement. Courts now endorse the seizure. But expropriation still happens, and the legal checks do break down under sufficient political pressure. Foreign courts continue to have limited ability to do anything more than preventing the exporting of the consequences of the expropriation.

This leaves international tribunals, both human rights and investment protection. As for the former, many in the human rights community have been skeptical of protecting property as such, in contexts where discrimination against protected groups

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117. *See* Zigurds L. Zile, *The Taking and Precariousness of Non-State Property in Soviet Law*, 12 REV. SOCIALIST L. 203, 205 (1986).

118. *See* George Nebolsine, *The Recovery of the Foreign Assets of Nationalized Russian Corporations*, 39 YALE L.J. 1130 (1930). In the United States, the Litvinov memorandum ultimately resulted in U.S. recognition of extraterritorial expropriations, regardless of conflicting state law. United States v. Pink, 315 U.S. 203, 234 (1942).

(national minorities and other weak communities) is absent. Their reasons include a resistance to commoditization of human values as such, a worry that property protection will deter needed regulation and social reform, and a suspicion that property rights reflect injustice more than entitlement.[119] The weak response of the Strasbourg Tribunal to Yukos's claims is consistent with this posture. As for investor protection treaties, jurisdiction is spotty, practice is inconsistent, and the tools to hold states to awards are limited. Its critics are many and in particular includes a substantial portion of the human rights community. The institution of BIT arbitration has come a long way in the last three decades, but one should not assume that these gains will continue indefinitely into the future.[120]

At the end of the day, states must account for the consequences of their indifferent embrace of legality, whether the victims are domestic or foreign. International institutions help to clarify what happened, but they lack the capacity on their own to bring to bear credible deterrents to this problem. Instead, external forces, normally economic responses through trade and investment and secondarily diplomatic pressure, must do most of the work. For states such as Russia, the question becomes what price the government is willing to pay for its misdeeds, even after foreign courts and international tribunals have clarified the extent of the misconduct. The vagaries of the world economy and international diplomacy, as much as law, will provide the answer.

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119. *See generally* JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE (2012).

120. *See* O. Thomas Johnson Jr. & Jonathan Gimblett, *From Gunboats to BITs—The Evolution of Modern International Investment Law* in YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 2010/2011 at 646 (Karl P. Sauvant ed. 2011).